07/2019

XPS Express for Employers

Bringing you the latest pensions news for employers

Managing your Accounting Gap

At a glance

Employers have a number of levers to manage pensions risk. How you use them is becoming increasingly important given the Pensions Regulator's focus on long-term funding targets (LTFT) (more detail on this here).

An additional challenge is how you manage stakeholder perceptions of your risk management given they view your pensions position through your accounts.

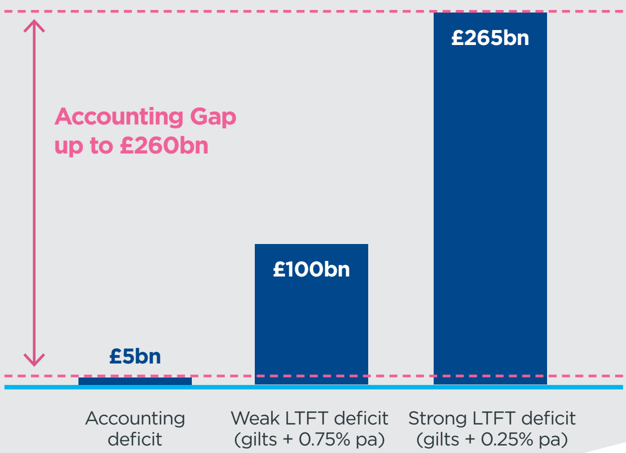
Despite consistent accounting standards, our recent survey shows large ranges in accounting assumptions adopted by different companies.

In addition, the accounting positions you disclose do not reflect the actual and expected future funding position of your scheme. We call this difference the 'Accounting Gap'.

It is important for stakeholders to understand any Accounting Gap, as well as how you plan to use the different levers to bridge your gap – cash is not the only option. This will avoid unnecessary concerns.

The Accounting Gap

The chart below shows our estimate of the aggregate difference between accounting balance sheets and new long-term funding targets across all UK companies at 31 December 2018.



The levers to manage your Accounting Gap

Companies have four main levers they can use to bridge the gap to their long-term funding target.

1. Cash	Simple and immediate if affordable.
2. Investment return	Can reduce cash requirements but could introduce volatility and downside risk.
3. Time	Can be a great healer, but may be limited despite pensions schemes being long term.
4. Member options	Can reduce the end target and bring it closer while improving your members' outcomes.

In addition, contingent assets are an important tool to support a balance between the levers above.

Actions employers can take

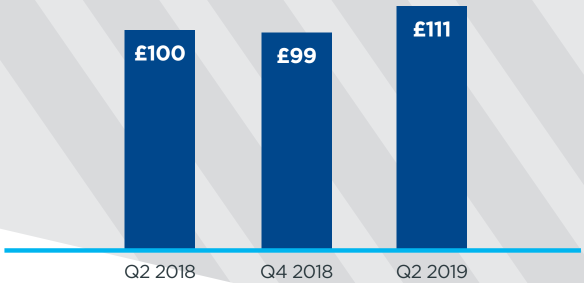
1. **Understand the requirements for long-term funding targets and what this means for your scheme**
2. **Consider the levers available to you to manage your scheme's journey to its long-term funding target**
3. **Look at what you disclose in your accounts and how your stakeholders will perceive your scheme and risk management, particularly:**
   - **Your assumptions: benchmark these and consider whether you should explore changes**
   - **Your Accounting Gap: both the size and the actions you are taking to manage it**

Accounting update

It has been a year of two halves with poor asset returns in the first half of the year typically more than offset by more positive returns in the second half. Liabilities are also likely to increase compared to the previous year end because of a fall in corporate bond yields and a slight increase in implied inflation over the year.

Overall, companies reporting at 30 June are likely to see a worsening in balance sheet positions, although this will depend on your investment strategy.

Changes in value per £100m of accounting liabilities



Source: XPS Pensions Group

Returns on key asset classes

	Jun 18 –Dec 18	Dec 18 –Jun 19	Year to Jun 19
Global equities	-5.5%	16.4%	**10.1%**
UK equities	-11.0%	13.0%	**0.6%**
Property	-13.9%	9.1%	**-6.0%**
Index-linked gilts	0.6%	7.9%	**8.6%**
Corporate bonds	-0.4%	7.3%	**6.8%**

Source: Thomson Reuters

Where do your accounting assumptions sit?

Although accounting standards are generally consistent, we found wide ranges in the assumptions adopted by different companies at the same date.

The results of our 2019 survey results on key assumptions at 31 December 2018 are set out below showing the minimum, maximum and average assumptions adopted. Where do your accounting assumptions sit in these ranges?

If your accounting date is different from 31 December 2018 please get in touch with us to find out the relevant ranges for your scheme.

	Higher liabilities	Average assumption	Lower liabilities
Discount rate	2.6%	2.8%	3.1%
RPI inflation	3.7%	3.3%	2.9%
CPI gap	0.5%	1.0%	1.3%
Life expectancy (years from 65 for males currently aged 65)	24.7	22.0	16.8

For further information, please get in touch with Vicky Mullins or Vicky Randhawa or speak to your usual XPS Pensions contact.

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