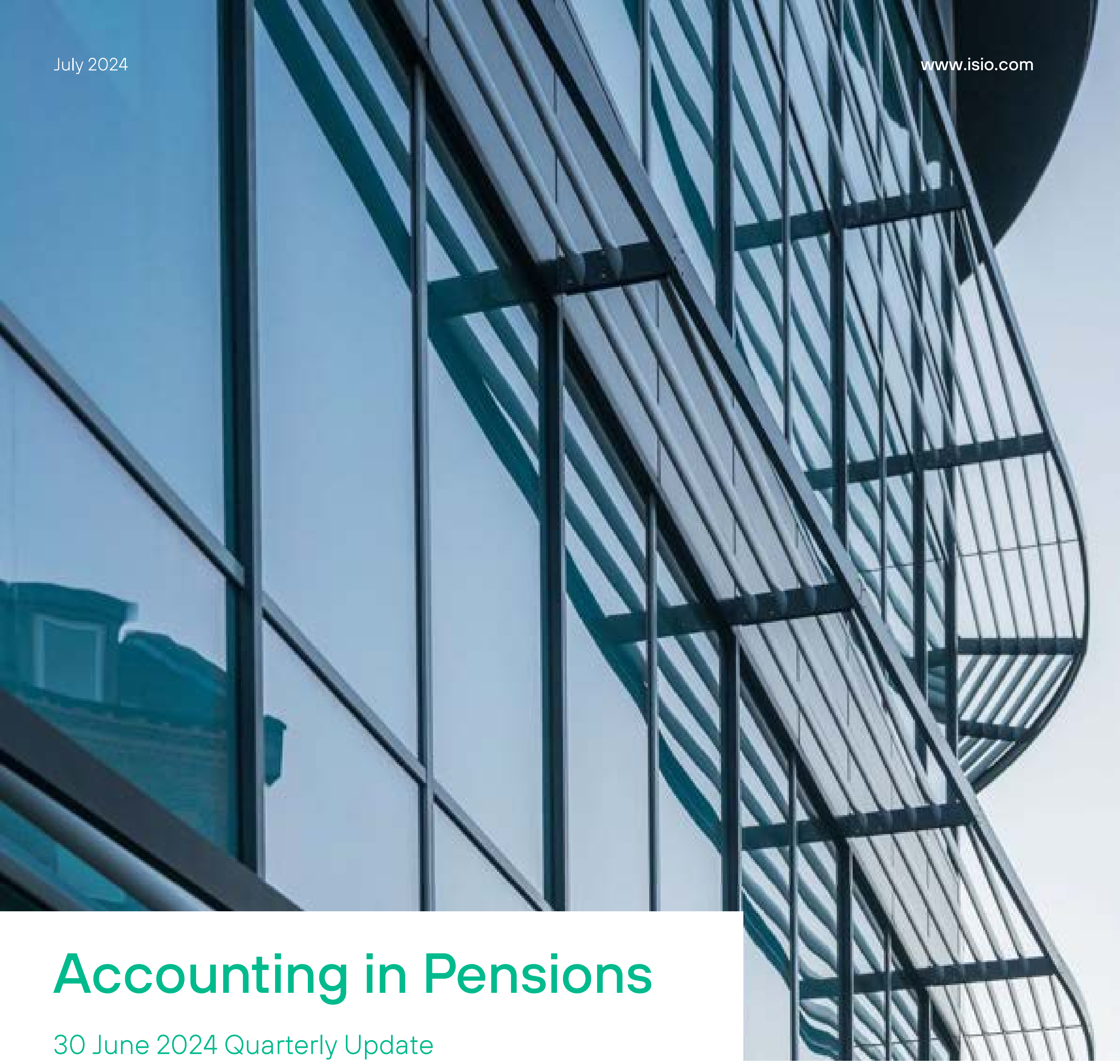


Accounting in Pensions

30 June 2024 Quarterly Update

isio.

Accounting benchmarks

Movement over the last year

For an average scheme, with a funding level of 95% at 30 June 2023, the changes in discount rate and inflation above may have resulted in a c.2% decrease in the liabilities. Assuming a typical investment strategy[3], assets are anticipated to have increased by c.3% over the year, resulting in an **overall c.5% improvement** in the funding position.

What are the key financial indicators for accounting?

The table below summarises Isio UK financial indicators for 30 June 2024 for company accounting purposes, as well as changes since 31 March 2024 and 30 June 2023.

