Housing briefing, May 2022

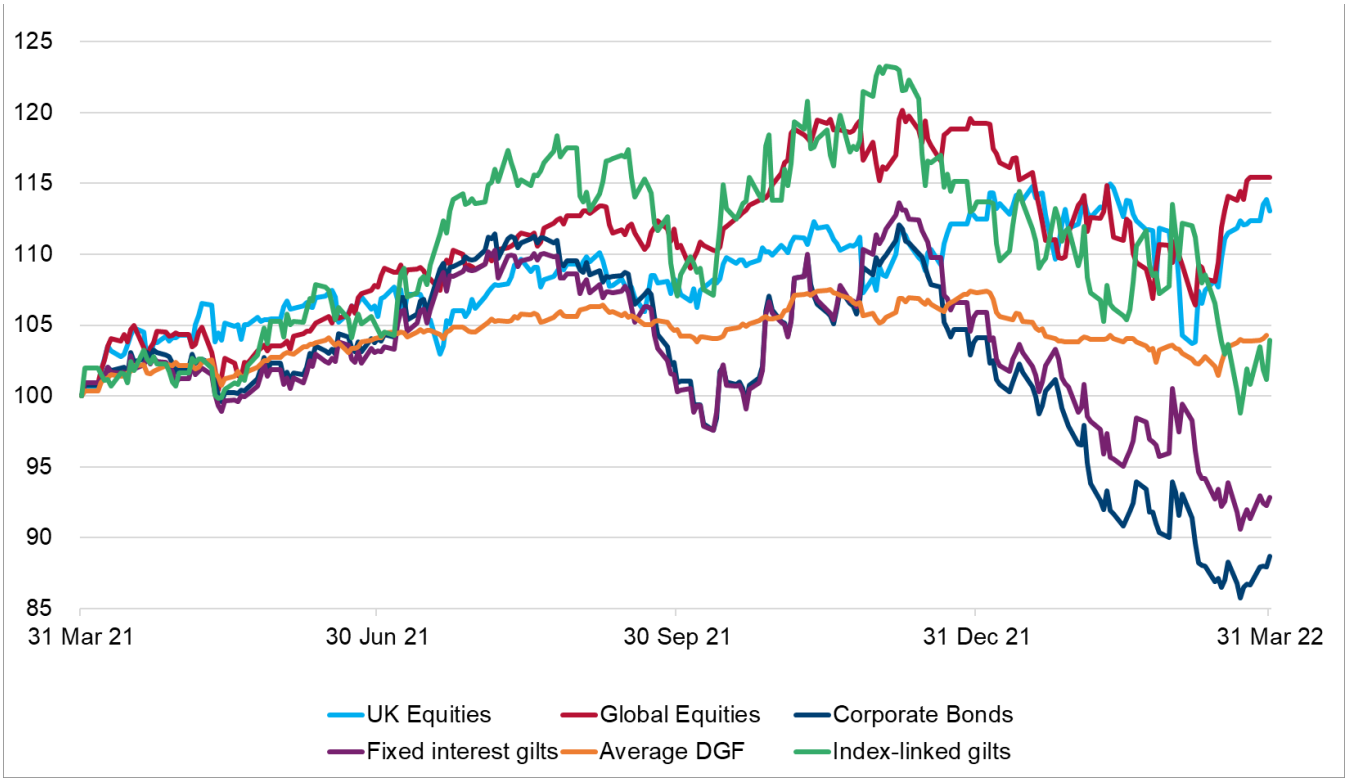
In this briefing, we highlight some of the key pension issues from the start of 2022, with a focus on important pension cost accounting issues to consider for 31 March year-ends.

Changes in markets since 31 March 2021

The first quarter of 2022 saw significant falls in bond markets, contributing to negative returns over the year, with corporate bonds falling by more than 10% since 31 March 2021 (and government bonds not far behind). Index-linked bonds have fared better, driven by increases in expectations of future inflation.

Equity markets saw a volatile year, although both global and UK equities had recovered from significant falls in February by the end of March. Over the course of the year to 31 March 2022, global equities were up by around 15%, with UK equities just slightly behind.

Overall, this means that we expect scheme assets to have risen, but the extent to which this is the case will depend on the make-up of each scheme's investment strategy.



Global equities: +15%

UK equities: +13%

Average DGF: +4%

Index-linked gilts: +4%

Fixed-interest gilts: -7%

Corporate bonds -11%

Impact on scheme liabilities

Both corporate bond yields (which drive FRS 102 discount rates) and gilt yields (which often drive funding discount rates) have increased over the year, which will have reduced the value placed on scheme liabilities. This has been offset, to some extent, by increased expectations of future inflation as shown below:

	31 March 2021	31 March 2022	Impact on the liabilities of an average[1] scheme
Corporate bond yield[2]	2.0% pa	2.7% pa	-13%
Gilt yield[3]	1.4% pa	1.9% pa	-9%
Market-implied inflation[4]	3.7% pa	4.1% pa	+6%

1 An average scheme is taken 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 Bank of England nominal gilt curve over a duration of 20 years
4 Gilt market implied inflation at a term of 20 years from the Bank of England implied inflation curve

Overall, this means that we expect scheme liabilities to have fallen, but the extent to which this is the case will depend on the make-up of each scheme's liabilities.

