Broadstone

SIRIUS
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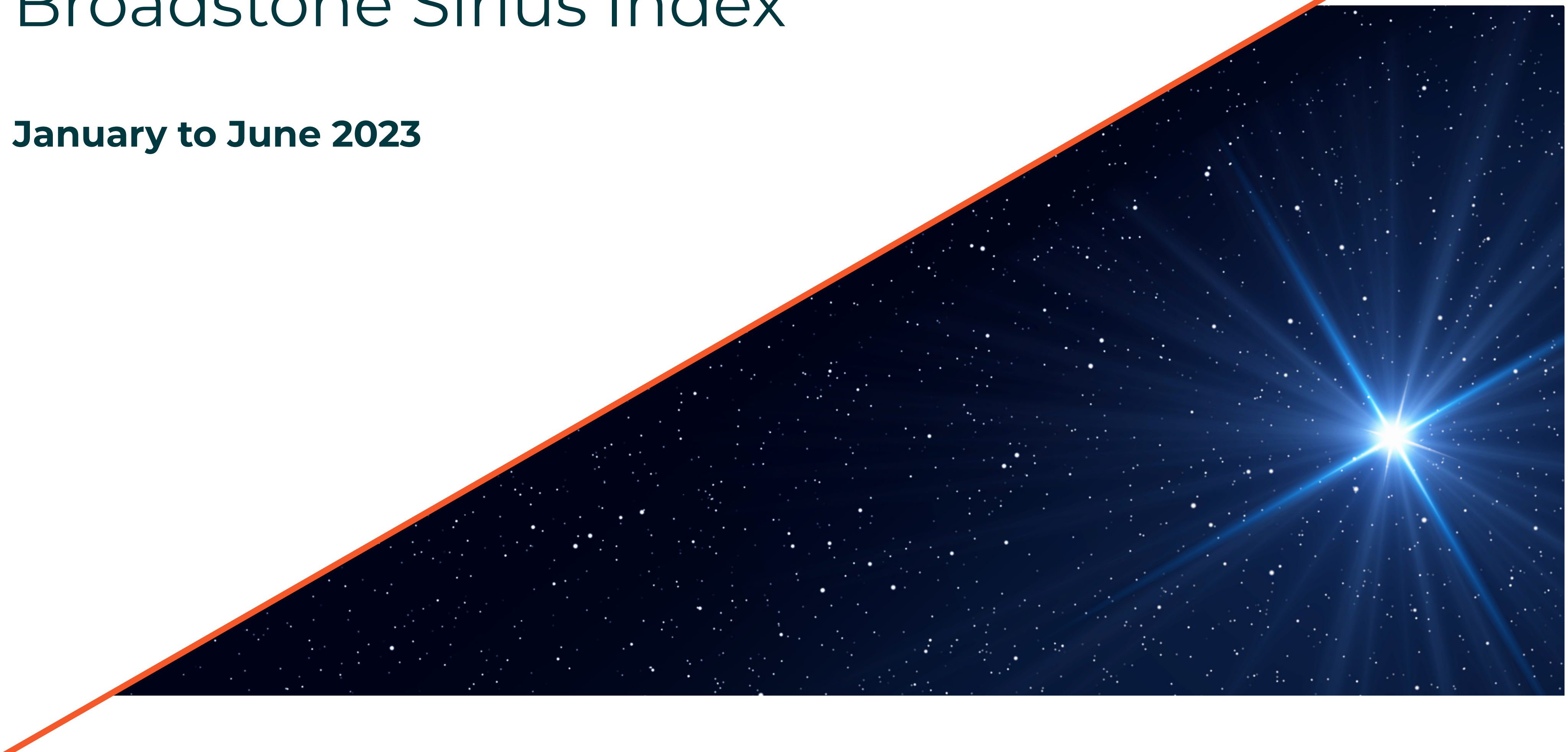
Welcome to the Broadstone Sirius Index

January to June 2023



Welcome to the Broadstone Sirius Index

Low dependency or self-sufficiency has been an integral part of the funding discussion since the launch of the Pension Regulator's funding code in 2020.

The final funding code has been delayed until 2024 but Trustees and sponsors will need to understand the progress of their scheme's funding on the low dependency basis as they head towards their date of significant maturity.

In October 2022 we launched the Broadstone Sirius Index to understand the progress of our pension schemes as they proceed on their journey. We'd have been hard pressed to find a more interesting time to launch.

The index has been published monthly and is derived by interrogating the schemes loaded onto our Sirius integrated actuarial and investment platform thereby creating an average scheme.

Using this average scheme as our barometer, and tracking its progress accordingly, we can capture the key issues that schemes face on their journey to low dependency.

