Housing Bulletin – May 2019

Frequently Asked Questions – FRS102

The online tool for employers to download their FRS102 disclosures for the Social Housing Pension Scheme (“SHPS”) was released on 13 May. This is the first time that full defined benefit (“DB”) accounting has been applied to SHPS and it will be a learning curve for some employers. Below are some of the frequently asked questions we have been asked when helping clients with their disclosures.

Q1: What does the FR102 funding deficit mean for pension costs?

It’s important to remember that the FRS102 results are for accounting purposes only and shouldn’t be used as the primary driver for strategic decisions (eg what benefit structures to offer employees).

Your liabilities are valued differently to determine cash contributions at the triennial actuarial valuation (known as the “technical provisions”) and differently again to determine exit debts (known as the “buyout basis” or “solvency basis”).

Measure	Purpose
FRS102 Accounting	To provide a (reasonably) consistent measure of the pension liabilities in the accounts
Ongoing Funding (Technical provisions)	To determine cash contributions To provide a prudent estimate of long-term cost
Best-estimate	To provide a best estimate of long-term cost
Buyout (Solvency)	The price to remove all future costs and risks by insuring the benefits. Section 75 debts

Q2: Which assumption is most important?

The discount rate is the most important assumption. This is the assumption used to determine how much money needs to be set aside now to meet future benefit cashflows. It’s effectively the investment return you’re going to earn in the future on the money you put aside today. So for example, if the discount rate is set at 2.5% pa, then to meet a £10,000 cashflow in 10 years’ time then £7,812 needs to be set aside today (calculated as £10,000 divided by 1.025^10).

The discount rate for FRS102 purpose is set by reference to corporate bond yields (even though a DB pension scheme is extremely unlikely to just invest in this asset class). A summary of the different discount rates is shown below.

Measure	Discount rate
FRS 102 Accounting	Based on the yield on high quality corporate bonds
Ongoing Funding (Technical provisions)	Prudent view of long-term investment strategy and returns
Best-estimate	Best-estimate view of long-term investment strategy and returns
Buyout (Solvency)	Returns from low risk investments less margins for insurer profit, expenses and reserving requirements

Q3: Who sets the FRS102 assumptions?

The assumptions for FRS102 are the responsibility of the employer's directors.

There is only limited prescription on how the assumptions are derived and no definitive right answer. As such, there is a range of assumptions that could be deemed appropriate and different actuaries and auditors may take different views.

For example, as at 31 March 2019 the discount rate could range from 1.9% pa to 2.6% pa (and a 0.1% pa change in the discount rate can change the liabilities by 1.5% to 2.5%).

Q4: Should the FRS102 assumptions for SHPS be the same as LGPS?

Some employers may wish to use the same (or some of the same) assumptions for their SHPS and LGPS liabilities – for example the same salary increase assumption – so that there is a consistent measurement of DB pension liabilities in the accounts. However, the assumptions should be set by reference to the duration of the liabilities, so in most cases some differences can be expected.

Q5: Why is the FRS102 funding level different for different employers?

There will be differences in the funding level for different SHPS employers because:

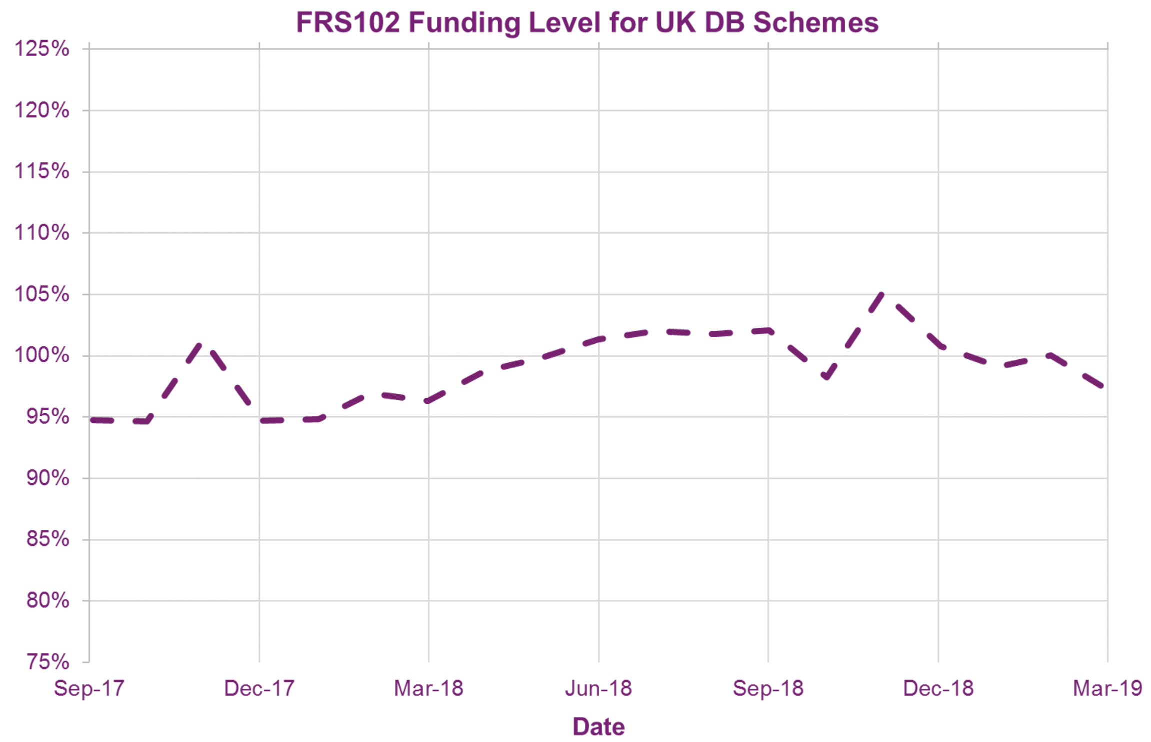
- the assets are assigned in proportion to each employer's ongoing funding liabilities (not FRS102 liabilities); and
- employers will use different assumptions to value the FRS102 liabilities.

Typically, we are seeing FRS102 funding levels for SHPS employers as at 31 March 2019 range from 70% to 80%.

Q6: How does the FRS102 funding level of SHPS compare to other schemes?

First Actuarial track the FRS102 funding position for the UK's 5,450 DB schemes. In aggregate, we estimate the FRS102 funding level to be c97% as at 31 March 2019. This means that SHPS has a lower funding level than average - which is to be expected as the strong covenant means

- SHPS can afford to take a more aggressive return seeking investment strategy than the majority of schemes (and does); and
- smaller margin for prudence is needed in the ongoing funding target.



Q7: Would the FRS102 disclosures change after a bulk transfer?

Introducing full DB pension accounting (and a higher balance sheet deficit) has put off some employers from a bulk transfer. However, the accounting position should now be broadly neutral before and after a bulk transfer. Having said that, as stated in Q1, we do not believe that accounting disclosures should be the primary driver for strategic decisions.

How First Actuarial can help

First Actuarial provides pensions advice to more housing associations than any other firm. To discuss your FRS102 disclosures, please contact your usual First Actuarial consultant, or any one of our nationwide team of housing consultants.

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