10/2020

XPS Express for Employers

Bringing you the latest pensions news for employers

Reflecting COVID-19 in company accounting for pensions

At a glance

COVID-19 is having a large impact on life expectancy and some auditors are expecting employers to consider COVID-19 in accounting mortality assumptions and pensions liabilities

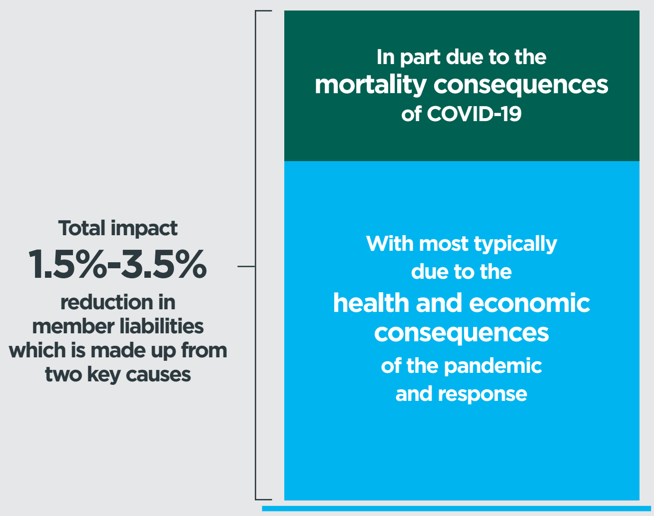
As this will not be reflected in standard mortality tables, employers need to make their own explicit allowance for the pandemic

This needs to include both the disease and the longer term economic and health impact of the pandemic, such as the impact on the economy, healthcare system and reduced diagnoses for other illness

Our analysis shows that full allowance for COVID-19 reduces total member liabilities by around 1.5% to 3.5%, over half of which is due to the consequential long term impact of COVID-19

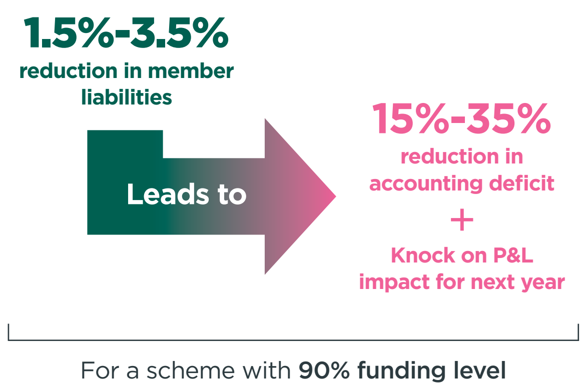
For a scheme that is 90% funded, this means a 15-35% reduction in the accounting deficit on the balance sheet, and a knock on improvement in earnings next year

Typical impact on member liabilities



Source: XPS Pensions Group

Impact on balance sheet and P&L



Source: XPS Pensions Group

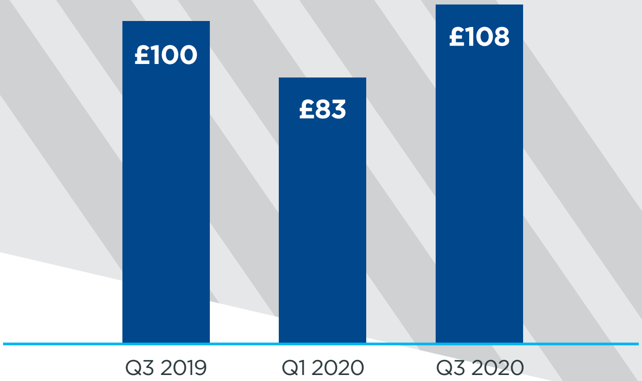
Actions employers can take

1. Analyse the impact COVID-19 has on your scheme and review your mortality assumptions.
2. Engage with your auditors early to understand their views.
3. Use the same member analytics to review the impact on other demographic assumptions, such as proportion of members married.

Accounting update

Companies reporting at 30 September 2020 are likely to have increased defined benefit obligations on their balance sheets due to a fall in corporate bond yields over the year, although the impact will be offset slightly by a fall in inflation expectations. The resulting net balance sheet positions will depend heavily on investment strategy, with schemes that have a high degree of interest rate and inflation protection being most likely to have a similar balance sheet position to last year. However, schemes with greater exposure to UK equity and property are likely to have fared significantly worse due to poor returns over the year from these asset classes.

Changes in value per £100m of accounting liabilities



Source: XPS Pensions Group
Note: Liability values exclude allowance for COVID-19 mortality changes

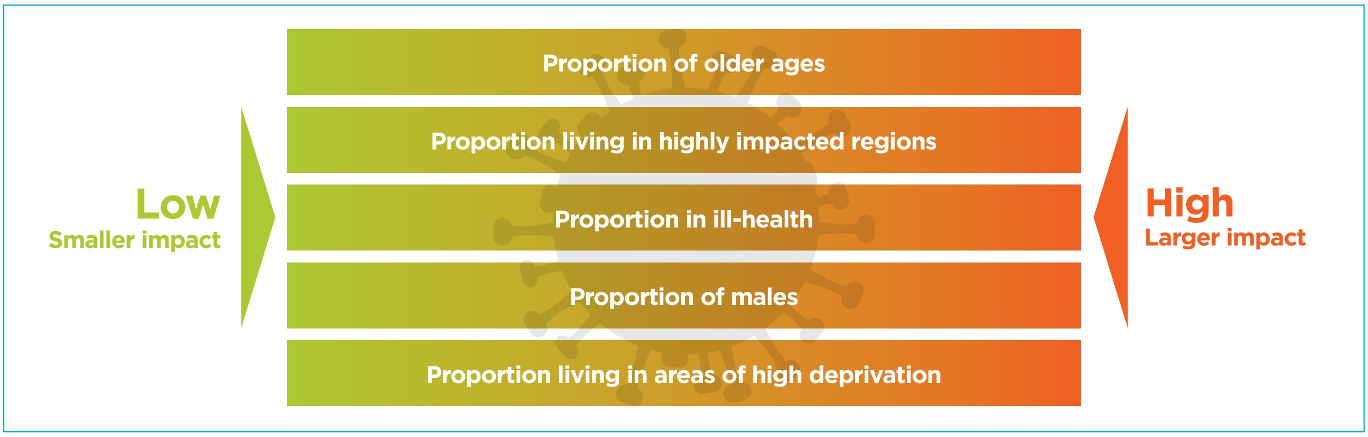
Returns on key asset classes

	Sept 19 –Mar 20	Mar 20 –Sept 20	Year to Sept 20
Global equities	-14.7%	23.8%	**5.7%**
UK equities	-22.0%	7.0%	**-16.6%**
Property	-18.4%	1.9%	**-16.9%**
Index-linked gilts	-7.0%	7.9%	**0.4%**
Corporate bonds	-5.8%	10.7%	**4.3%**

Source: Thomson Reuters

Assessing COVID-19 risk

Any change to mortality assumptions will need to be supported by robust analysis to meet audit scrutiny. We have built a detailed, proprietary model that assesses both the impact of the disease and its longer term consequences on the scheme population. This includes analysing the following factors for scheme members.



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