Since inception we have tracked two schemes with different hedging strategies:

- Scheme 1 – has 50% interest/inflation rate hedging in place.
- Scheme 2 – has 100% interest/inflation rate hedging in place.

We have analysed the data to June 2023 from the beginning of the year to give us an overview of the year to date.

In the following few pages we look at:

- The experience across June 2023
- The story of the year so far
- What schemes should be doing now

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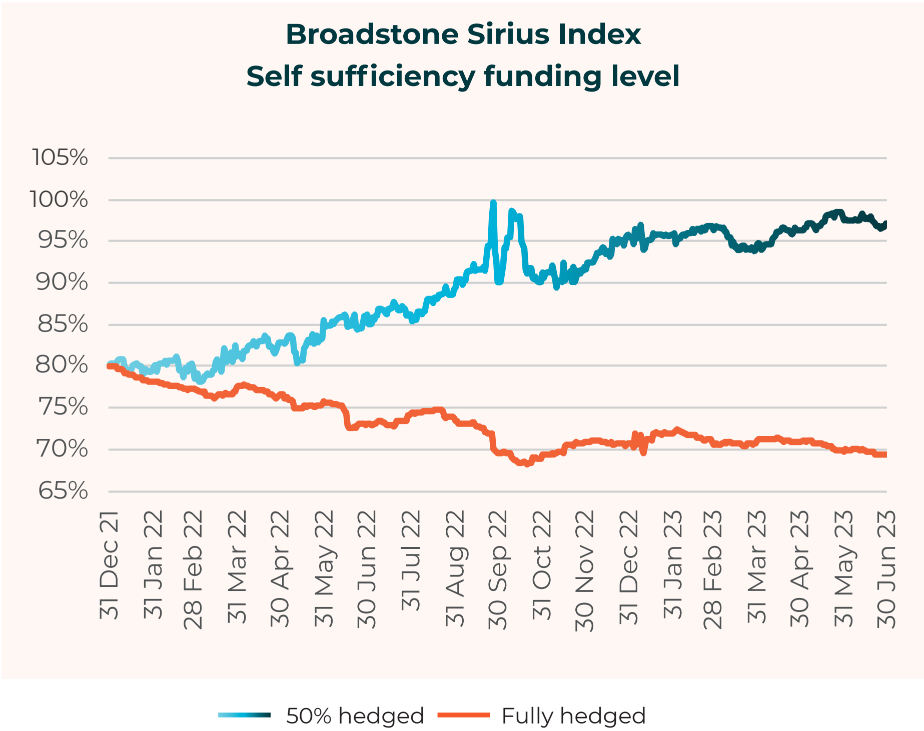
Results month to June 2023

Higher than expected inflation for a sustained period alongside higher historical inflationary increases feeding through into June have increased the present value of liabilities.

