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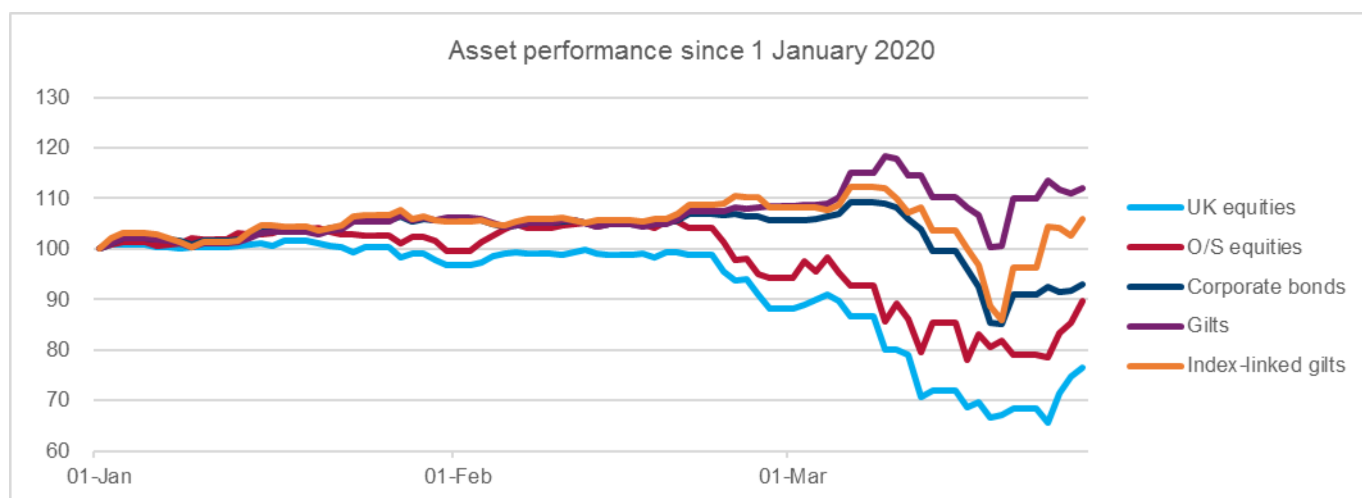
Housing briefing, April 2020

The past month has seen unparalleled volatility in financial markets due to Covid-19.

For housing associations with a 31 March accounting year end, this means assumptions and disclosures are likely to be materially different from last year. In this briefing, we explore the impact of financial markets on your FRS102 disclosures.

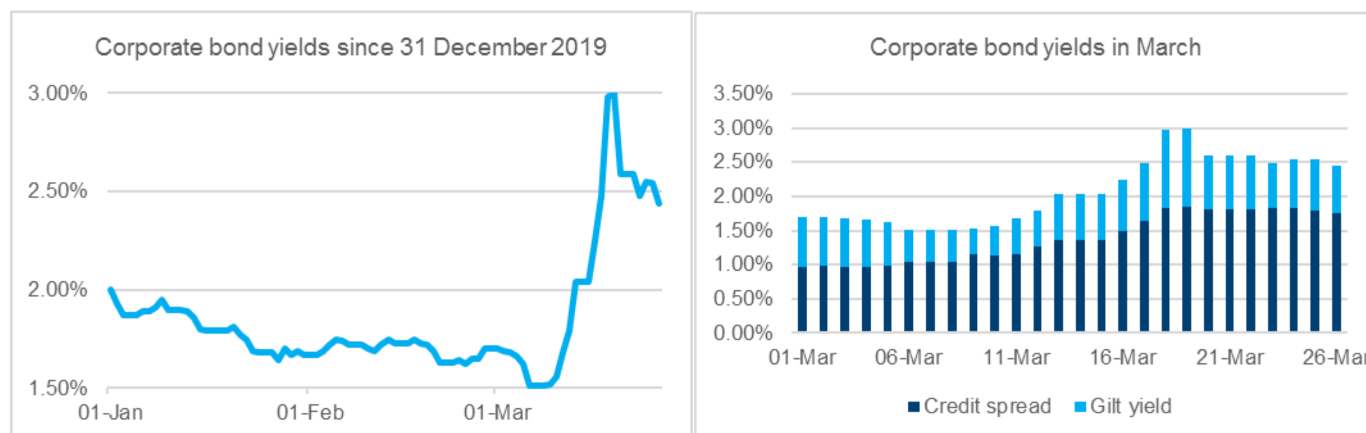
Market volatility



As well as the headline falls (and subsequent gains) in equity markets over the past month, we've also seen significant moves in bond yields, credit spreads and future expectations of inflation.

