

# Accounting in Pensions

30 September 2024 Quarterly Update

# Accounting benchmarks

## What are the key financial indicators for accounting?

The table below summarises Isio UK financial indicators for 30 September 2024 for company accounting purposes, as well as changes since 30 June 2024 and 30 September 2023.

	30 Sep 2024 <sup>1</sup>	30 Jun 2024	Change	30 Sep 2023	Change
Discount rate <sup>2</sup>	5.05%	5.09%	-0.04%	5.43%	-0.38%
RPI inflation <sup>2</sup>	3.33%	3.38%	-0.05%	3.49%	-0.16%
CPI inflation <sup>2</sup>	2.48%	2.53%	-0.05%	2.64%	-0.16%
Gilt yield <sup>2</sup>	4.54%	4.61%	-0.07%	4.82%	-0.28%
FTSE All Share-TR	9,948.4	9,728.9	+2.26%	8,772.8	+13.40%

<sup>1</sup> Figures are based on high level analysis and for illustrative purposes only.

<sup>2</sup> Financial indicators based on an average pension scheme with a 20-year term.

<sup>3</sup> Assuming a typical investment strategy consists of 40% growth assets and 60% matching assets with 70% level of hedging

## Movement over the last year

For an average scheme, with a funding level of 95% at 30 September 2023, the changes in discount rate and inflation above may have resulted in a c.5% increase in the liabilities. Assuming a typical investment strategy<sup>3</sup>, assets are anticipated to have increased by c.6% over the year, resulting in an overall c.1% improvement in the funding position.

## Movement over the last quarter and year

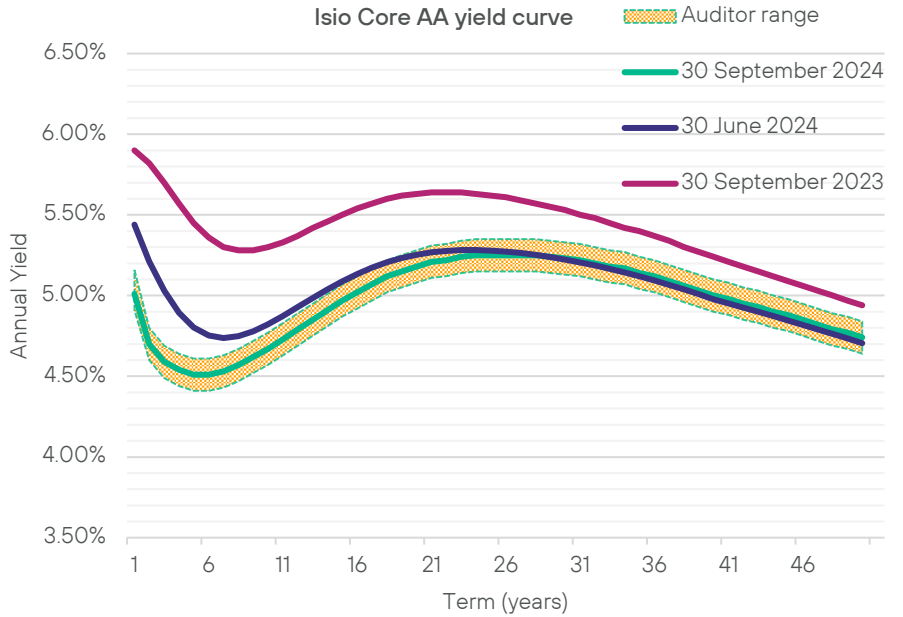
For an average scheme with a funding level of 95% at 30 June 2024, the changes in discount rate and inflation above may have resulted in the liabilities remaining stable over the period. Assuming a typical investment strategy<sup>3</sup>, assets are anticipated to have increased by c.1%, resulting in an c.1% improvement in the overall funding position.

Over the quarter corporate bond yields have reduced slightly. In isolation this will typically result in small increases in schemes' liabilities. However, long-term inflation expectations have also reduced which will, to an extent, offset the increase in liabilities for many schemes. Movements in asset indices indicate that many schemes will see slight increases in fund values. Overall, movements in financial indicators over the quarter are unlikely to result in material movements to balance sheets; and the precise movements will depend on schemes' investment strategies and their level of hedging.

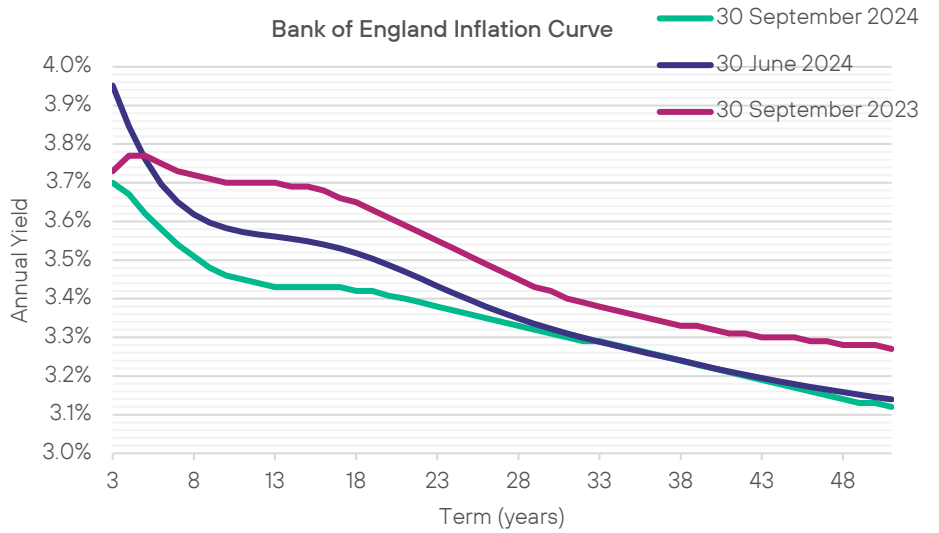
Reductions in bond yields over the year have been more significant, with corresponding reductions in long-term inflation expectations tempering the impact of these to a lesser extent. Whilst liabilities will have likely increased for many schemes as a result of this, positive returns on grown assets over the year may still provide improvements in balance sheet positions, depending on schemes' exposures to these types of assets.