First Actuarial can help you set the financial assumptions for your FRS102 disclosures, taking into account the profile of your liabilities and demonstrating to your auditor that the board has taken appropriate advice.

Mortality

The financial markets aren't the only factor to affect the value of your Defined Benefit (DB) scheme liabilities, and it wouldn't be a pension briefing without mentioning mortality.

When it comes to setting the mortality assumption for year-end FRS102 disclosures, employers need to consider these questions:

- For multi-employer schemes, should an adjustment be made to the mortality base table to reflect your specific membership characteristics (e.g. location)?
- Should the mortality improvements model allow for mortality experience in 2020 and 2021 (which has been higher than expected due to Covid-19)?

The impact of these decisions can impact the liability calculation by up to 10%.

First Actuarial can help you set mortality and other demographic assumptions for your FRS102 disclosures, taking into account the profile of your membership (including a postcode mortality analysis).

Other pensions news

The war in Ukraine

At the time of writing this briefing, we are more than two months into the crisis in Ukraine and our thoughts are with those suffering from the humanitarian consequences of the war.

Looking at the financial side of the war, the list of Russian sanctions grows as time passes, with some of the headline financial restrictions being sanctions on government officials, business leaders, imports and exports, and the removal of some larger banks from SWIFT, effectively freezing their foreign currency reserves.

A typical UK scheme will have a trivial exposure to Russian markets, and so the immediate impact on the value of assets held by the scheme will be limited. However, a far more concerning impact for DB schemes will be the knock-on effect on inflation, already a growing issue following the pandemic, and further exacerbated by the crisis in Ukraine.

Many schemes' liabilities are linked to inflation, and so as inflation rises, so does the corresponding value of the liabilities. Fortunately, however, the majority of benefit structures include 'caps', which reduce the impact of rising inflation as increases in inflation become more material. Any assets held by schemes to hedge inflation do not operate with 'caps', so increases in these assets will overtake increases in the corresponding liabilities, resulting in a net surplus for the scheme.

Our recent investment briefing examines the impact of the Ukraine invasion on scheme assets but in this rapidly changing environment, analysis can quickly become out of date.

You should consider preparing for questions from employees about how much of their pension savings (DB and DC) were invested in Russia and Ukraine (and more generally how your pension arrangements are taking into account ESG factors in their investment strategy).

New Pensions Regulator notifiable events framework delayed

The introduction of new notifiable event regulations, which were expected to come into force on 6 April 2022, has been delayed.

It is proposed that the new notifiable event regulations will oblige employers with DB schemes to notify The Pensions Regulator of a broader range of corporate events and activities, and to do so at an earlier stage than is currently the case. The proposals contained the introduction of two new employer-related notifiable events:

1. Sale of a material proportion of the business or assets of a scheme employer
2. Granting of security on a debt to give it priority over debt to the scheme.

The materiality threshold for both these events is proposed to be 25% of assets/gross revenues as appropriate, and needs to be considered cumulatively on a rolling 12-month basis.

However, following a consultation on the draft regulations in September 2021, many commentators in the industry raised concerns about difficulties interpreting certain provisions.

The latest indications are that the DWP's response to the consultation and final regulations will be delayed for some weeks. The expectation is that the new regulations will now be effective from October 2022. We hope that this delay will mean a revised set of regulations which address some of the practical concerns raised by the industry in the consultation responses.

We recommend that housing associations should be considering the implications of the Pension Schemes Act 2021 in its entirety on corporate activity (e.g. new debt and mergers) and establishing the appropriate governance framework to comply.

Collective Defined Contribution (CDC) pension schemes get closer

Introduced in the Pension Schemes Act 2021, CDC pensions are set to become a reality for millions of people in the UK. The Government continues to work towards a 'go-live' date of August 2022 for CDC schemes supported by a single employer or a group of connected employers.

The consultation on a new code of practice for the authorisation and supervision of CDC pension schemes ended on 22 March 2022. First Actuarial responded to the consultation.

Derek Benstead – who has played an instrumental role in the introduction of CDC in the UK – has **written a blog post** on where we are with CDC and where we're heading.

CDC is an attractive alternative for employers keen to offer decent pensions without the risk of cost increases and large liabilities. First Actuarial offers a **complimentary training session** to any organisation interested in what CDC can offer.