This has led to considerable volatility in the balance sheet position of UK pension schemes. Assets may be down by as much as 20% and liabilities may have moved by up to 30% during March, as corporate bond yields bounced between 1.5% p.a. and 3.0% p.a.

The chart on the left below shows the movement in corporate bond yields since the start of the year, while the chart on the right shows how the driving force for the increase in yields has been the widening of the credit spread over the period (an increase of around 0.8% p.a. over the period):



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Impact on balance sheet positions

Taking both sides of the equation into account (i.e. assets and liabilities), the balance sheet position is likely to have improved since 31 December 2019. The table below shows the change in corporate bond yields since 31 March 2019 and 31 December 2019:

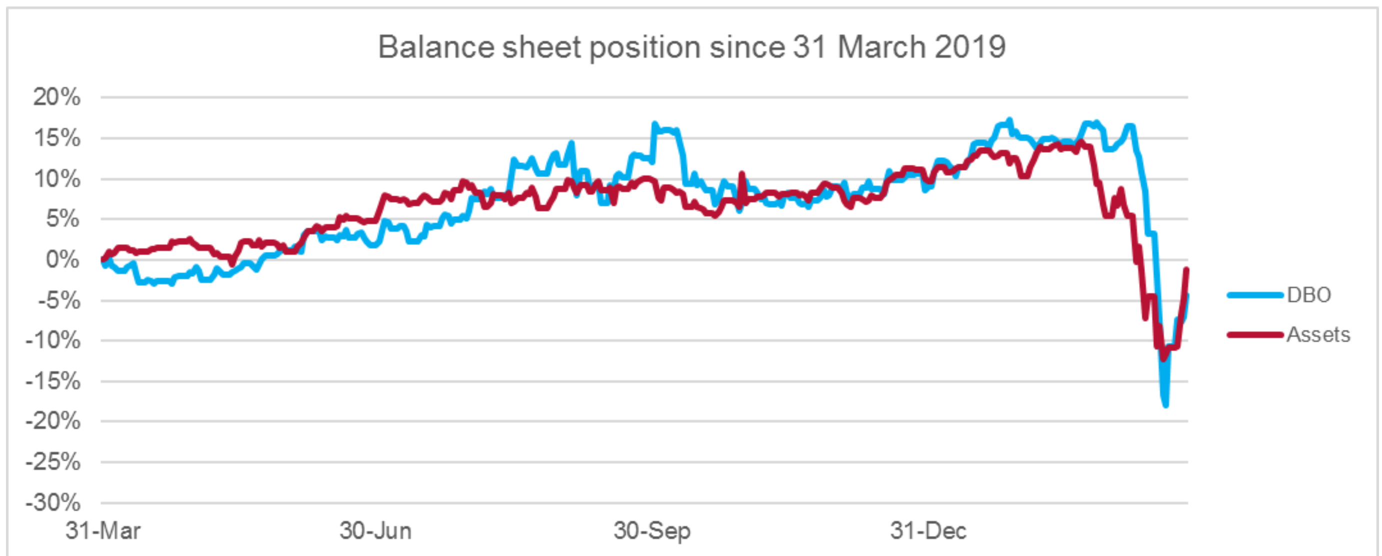
	31 March 2019	31 December 2019	26 March 2020
Corporate bond yield[1]	2.36% pa	2.00% pa	2.44% pa
Implied RPI inflation[2]	3.59% pa	3.41% pa	3.15% pa

1) iBoxx over 15 year £ AA corporate bond yield
2) Market implied RPI inflation for a duration of 15 years

Looking at the changes since 31 March 2019, corporate bond yields (and therefore accounting discount rates) are up by around 0.1% p.a., while future expectations of inflation are around 0.4% p.a. lower. It is worth noting that the change in implied RPI inflation might, in some part, reflect the proposed future changes to the calculation of RPI (and as a result, CPI expectations may not have fallen by as much).

