Briefing note

31 March 2022 Accounting – Options and Assumptions **February 2022**

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What options are available to you?

1a Enhanced Service – Assumption Setting

For employers who wish to take more control of the figures disclosed in their pension accounts, using this enhanced service would allow your organisation to:

- Receive an employer specific assumptions paper covering the assumptions key to your organisation, which assumptions could be updated, and the financial impact on your balance sheet and P&L of doing so; and/or
- Arrange a call with an Actuary to discuss the assumptions and their impact on your organisation's disclosures; and/or
- Receive provisional FRS102/IAS19 figures in advance of the reporting date, giving an early indication of how your balance sheet position has changed.

1b Enhanced Service - Supplementary Paper

Alongside receipt of your FRS102/IAS19 report, you are able to request an additional supplementary paper explaining the key movements on your specific numbers over the year. This would include the financial impact of each different market movement on your 31 March 2022 FRS102/IAS19 results (compared to 31 March 2021). It aids understanding of the figures and helps with audit questions.

1c Enhanced Service – Slide Deck (new for 2022)

Alongside receipt of your FRS102/IAS19 report, you are able to request a slide deck and accompanying script to assist explaining your results to committees/boards/directors. This will summarise your organisation's key accounting figures and the movements that have taken place within your own disclosures in 21/22.

1d Enhanced Service – Employer/Audit Call

After receiving your FRS102/IAS19 reports or during your audit, you may find it useful to arrange a call with an Actuary (and this can be arranged in the advance). The call could be with your Auditor (and yourself) to answer their queries on items like the process, methodology, assumptions, and the year end figures themselves. Or with your Director of Finance and others with an interest in your organisation's pension disclosures to answer their questions on the accounts and the LGPS. We can also attend your board, finance or audit committee virtually to deliver the key messages and answer questions from the room.

If you would like to receive more information on the above options, please do get in touch with your local contact within the Employer Services Team at the West Midlands Pension Fund.

2 Standard Service

For employers who are happy to adopt the default assumptions, appropriate for an average LGPS employer with your liability profile, we will prepare a standard accounting report for the standard fee.

Details on the default financial and demographic assumptions are set out in the remainder of this Briefing Note.

Assumptions

From listening to LGPS employers, we understand the importance of the pension figures disclosed in your accounts and that they can have a material impact on your ability to carry out your normal business function.

The pension figures, in both the balance sheet and revenue account, are heavily dependent on the choice of assumptions. Crucially, as directors of the organisation, it is your responsibility to set assumptions that best reflect the characteristics of your organisation.

As the actuary to the LGPS fund in which you participate, we provide a set of default accounting assumptions for a ‘typical LGPS employer’. The approach to our default assumption setting applies to all accounting disclosures (unless otherwise stated) and is discussed in advance with the National Audit Office, Audit Scotland and Wales Audit Office. Whilst we propose default assumptions for LGPS employers, the accounting assumptions adopted are ultimately the responsibility of your organisation’s directors (or equivalent) based on actuarial advice.

We therefore strongly recommend that you consider the suitability of the default assumptions to your specific organisation. It is up to you to determine how to proceed with the choice of assumptions given the relative importance of the LGPS accounting figures to your organisation’s own circumstances.

There are several options (as per Enhanced Service 1a) available to employers who wish to pursue alternative assumptions which might be more suitable for your organisation (e.g. salary increase assumptions in line with your business plan).

Indicative default assumptions (based on market conditions as at 31 January 2022)

This table shows our default financial assumptions at 31 January 2022, based on the below methodology. The default Hymans Robertson default assumptions used for the 31 March 2021 exercise are also shown for comparison purposes. Please note, the default assumptions at 31 March 2021 may differ from those adopted in your 2020/21 yearend disclosures.

