

XPS Express for Employers

Bringing you the latest pensions news for employers

Accounting for pensions – has your balance sheet improved?



At a glance

The last six weeks have seen significant market volatility, and the majority of DB pension schemes have seen funding levels reduce

However, many employers reporting at the end of March will actually see an improvement in accounting positions

This is because corporate bond yields rose sharply at the end of March and inflation expectations fell, which both act to reduce accounting liabilities

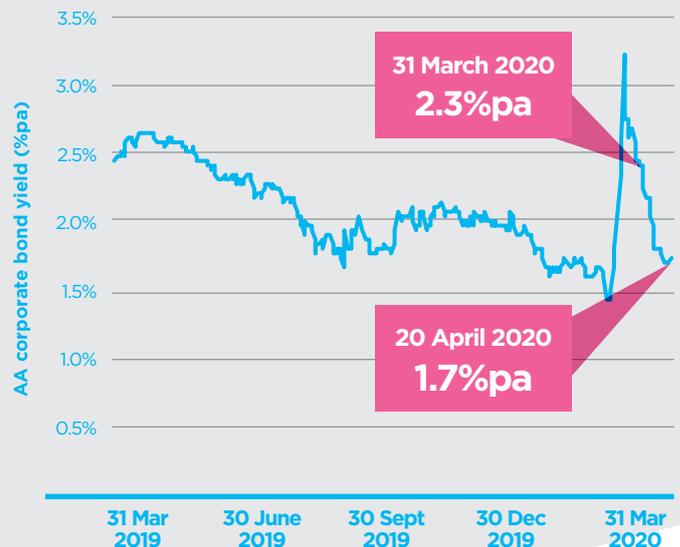
Corporate bond yields have fallen back over April so the improvement in accounting positions may be short-lived

Employers should carefully review their assumptions, particularly inflation and mortality given recent new information

Market volatility could also give rise to issues with asset valuations and audit sign-off



Corporate bond market volatility



Source: iBoxx over 15 year AA corporate bond yield



Areas of additional auditor scrutiny

Uncertain asset valuations	Expect more attention on how assets are valued and when
Discount rate	Different methodologies may give surprising results
Inflation	Changes may be required due to the Retail Prices Index (RPI) consultation (see overleaf)
Mortality	Expect requests for justification of appropriateness of mortality assumption

Auditors are likely to request additional disclosures to provide further information on these areas.



Actions employers can take

1. Understand how recent market changes have impacted your scheme's accounting position.
2. Review your financial assumptions to ensure they remain appropriate in view of recent market movements.
3. Engage with your auditors early to understand their views on asset valuations and other key assumptions.
4. Review the impact of new mortality data on your assumptions and liability values.
5. Consider adding additional disclosures to support asset valuations.



Accounting update

Most companies will see a reduction in their accounting deficit at 31 March 2020 due to increasing corporate bond yields and falling inflation expectations. However, this will depend heavily on investment strategy, with schemes with greater equity and property exposure potentially facing a worse accounting position.

Changes in value per £100m of accounting liabilities



Source: XPS Pensions Group

Returns on key asset classes

	Mar 19 -Sept 19	Sept 19 -Mar 20	Year to Mar 20
Global equities	9.9%	-14.7%	-6.2%
UK equities	4.6%	-22.0%	-18.5%
Property	4.4%	-18.4%	-14.8%
Index-linked gilts	9.8%	-7.0%	2.2%
Corporate bonds	6.1%	-5.8%	0.0%

Source: Thomson Reuters

Other key assumptions that could affect your accounting position

1 Outlook for future inflation: Markets pricing in RPI reform?

What has happened?

- RPI inflation expectations have fallen over the past year, especially during March.
- This is likely to be driven both by expectations of a worldwide recession as a result of the Coronavirus, and by the consultation on the future of RPI recently launched by the Chancellor.

What should employers do?

- Employers should carefully review your assumptions for the increase in RPI and the Consumer Prices Index (CPI) as both the inflation risk premium and the RPI/CPI wedge may need changing.

2 Mortality improvements: A reversal of recent trends

What has happened?

- The Continuous Mortality Investigation (CMI) have released the latest version of their mortality improvements model – CMI 2019.
- Mortality improvements in 2019 were the highest since 2011, meaning life expectancies are around 0.3% higher and accounting liabilities will increase, all else being equal.

What should employers do?

- Careful consideration of adopting the new CMI model is needed, particularly in terms of the parameters used.
- Make sure that excess prudence does not creep into your accounting mortality assumptions.

For further information, please get in touch with **Vicky Mullins**, **Oliver Ashworth** or **Simon Reddish** or speak to your usual XPS Pensions contact.



t 020 3725 7017

e vicky.mullins@xpsgroup.com



t 0113 284 8024

e oliver.ashworth@xpsgroup.com



t 0113 467 3387

e simon.reddish@xpsgroup.com

@xpsgroup

xpspensionsgroup



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