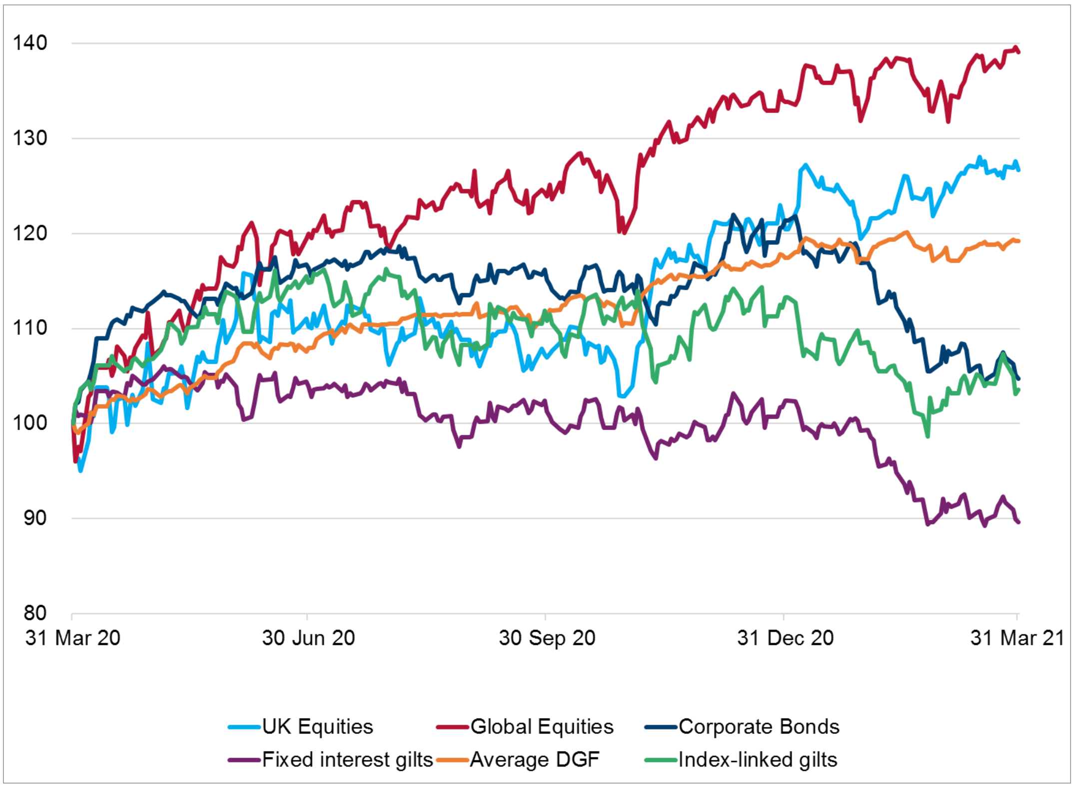
Employer pension briefing, Quarter 1 2021

In this briefing we highlight key pension issues for employers from the first quarter of 2021, with a focus on pension cost accounting issues to consider for 31 March 2021 year end, particularly in the context of market changes.

Changes in markets since 31 March 2020

Before considering what has happened in the previous 12 months, it's worth remembering the position a year ago. Q1 2020 had seen unprecedented volatility in financial markets, with UK equities falling by c30% from mid-February to mid-March and corporate bond yields increasing by 150 bps over a two-week period (and then falling back) as markets reacted to the Covid-19 crisis.

In the nine months that followed, we saw asset values recover, with almost all asset classes increasing in value by the end of 2020 (with a corresponding reduction in yields on both government and corporate bonds). The first quarter of 2021 saw further recovery for growth assets but falls in the value of bond holdings, as both corporate bond and gilt yields increased from record lows in December 2020.



Global equities: +40%

UK equities: +25%

Average DGF: +20%

Corporate bonds +5%

Index-linked gilts: +4%

Fixed-interest gilts: -10%

Impact on pension cost accounting liabilities

All else being equal, pension scheme liabilities will have increased over the year. Market expectations of future inflation are up, while corporate bond yields (which drive IAS19 and FRS102 discount rates) have fallen. Both factors will serve to increase Defined Benefit (DB) obligations, as shown in the table below:

	31 March 2020	31 March 2021	Impact on the DBO for an average[1] scheme
Corporate bond yield[2]	2.3% pa	2.0% pa	+6%
Market-implied inflation[3]	3.0% pa	3.7% pa	+10%

1 An average scheme is assumed to have a duration of 20 years and around 75% of liabilities linked to inflation.
2 Yield on the iBoxx over 15-year AA rated corporate bond index.
3 Implied inflation at a term of 20 years from the Bank of England implied inflation curve.

To find out more about the effect of changes in the financial markets on pension cost accounting positions, **see our PCA index page**.

Changes in funding liabilities

While we expect pension cost accounting liabilities to have increased over the year, this is not necessarily the case with funding liabilities. Gilt yields (which often underlie funding discount rates) are slightly higher as at 31 March 2021 than they were 12 months ago. Whether this means your funding liabilities are up or down will depend on the extent to which they are inflation-linked, and whether your scheme's trustees make any other changes to the assumptions used.

If you have an upcoming pension scheme funding valuation and you'd like to understand the key areas for employers to consider, please ask your usual First Actuarial contact for a copy of our *Finance director's guide* or contact one of the Employer Services team below.

CMI 2020 and the impact of Covid-19 on life expectancy

Covid-19 has led to a marked increase in the number of deaths over the past 12 months, with more than 100,000 'excess' deaths since the start of the pandemic. Typically, you would not expect to see the impact of mortality experience on your pension cost accounting liabilities until the scheme trustees carry out the next funding valuation. However, there may be scope to allow for the 2020 experience if you can demonstrate a material impact.

There is an argument that ignoring the 2020 experience is potentially overstating scheme liabilities. Most employers and trustees are likely to be happy to take a 'wait and see' approach when setting assumptions, but for those who have stronger views on the longer-term impact of Covid-19, adjusting mortality assumptions could reduce liabilities by up to 4%.

Looking to the future, it's difficult to say with any certainty how Covid-19 will affect mortality. The Continuous Mortality Investigation (CMI) Bureau has recently released the 2020 version of its model for future mortality improvements. This shows a slight fall in life expectancy (compared with the CMI 2019 model), but effectively ignores the 2020 experience when using its default parameters.

Pension Schemes Act 2021

The much-delayed Pension Schemes Act 2021 (originally published in October 2019), finally received Royal Assent in February. The overarching aim of the Act is to improve security for DB scheme members, with some of the key areas covered being:

1) The introduction of a new DB funding regime, although the detail is still at the consultation stage with The Pension Regulator
2) New criminal offences for those avoiding employer debts or acting in a way that detrimentally affects member security
3) New powers for The Pensions Regulator to impose Contribution Notices more easily
4) Introduction of the framework for Collective Defined Contribution (CDC) schemes.

While the date when the provisions of the Act will come into effect has yet to be confirmed, employers will need be ready for these upcoming changes.

Get in touch with our experts

If you would like to discuss pensions with us, contact your usual First Actuarial consultant or our **employer services team**.

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