Pensions accounting trends
31 December 2020

Observed market practice on pensions accounting assumptions at 31 December 2020

This document sets out the market practice on pensions accounting assumptions at 31 December 2020 that PwC has observed, key market indicators and current pensions accounting developments.

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Assumptions at 31 December 2020</th>
<th>Assumptions at 31 December 2019</th>
<th>Sensitivity for £500m scheme (0.1% pa / 1yr)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Optimistic</td>
<td>Median</td>
<td>Prudent</td>
</tr>
<tr>
<td>Discount rate</td>
<td>1.9% pa</td>
<td>1.4% pa</td>
<td>1.2% pa</td>
</tr>
<tr>
<td>RPI inflation</td>
<td>2.7% pa</td>
<td>2.9% pa</td>
<td>3.3% pa</td>
</tr>
<tr>
<td>CPI inflation**</td>
<td>2.0% pa</td>
<td>2.3% pa</td>
<td>2.7% pa</td>
</tr>
<tr>
<td>Life expectancy (male @ 65)</td>
<td>c.20 years</td>
<td>c.22 years</td>
<td>c.24 years</td>
</tr>
</tbody>
</table>

*RPI inflation assumption sensitivity allows for an equivalent movement in the CPI inflation assumption.

** The range of CPI inflation assumptions quoted at 31 December 2020 reflects an average of pre- and post-2030 rates for a typical scheme.

Key market indicators

<table>
<thead>
<tr>
<th></th>
<th>31 December 2020</th>
<th>30 September 2020</th>
<th>Change</th>
<th>31 December 2019</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>FTSE All-Share Total Return Index</td>
<td>7,068.59</td>
<td>6,276.31</td>
<td>UP 12.6%</td>
<td>7,837.96</td>
<td>DOWN 9.8%</td>
</tr>
<tr>
<td>UK fixed interest gilt index</td>
<td>6,648.14</td>
<td>6,575.04</td>
<td>UP 1.1%</td>
<td>5,837.64</td>
<td>UP 13.9%</td>
</tr>
<tr>
<td>iBoxx AA corporate bond index yield</td>
<td>1.34% pa</td>
<td>1.53% pa</td>
<td>DOWN 0.19%</td>
<td>2.00% pa</td>
<td>DOWN 0.66% pa</td>
</tr>
<tr>
<td>RPI inflation (20-year spot rate)</td>
<td>3.36% pa</td>
<td>3.32% pa</td>
<td>UP 0.04% pa</td>
<td>3.42% pa</td>
<td>DOWN 0.06% pa</td>
</tr>
</tbody>
</table>

Notes

1. The figures in this document are for illustrative purposes only. The ranges quoted do not represent PwC’s internal expected ranges and cover schemes of all commonly observed durations.
2. The sensitivity figures provided represent a typical scheme with liabilities of £500m.
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Current pensions accounting developments

Market movements over the quarter
Equities rebounded strongly over the last quarter of 2020, mainly due to the news of the successful COVID-19 vaccines and the Brexit trade deal. Whilst the FTSE All-Share Total Return Index fell during October, it rose sharply in November, continuing the momentum into December. The index ended the quarter 13% up; however, the index remains 10% down on the start of the year.

Corporate bond returns outpaced those from government bonds over the last quarter, with both significantly up for 2020. The flipside of this is that AA-rated corporate bond yields fell further in the final quarter, ending the year at around 1.3% pa - the lowest ever month-end yield.

Long-term UK gilt yields ended the last quarter broadly unchanged, ending December at around 0.7% pa, meaning that implied credit spreads narrowed by around 0.15% over the quarter.

Long-term inflation expectations increased by 0.05% pa over the fourth quarter, despite the RPI consultation response announcement (see below). The Bank of England inflation curve at the end of 2020 had a very similar shape compared to the start of the year, albeit around 0.05% pa lower.

RPI reform
On 25 November 2020, HM Treasury and the UK Statistics Authority (UKSA) released their joint response to the consultation on the ‘Reform to RPI methodology’, which covered the proposal to align RPI with CPIH (CPI including owner occupiers’ housing costs) from 2030, or as early as 2025. The Chancellor confirmed he is unable to consent to a change in methodology before 2030 due to the negative impact on ‘relevant’ index-linked gilts (those issued before 2002), whilst the UKSA stated that they plan to make the change to RPI from February 2030, noting that they had obtained confirmation that they would be able to “legally and practically implement” the proposal. No compensation will be given to other index-linked gilt holders (i.e. those holding index-linked gilts issued from 2002) or pension scheme members.

Companies with material pension schemes and reporting dates after 25 November 2020 will be expected to take the consultation response into consideration when setting their RPI and CPI inflation assumptions (and any assumptions linked to those), with appropriate disclosure around any key judgements made. Please see our blog here for a discussion of the challenges in predicting future inflation.

GMP equalisation for transfer values
On Friday 20th November, the High Court handed down its judgment in the latest instalment of the Lloyds GMP equalisation case. It concluded that trustees of pension schemes will need to consider whether to review past transfer values - potentially going back 30 years - and determine whether these need to be topped up. Similar to the original judgment, the impact will vary considerably from scheme to scheme, depending on the benefit structure, as well as the number and size of historical transfers.

As data quality will be a key issue in determining whether a reliable estimate can be made, it is important that companies have a clear understanding of the size of the potential impact, what information is readily available and their auditor’s views on an appropriate approach given materiality levels.

Similar to the original ruling, auditors are likely to insist on a plan amendment to be recognised with an effective date of 20th November 2020 where the impact is deemed to be material and where no prior allowance was made.

PwC
With over 2,500 pension experts around the world and unrivalled expertise in audit and accounting, PwC is uniquely placed to help companies understand the impact of their pension arrangements on their financial statements.

PwC’s market-leading online tool, Accounting Consolidate, enables companies to seamlessly consolidate their IFRS or US GAAP results, interrogate the results, test the impact of key economic changes, carry out projections and produce fully compliant downloadable disclosures.

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