Taking into account the changes in both corporate bond yields and inflation, your Defined Benefit Obligation (DBO) may have fallen by between 5% and 10% since 31 March 2019, although the exact impact will vary by scheme.

The charts below show how the position has changed for an example scheme over the past 12 months (up to 26 March 2020):

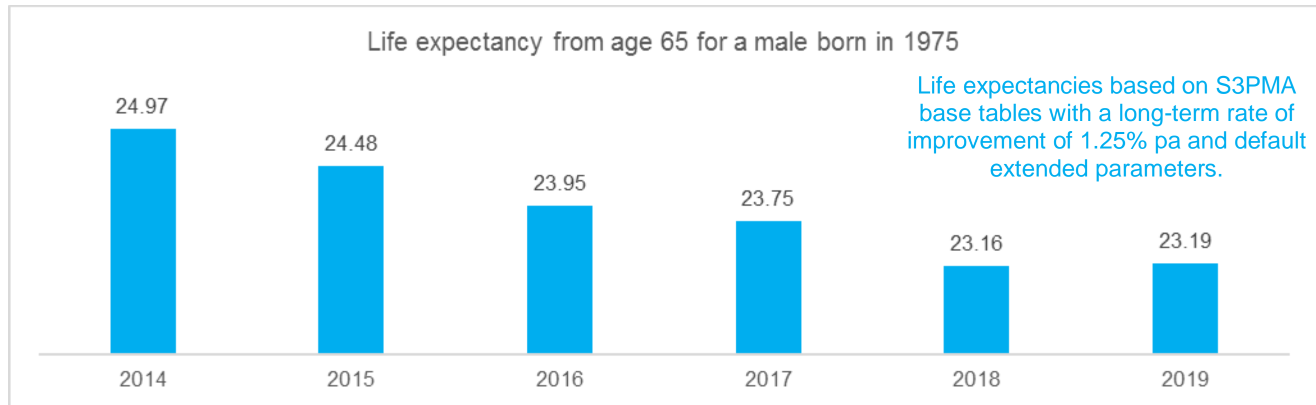


The impact on your Defined Benefit schemes will depend on investment strategy, the scheme's duration, and the extent to which benefits are linked to inflation. The example scheme has an asset allocation of 75% equities (similar to most LGPS funds).

New CMI projections

Earlier this month, the Continuous Mortality Investigation (CMI) released the latest model for projecting improvements to life expectancies, CMI 2019.

CMI 2019 shows a slight increase in life expectancies against the previous model, CMI 2018, reflecting the lower number of deaths than expected during 2019. This is the first such increase in life expectancy since CMI 2014, as shown in the chart below:



On average, we'd expect moving to CMI 2019 from CMI 2018 to increase liabilities only very slightly (by less than 0.5%), assuming the same parameters are used for both models. As a reminder, the key parameter in the CMI models is the long-term rate of improvement, but when CMI 2018 was released two extended parameters were introduced: an initial addition to mortality and the smoothing parameter.

These additional parameters allow the model to be better tailored to suit your scheme membership, giving you more flexibility in choosing your mortality assumption. However, it also opens up your assumption choices to more scrutiny from auditors.

Our Demographic Assumptions Working Group is currently analysing the latest model and available information to determine the most appropriate parameters for use by our clients.

Deficit reduction contributions

The Covid-19 crisis represents an unprecedented challenge for businesses, with the global economy all but grinding to a halt. For many employers, deficit reduction contributions (DRCs) represent a significant outlay. Where the employer is struggling, it may be possible to suspend or reduce DRCs for a temporary period.

The Pensions Regulator (TPR) has provided some guidance for employers, which sets out its pragmatic position on ceasing / reducing DRCs where this can be justified, and putting a plan in place to make these payments in the future. Reducing contributions in multi-employer schemes such as SHPS and LGPS is more difficult but possible. TPT, which runs SHPS has released guidance for employers including affordability appeals. Those employers furloughing staff will also need to decide how to treat employee and employer pension contributions. As always, our team are here to help.

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