Housing briefing, April 2022
Pension cost accounting assumptions

For most housing associations, 31 March means year-end and the preparation of annual accounts. Whether you participate in LGPS, SHPS or any other Defined Benefit pension scheme, you have flexibility in choosing the assumptions used to calculate your pension accounting costs.

The value placed on Defined Benefit scheme liabilities for company accounting is heavily dependent on what assumptions are used.

Crucially, accounting assumptions are the responsibility of the directors of the participating employer. You have the ability to set assumptions which are appropriate to your circumstances, and do not need to adopt the default assumptions given by the scheme. FRS 102 states:

> *"The actuarial assumptions shall be unbiased (neither imprudent nor excessively conservative), mutually compatible, and selected to lead to the best estimate of the future cash flows that will arise under the plan.*
>
> *"An entity shall measure its defined benefit obligation on a discounted present value basis. The entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds."*

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 varying views.

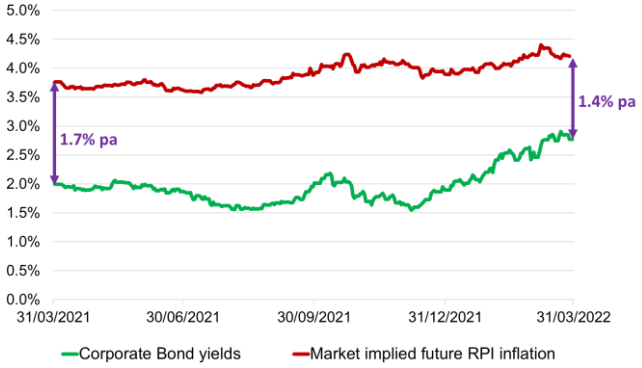
In addition, sometimes the default assumptions contain a margin of prudence, which may be appropriate for a cash funding valuation but is not in line with FRS 102, which required a 'best estimate' valuation.

Increasingly, we are seeing auditors scrutinise how directors have selected pension cost accounting assumptions. It can't be deliberately biased, and it still needs to show a 'true and fair' representation.

What has happened to FRS 102 liabilities in the last 12 months?

FRS 102 requires a best estimate of the future benefit cash flows to be discounted by the yield on 'high quality corporate bonds'.

Corporate bond yields have risen over the 12 months to 31 March 2022 by around 0.8% pa. This has been partially offset by higher market inflation expectations – but overall, we expect most organisations to see a fall in their FRS 102 pension scheme accounting liabilities over the year.



What about assets?

The change in the value of a scheme's assets over the last 12 months will be highly dependent on the investment strategy. In general, fixed interest assets (such as gilts and corporate bonds) have fallen in value in response to concerns about inflation, while assets with some short- or long-term inflation protection (for example index linked gilts and equities) have performed better.

The long-term cost of your Defined Benefit scheme is primarily driven by its investment returns. In a single employer scheme, the trustee must consult the employer about any investment strategy changes.

Arguably, the world economy may be on the brink of a new inflationary era. Now is an ideal time for employers to take a proactive approach to investment strategy and engage with scheme trustees to ensure the risk and return balance is appropriate.

How does my scheme compare to others?

First Actuarial carries out an annual survey analysing FRS 102 pension cost accounting results and assumptions for the social housing sector.

In 2021, our survey covered 232 disclosures, representing over £11bn in pension accounting liabilities. This means we can help clients benchmark key metrics such as funding level, discount rate and inflation assumptions.

Read our 2021 FRS 102 survey for the latest results and insights.

If you have participated in the survey in the past, we'll be in touch shortly. If you haven't, but would like to do so in future, please email enquire.employer@firstactuarial.co.uk. New survey respondents will receive a copy of our bespoke benchmarking report, free of charge.

Next steps for your year-end disclosures

The choice of assumptions can have a significant impact on your balance sheet at year-end and on next year's profit and loss account. We suggest you begin these conversations as soon as possible.

Take control and consider actuarial advice to select suitable FRS 102 pension cost accounting assumptions.

SHPS bulk transfer news

Wales & West Housing has left the Social Housing Pension Scheme (SHPS), via a bulk transfer, on 1 April 2022, Inside Housing has reported.

First Actuarial and Devonshires LLP advised Wales & West on the bulk transfer, and trustee services for the new scheme will be provided by TPT Retirement Solutions.

First Actuarial's view is that bulk transfers from multi-employer pension scheme are a rational undertaking for many organisations. This is because the 'one size fits all' financial strategy of a multi-employer scheme will not always be appropriate. However, the reality is that a bulk transfer is only a feasible option for a minority of employers, and we expect SHPS to remain a large scheme supported by a large number of strong employers.

While we are advising on several active bulk transfer cases, we have advised even more clients that we believe a bulk transfer is not in their interests. We ensure that our advice is always tailored to each client's objectives.

How First Actuarial can help you

First Actuarial provides independent advice to more housing associations than any other firm.

To discuss this briefing or any area of pensions, please contact your usual First Actuarial consultant or any of our nationwide housing specialists.

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