10/2021

XPS Express for Employers

Bringing you the latest pensions news for employers

Planning for year-end accounting in advance

At a glance

Reporting for DB pensions in company accounts has grown in complexity over recent years, and we have seen increased auditor scrutiny

As a result, we expect finance teams to continue to see heightened levels of audit review in pension areas such as asset valuations; benefit data; treatment of one-off pension events; and the approach to assumptions

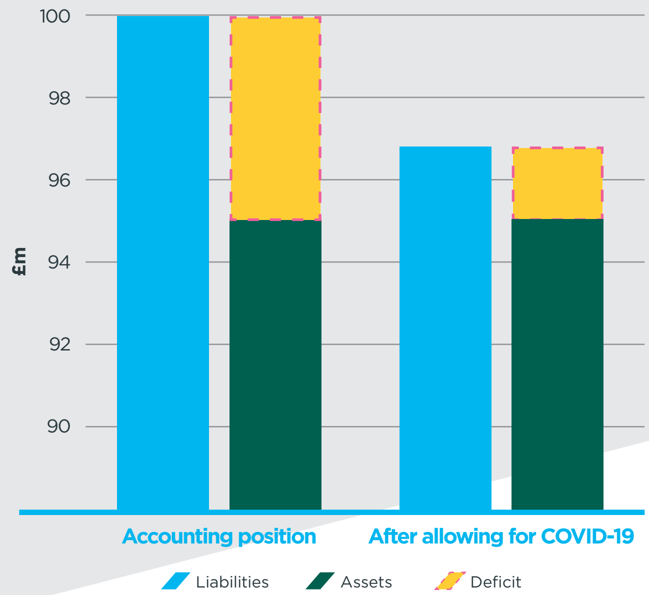
As such, early engagement and planning between the finance team, your corporate actuary and your auditor on these areas is essential and can help avoid delays or surprises

In particular, our ongoing, in-depth research into the impact of the COVID-19 pandemic shows that life expectancies have reduced as a result of the medium term consequences of the pandemic, such as longer NHS waiting lists and late diagnoses of serious illnesses

It is important that companies review their life expectancy assumptions, reflecting COVID-19, to avoid the risk of overstating balance sheet liabilities

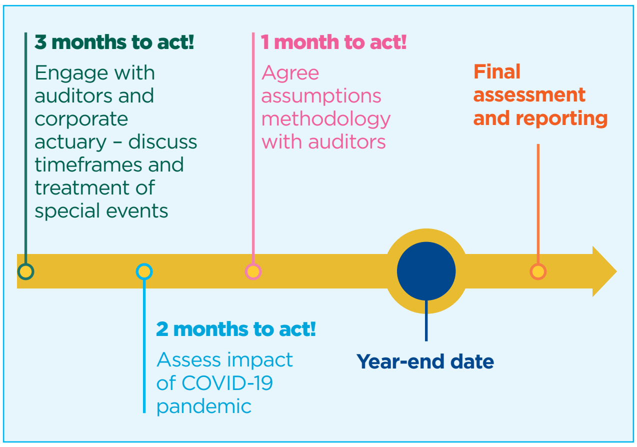
Allowing for the COVID-19 pandemic

Last year just over a third of companies we worked with reflected the pandemic in their balance sheets, leading to a reduction in accounting liabilities of 1.5% to 3.5%.



Source: XPS Pensions Group

Year-end timeline



Actions employers can take

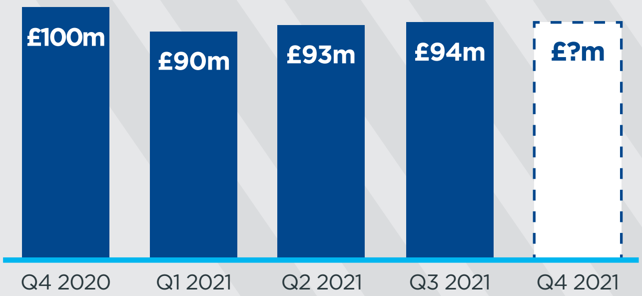
1. **Assess the impact of COVID-19 on your scheme members' life expectancy;**
2. **Review the treatment and impact of any one-off events you will need to account for; and**
3. **Plan for year-end with your advisers and engage early with your auditors to understand their views.**

Accounting update

Market conditions have been volatile since December 2020. Corporate bond yields have risen since their unprecedented low levels seen in Q4 2020 and, if this trend were to continue to December 2021, employers should expect a fall in the value placed on benefits. Expectations for future inflation continue to rise, and in particular, market expectations of RPI inflation after 2030 (when it is aligned with CPIH) look much higher than the Bank of England's 2% pa target for CPI.

Growth focussed asset classes have performed well since December 2020. Schemes that have greater exposure to assets such as equity and property are likely to have seen an improvement in asset values. Schemes with high levels of interest rate and inflation hedging are likely to have seen a decrease in the value of matching portfolios.

Accounting liabilities for an example scheme of medium to young maturity



Source: XPS Pensions Group

Returns on key asset classes

	Dec 20 –Jun 21	Jun 21 –Sept 21	Year to Sept 21
Global equities	11.4%	1.5%	**13.0%**
UK equities	11.1%	2.2%	**13.6%**
Property	10.7%	4.8%	**16.1%**
Index-linked gilts	-3.0%	2.3%	**-0.7%**
Corporate bonds	-2.5%	-1.0%	**-3.5%**

Source: Thomson Reuters

Accounting impact of one-off scheme events

Many pensions projects such as benefit change, member options exercises and risk transfer/insurance deals were put on hold last year due to the COVID-19 pandemic. These are now moving forwards and can often have a significant impact on the balance sheet.

One area we are seeing heightened activity in is risk transfer – employer cash funding, maturing journey plans and favourable returns on growth assets have improved the funding position of many schemes. Trustees may now be seeking to insure scheme benefits to protect their members.

This is most often in the form of either a buy-in or buy-out with an insurer, but there are many other options such as longevity hedging or DB pensions consolidators.

Whilst the power to enter into some of these transactions lies with scheme trustees, we recommend employers take a proactive role in any risk transaction to understand potential impact on their balance sheet, P&L and future requirements to fund the pension scheme.

We recommend employers engage with their auditors early to discuss any one-off events to avoid any surprises in the accounting treatment, and in particular to avoid unexpected large exceptional charges to their P&L.

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