	30 June 2024[1]	31 March 2024	*Change*	30 June 2023	*Change*
Discount rate[2]	5.09%	4.81%	*0.28%*	5.00%	*0.09%*
RPI inflation[2]	3.38%	3.40%	*-0.02%*	3.41%	*-0.03%*
CPI inflation[2]	2.53%	2.55%	*-0.02%*	2.56%	*-0.03%*
Gilt yield[2]	4.61%	4.37%	*0.24%*	4.32%	*0.29%*
FTSE All Share-TR	9,728.9	9,379.3	*3.73%*	8,610.8	*12.98%*

[1] Figures are based on high level analysis and for illustrative purposes only.
[2] Financial indicators based on an average pension scheme with a 20-year term.
[3] Assuming a typical investment strategy consists of 40% growth assets and 60% matching assets with 70% level of hedging

Movement over the last quarter and year

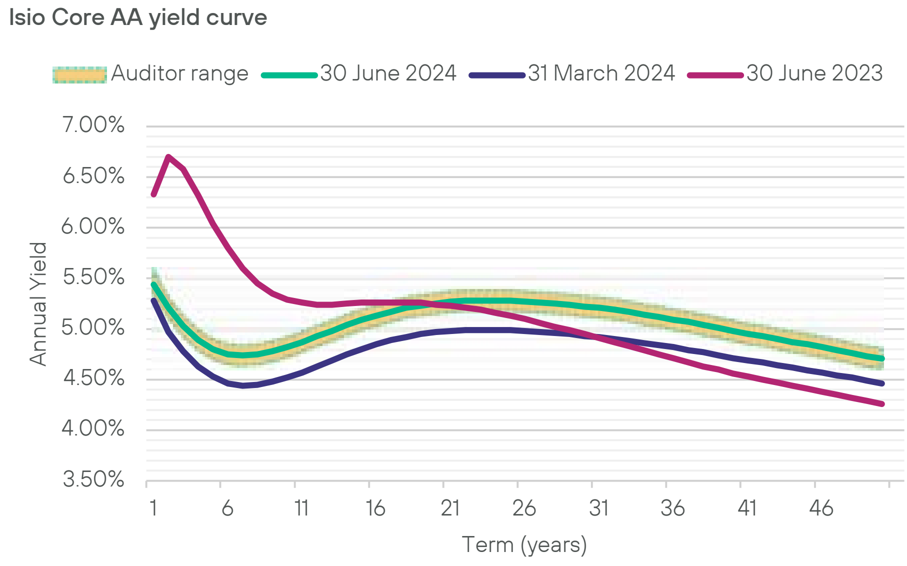
For an average scheme with a funding level of 95% at 31 March 2024, the changes in discount rate and inflation above may have resulted in a c.6% decrease in liabilities. Assuming a typical investment strategy[3], assets are anticipated to have reduced by c.1%, resulting in an **c.5% improvement** in the overall funding position.

Corporate bond yields have risen modestly over the quarter to 30 June 2024, and this will be offset to an extent by corresponding increases in long-term inflation expectations. Schemes will likely see reductions in their accounting liabilities to varying degrees, depending on the extent to which their level of hedging exposes them to interest rate and inflation movements. Changes to scheme assets will depend on the amount by which improvements in growth assets have been offset by interest rate hedges.

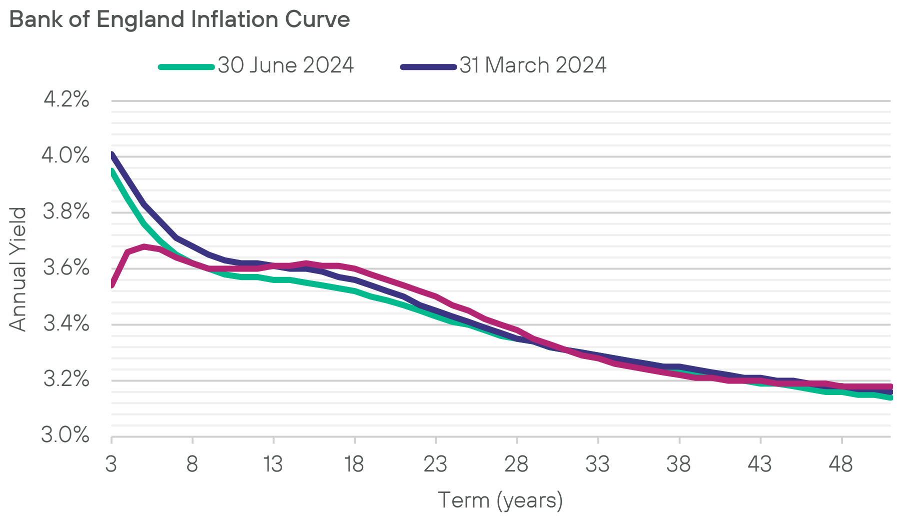
Over the year to 30 June 2024 corporate bond yields and long-term inflation expectations have not changed materially. Movements in funding position over the year will mostly be influenced by individual schemes' investment strategies and their exposure to growth assets, which have seen high returns over the period.

What does this look like at different terms?

The chart below shows the expected discount rates for all terms at 30 June 2024, as well as at 31 March 2024 and 30 June 2023. This is based on Isio's Core approach and includes an indicative auditor acceptable range (further detail below).