Duration category	*31 March 2021*		31 January 2022	
	Discount rate	*(RPI) CPI*	Discount rate	(RPI) CPI
Short	*1.95%*	*(3.35%) 2.85%*	2.20%	(3.70%) 3.15%
Medium	*2.00%*	*(3.30%) 2.85%*	2.25%	(3.55%) 3.10%
Long	*2.05%*	*(3.20%) 2.80%*	2.25%	(3.45%) 3.05%

Discount Rate

Both FRS102 and IAS19 state that the discount rate used to place a value on the obligations should be determined by reference to market yields on high quality corporate bonds at the reporting date. In addition, the currency and term of the high quality corporate bonds used to set the discount rate should be consistent with the currency and term of the obligations.

Corporate bond yield curve

Government bond yield curves are updated and available on a daily basis from the Bank of England. It is therefore relatively easy to identify a spot yield on Government bonds at any duration and at any date. Unfortunately, a similarly accessible corporate bond yield curve is not so readily available. We have adopted an approach to setting the discount rate whereby a “Hymans Robertson” corporate bond yield curve is constructed based on the constituents of the iBoxx AA corporate bond index.

Weighted average duration

The discount rate should reflect the ‘term’ of the benefit obligation. We have interpreted ‘term’ to be the weighted average duration of the benefit obligation. This is broadly defined as *‘the weighted average time until payment of all expected future discounted cashflows, determined based on membership and the financial and demographic assumptions at a particular time’.*

With increased divergence of LGPS employers, the weighted average durations of individual employers are different and therefore different financial assumptions are adopted for accounting purposes. Our default assumption approach sets out 3 separate discount rates (and corresponding RPI/CPI inflation assumptions) for employers who fall into each duration category below:

Weighted average duration at most recent actuarial valuation	Duration category
Less than 17 years	Short
Between 17 and 23 years	Medium
More than 23 years	Long

Retail Prices Inflation (RPI)

This assumption is typically derived from yields available on fixed interest and index linked government bonds and should be consistent with the derivation of the discount rate. We use a market implied inflation curve over a range of maturities. Cashflow weighted single RPI rates are derived from the market implied inflation curve that recognise the weighted average duration of each corresponding duration category defined above.

Based on 31 January 2022 market conditions, these RPI rates have then been adjusted to take account of an Inflation Risk Premium (IRP) of 0 basis points (bps) pre 2030 and 30bps post 2030. This gives an average IRP of 15bps over short durations; and 20bps over medium and long durations.

Pension Increases (CPI)

The pension increase assumption is set in line with our default Consumer Prices Index (CPI) assumption. As a market in CPI linked bonds does not exist, we need to estimate the long-term gap between RPI and CPI to derive a CPI assumption for accounting purposes. Our estimate is based on analysis of past and emerging future trends in the gap between these indices.

For the CPI assumption, we have used an RPI-CPI gap of 100bps pre 2030 and a gap of 10bps post 2030. The former reflecting differences between RPI and CPI pre 2030 and the latter reflecting differences between CPI and CPIH post 2030 (when RPI will become aligned with CPIH). The resulting average RPI-CPI gap is 0.55% over short durations, 0.45% over medium durations and 0.40% over long durations.

Salary growth

Our default assumption for salary growth is set relative to the derived CPI assumption at the reporting date using the same methodology as the latest funding valuation for the LGPS fund(s) in which you participate. Further details on the salary growth assumption can be found in the actuarial funding valuation reports (which can be publicly found on each LGPS fund’s website).

Longevity assumptions

Setting appropriate life expectancies remains a key assumption for the accounting disclosures, particularly as the country deals with the ongoing impact of COVID-19. As per last year and in line with best practice, we will make allowance within the accounting disclosures for the latest available life expectancy improvement tables (i.e. the Continuous Mortality Investigation (CMI) 2021 tables which are expected to be published in March 2022).

Other demographic assumptions

These include assumptions for commutation, withdrawal, ill-health early retirements, etc. We gathered data on recent experience of LGPS funds in order to set appropriate demographic assumptions for the previous formal triennial funding valuation. Our default approach will be to use the same (non longevity) demographic assumptions for accounting purposes as at the latest funding actuarial valuation. Collectively, these demographic assumptions are intended to be best estimate.