**What does this look like at different terms?**

The chart below shows the expected discount rates for all terms at 30 September 2024, as well as at 30 June 2024 and 30 September 2023. This is based on Isio's Core approach and includes an indicative auditor acceptable range (further detail below).



The chart below shows the Bank of England inflation rates for all terms at 30 September 2024, as well as at 30 June 2024 and 30 September 2023.



## What are we seeing in the market?

We have summarised our findings from conversations with auditors, and information collected from accounting exercises to date, which may be useful when setting assumptions.

### Discount rate

- Auditors' typical acceptable ranges are up to  $\pm 0.25\%$  of the market median, but this range can be larger at longer durations.
- Isio's yield curve approaches are expected to be within audit firms' acceptable ranges. Whilst only our core approach is illustrated on Page 3, there are alternative approaches which result in slightly higher discount rates.

### Inflation

- Current expectations are that RPI will continue to be calculated and published in the future, but from February 2030 these calculations will mirror those used for setting CPIH. Theoretically, this should mean published RPI should run 0.8%-1.1% lower from around 2031.
- Historically, a typical acceptable range for any Inflation Risk Premium ("IRP") was nil to 0.3%. The recent changes have seen some entities adopt higher IRPs, including applying post-2030 increases, reflecting views that market based RPI is being overstated.
- Most auditors default position will be to expect no RPI-CPI wedge post-2030, but a number of firms do make some modest allowance.
- Isio's break-even RPI inflation rates are expected to be close to the benchmark rates for each audit firm across terms.
- Auditors may expect RPI and CPI assumptions to be derived using separate durations, where they distinctly relate to benefits of different terms.

### Mortality

#### Long-term mortality improvements

Auditors would normally look for the use of the latest long-term improvements data, with a preference for this to be updated annually rather than triennially.

- The CMI released the 2023 version of its projections model in April 2024. The core version of the 2023 model applies greater weighting to mortality experience over the last two years, resulting in marginal reductions in life expectancies where schemes transition from the core 2022 model (typically equivalent to c0.5% reductions in liabilities).
- Users of the 2023 model can choose to place more or less weight on the post pandemic years mortality experience data; placing greater weight implies that recent, high mortality experience is indicative of longer-term trends and results in reduced life expectancies.
- Analysis by Isio indicates that higher weightings than those under the CMI's core version of the model should be considered for accounting purposes, to achieve a set of mortality assumptions that are best-estimate. However, auditors may challenge schemes that make significant adjustments.

#### Mortality base tables

- In addition to the release of CMI 2023, updated Self-Administered Pension Scheme ('S4') mortality data was released by the CMI in February 2024. The updated dataset is based on mortality data from 1 January 2014 to 31 December 2019, excluding years affected by COVID. The 'S4' tables point to a slight reduction in life expectancy, although the impact on individual schemes will differ.

- For accounting, schemes typically adopt the mortality base tables used at their most recent funding valuation when setting assumptions. Where this is the case, auditors therefore typically expect this assumption to be updated following the completion of scheme-specific mortality studies.

Most auditors will look at the resultant life expectancies from the proposed mortality assumptions with follow-up questions being raised if the life expectancies do not fit within the auditor's acceptable range – i.e. it's the combination of assumptions and parameters which is important, rather than specific individual parameters in isolation.

### Other pensions accounting issues

- **Virgin Media vs NTL Pensions Trustees** – The High Court made a landmark judgement in June 2023, concluding that certain amendments made to the scheme between April 1997 and April 2016 may be invalid if a confirmation known as a 'Section 37' certificate was not completed at the time. An appeal against the High Court's ruling was dismissed in July 2024.

The case is of significance as it could mean that the amendments of other schemes are considered invalid, resulting in additional unforeseen liabilities.

The necessary work to understand the implications of this case for schemes will take time. However, following the dismissal of the appeal, most auditors will expect meaningful consideration to be given to the ruling. This may involve schemes identifying the key amendments to rules over the relevant period and whether their unwinding would result in a material impact on liabilities.

- **Inflation experience** – Over recent months inflation has reduced materially. RPI inflation for the year to Sep 2023 was 8.9%, but for the following eleven months to Aug 2024, RPI has been c.3.0%. Many schemes may still experience large increases to pensions over 2024, as lags in indexation may mean schemes reference this higher period of inflation around September. However, more recently, actual inflation could be lower than schemes' long-term assumptions, and therefore schemes may experience positive inflation experience at future reporting dates once this is allowed for.
- **Recognising experience** – Some auditors are focusing on ways that any roll forward methodology being used can be refined to reduce the size of experience items arising following the completion of the triennial funding valuations every three years (e.g. allowing for known historic and upcoming pension increases).
- **Onerous data requests** – Auditors are continuing to ask for more granular levels of data and information from companies, which in most cases will have to be requested from the trustees.

**Note auditor ranges are indicative based on data from 30 September 2024 and ranges will vary between auditors. We can provide further insight on request.**