The chart below shows the Bank of England inflation rates for all terms at 30 June 2024, as well as at 31 March 2024 and 30 June 2023.



What are we seeing in the market?

We have summarised our findings from conversations with auditors, and information collected from accounting exercises to date, which may be useful when setting assumptions.

Discount rate

- Auditors' typical acceptable ranges are up to ±0.25% of the market median, but this range can be larger at longer durations.
- Compared to a year ago, credit spreads have reduced. Most schemes hedge interest rate movements against Gilt-linked funding bases. Because of this, asset performance may not be as significant as expected, due to those scheme assets related to interest rate hedges having reduced in line with increases in gilt yields over the period.
- Isio's yield curve approaches are expected to be within audit firms' acceptable ranges. Whilst only our core approach is illustrated on Page 3, there are alternative approaches which result in slightly higher discount rates.

Inflation

- Current expectations are that RPI will continue to be calculated and published in the future, but from February 2030 these calculations will mirror those used for setting CPIH. Theoretically, this should mean published RPI should run 0.8%-1.1% lower from around 2031.
- Historically, a typical acceptable range for any Inflation Risk Premium ("IRP") was nil to 0.3%. The recent changes have seen some entities adopt higher IRPs, including applying post-2030 increases, reflecting views that market based RPI is being overstated.
- Most auditors default position will be to expect no RPI-CPI wedge post-2030, but a number of firms do make some modest allowance.
- Isio's break-even RPI inflation rates are expected to be close to the benchmark rates for each audit firm across terms.
- Auditors may expect RPI and CPI assumptions to be derived using separate durations, where they distinctly relate to benefits of different terms.

Mortality

Long-term mortality improvements

Auditors would normally look for the use of the latest long-term improvements data, with a preference for this to be updated annually rather than triennially.

- The CMI released the 2023 version of its projections model in April 2024. The core version of the 2023 model applies greater weighting to mortality experience over the last two years, resulting in marginal reductions in life expectancies where schemes transition from the core 2022 model (typically equivalent to c0.5% reductions in liabilities).
- Users of the 2023 model can choose to place more or less weight on the post pandemic years mortality experience data; placing greater weight implies that recent, high mortality experience is indicative of longer-term trends and results in reduced life expectancies.
- Analysis by Isio indicates that higher weightings than those under the CMI's core version of the model should be considered for accounting purposes, to achieve a set of mortality assumptions that are best-estimate.

Mortality base tables

- In addition to the release of CMI 2023, updated Self-Administered Pension Scheme ('S4') mortality data was released by the CMI in February 2024. The updated dataset is based on mortality data from 1 January 2014 to 31 December

2019, excluding years affected by COVID. The 'S4' tables point to a slight reduction in life expectancy, although the impact on individual schemes will differ.

- For accounting, schemes typically adopt the mortality base tables used at their most recent funding valuation when setting assumptions. Where this is the case, auditors therefore typically expect this assumption to be updated following the completion of scheme-specific mortality studies.

Most auditors will look at the resultant life expectancies from the proposed mortality assumptions with follow-up questions being raised if the life expectancies do not fit within the auditor's acceptable range – i.e. it's the combination of assumptions and parameters which is important, rather than specific individual parameters in isolation.

Other pensions accounting issues

- **Virgin Media vs NTL Pensions Trustees** – A challenge by the trustees of this pension scheme led to the High Court making a landmark judgement in June 2023. The judgement concluded that certain amendments made to schemes between April 1997 and April 2016 may be invalid if a confirmation known as a 'Section 37' certificate was not completed at the time. Whilst the ruling remains under appeal, the case is of significance as it could mean that the amendments of other schemes are considered invalid, resulting in additional unforeseen liabilities.

  The necessary work to understand the implications of this case for schemes will take time. However, most auditors will expect consideration to be given to the ruling, which may involve schemes identifying the key amendments to rules over the relevant period and whether their unwinding would result in a material impact on liabilities.

- **Inflation experience** – Over recent months inflation has reduced materially. RPI inflation for the year to Sep 2023 was 8.9%, but for the following seven months to April 2024, RPI has been 1.7%. Many schemes may still experience large increases to pensions over 2024, as lags in indexation may mean schemes reference this higher period of inflation around September. However, more recently, actual inflation will typically be lower than schemes' long-term assumptions, and therefore schemes may experience positive inflation experience at future reporting dates once this is allowed for.

- **Recognising experience** – Some auditors are focusing on ways that any roll forward methodology being used can be refined to reduce the size of experience items arising following the completion of the triennial funding valuations every three years (e.g. allowing for known historic and upcoming pension increases).

- **Onerous data requests** – Auditors are continuing to ask for more granular levels of data and information from companies, which in most cases will have to be requested from the trustees.

Note auditor ranges are indicative based on data from 30 June 2024 and ranges will vary between auditors. We can provide further insight on request.

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