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XPS Express for Employers

Bringing you the latest pensions news for employers

Making sure you value the right benefit payments

At a glance

2019 will see proposals on new rules for defined benefit (DB) pension schemes, including proposals on a new code of funding and long term targets.

In time, employers will need to manage 3 measures of their pension schemes – accounting, cash funding and long term target. All can have an economic effect on your business.

The different measures have one thing in common; they all place a value on the same benefit payments.

Given this, it is important to ensure the right benefit payments are being considered.

These are affected by three key areas:
- **The pension increases in your scheme**
- **How long members live**
- **Which options your members take**

Critically assessing these areas could reduce accounting liabilities by up to 15% and give a more relevant base for funding and member options.

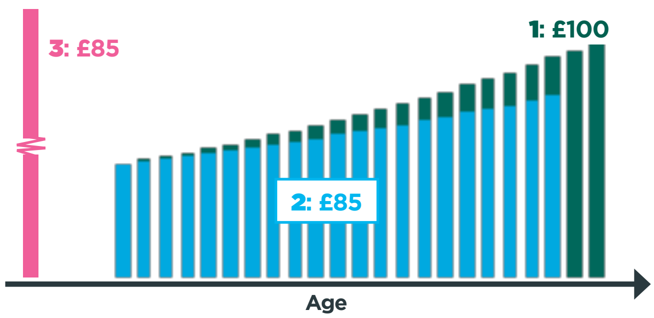
What affects benefit payments?

	Impact on expected benefit payments	
	Higher/more payments	**Lower/fewer payments**
How long members live	Recent data shows pensioners are increasingly living longer than the national population	Improvements in life expectancy have been low recently and greater emphasis on recent data reduces life expectancy
Member options	Option values are increasing as funding improves and investments are de-risked	More members are accessing options, e.g. taking transfers out of their scheme
Pension increases	Some schemes are reducing the assumed gap between RPI and CPI due to recent comments about the structure of RPI	Companies are looking at changing pension increases from RPI to CPI

How actual benefits impact cost

The graph below shows three scenarios for benefit payments to a deferred member and their overall cost:

1. Member takes pension – RPI increases and typical assumptions for life expectancy
2. Member takes pension – CPI increases and 'best estimate' life expectancy
3. Member takes transfer



Actions employers can take

It is important for employers to assess benefit payments to prevent overvaluing liabilities:

1. **Understand what your rules allow for inflation increases in your scheme**
2. **Assess your mortality assumptions compared to the latest data and your scheme characteristics**
3. **Check member activity around options such as transfers**
4. **Engage with trustees to ensure latest information is being reflected in funding and member options**

What pension increases should your scheme be paying?

A number of schemes are considering changing their pension increases from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) where their rules allow. It is important to consider which category your scheme falls into:

1. Rules automatically followed the Government's decision to move statutory increases from RPI to CPI.
2. RPI inflation hardcoded in the rules.
3. Some level of choice of inflation index.

If some choice of inflation index is available in scheme rules, whether increases can be moved from RPI to CPI depends on the specific wording of the rules.

Some schemes have tested their wording in court

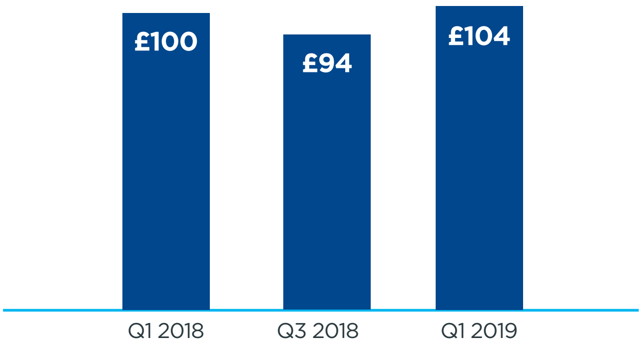
Rule	Court decision
The Government's Index of Retail Prices or any similar index satisfactory for the purposes of the Inland Revenue.	✓
The Index of Retail Prices published by the Office of National Statistics or any other suitable cost-of-living index selected by the Trustees.	✓
The General Index of Retail Prices published by the Department of Employment or any replacement adopted by the Trustees without prejudicing Approval.	✗
The cost of living will be measured by the Government's published General (All Items) Index of Retail Prices or if this ceases to be published or becomes inappropriate, such other measure as the Principal Company, in consultation with the Trustees, decides.	✗

Other schemes have changed the inflation index they use without going to court for confirmation.

Accounting update

Companies with a March year-end should have seen a modest improvement in their balance sheet position over the last year. Liabilities have increased, primarily due to falling corporate bond yields. However, for most schemes this should be more than made up for by positive asset returns.

Changes in value per £100m of accounting liabilities



Source: XPS Pensions Group

Returns on key asset classes

	Mar 18 –Sep 18	Sep 18 –Mar 19	Year to Mar 19
Global equities	12.9%	-1.9%	**10.7%**
UK equities	8.3%	-1.8%	**6.4%**
Property	-0.3%	0.9%	**0.6%**
Index-linked gilts	-2.2%	7.9%	**5.5%**
Corporate bonds	-0.5%	4.6%	**4.1%**

Source: Thomson Reuters

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