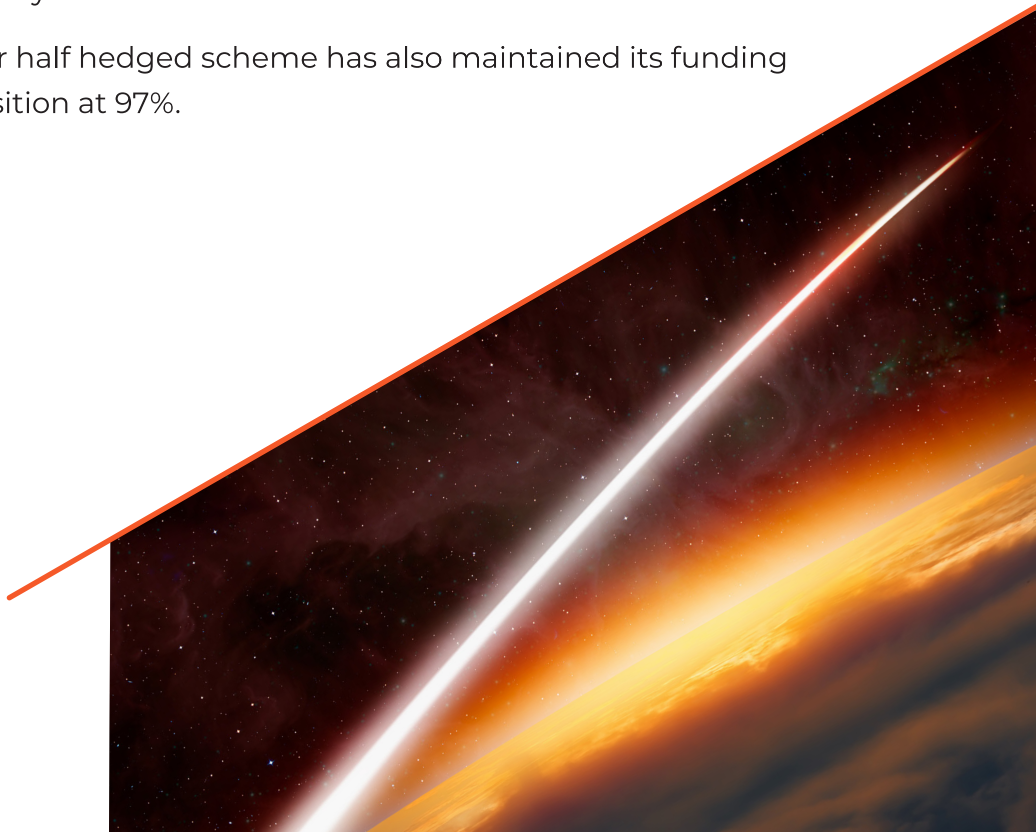


These increases were offset by expected falls in liability values caused by a rise in interest rates, the combined impact being a liability increase of 0.5%.

The Bank of England's Base Rate decision had a lower impact than expected as rising short term rates were partially offset by falling longer term rates, further inverting the yield curve.

Our fully hedged scheme's funding position has remained steady at 70%.

Our half hedged scheme has also maintained its funding position at 97%.



After a dramatic month of May which saw large rises in yields, June has been a lot quieter. We expected more volatility given the interest rate rise from the Bank of England, but while that decision causes issues for individuals, defined benefit pension schemes have been largely immune with markets not moving as one may have expected.

An inverted yield curve is often considered as an indicator of a forthcoming recession, so Trustees should be discussing with their investment consultant the extent to which their scheme's investment strategy can weather this potential scenario.

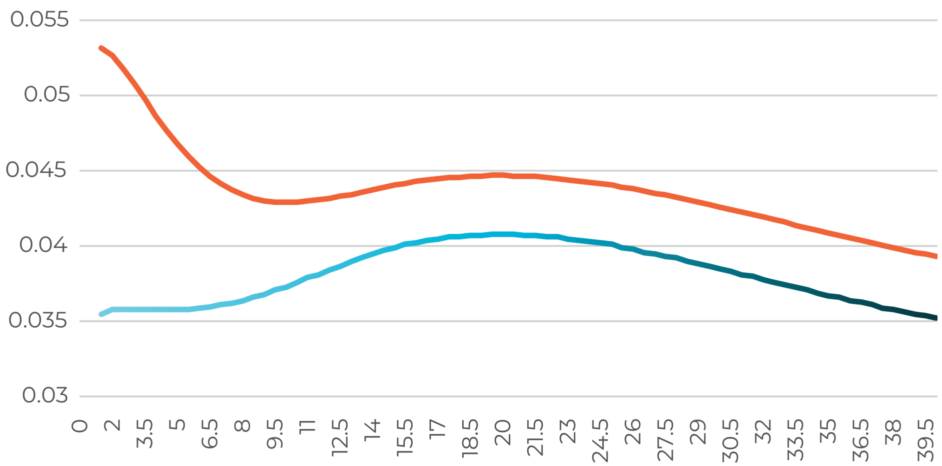
Inflation is often discussed in pension schemes as being of lower impact because of the various caps and collars constraining its influence on benefits. However, if expectations of prolonged high inflation are true, the present value of the liabilities will begin to creep up too.

We expect that Trustees will be discussing the impact of higher than expected inflation with their Scheme Actuary, both the impact on funding, and member benefit calculations.

The tale of 2023

The tale of the year has been one of gilt yield movements which have steadily risen through the year. As the present value of liabilities are assessed relative to the price of the gilt yields, the higher the yields rise, the lower the liabilities become.

Bank of England Nomial Gilt Yield Curve Spot Rate



50% hedged scheme

The deficit for our 50% hedged scheme began the year at just under £1.4m, peaking at just below £2.0m at the end of March, before closing under £1m thanks to the rise in long-term interest rates reducing liabilities with the unhedged assets standing firm. This represents a reduction in deficit of around £0.6m year to date.

100% hedged scheme

With a larger quantum of deficit, as it did not improve to the same extent in 2022, our 100% hedged scheme has seen a largely similar story in deficit movement over the year to date. There has been broadly no improvement, as the fully hedged scheme has not benefited from the fall in yields causing the liabilities to fall by less than the assets.

The key message from the graphs above is that the deficits for both schemes have moved much more consistently over 2023, compared to a significant divergence in 2022, noting that at 1 January 2022 both schemes started with a deficit of £10m.

What should schemes be doing

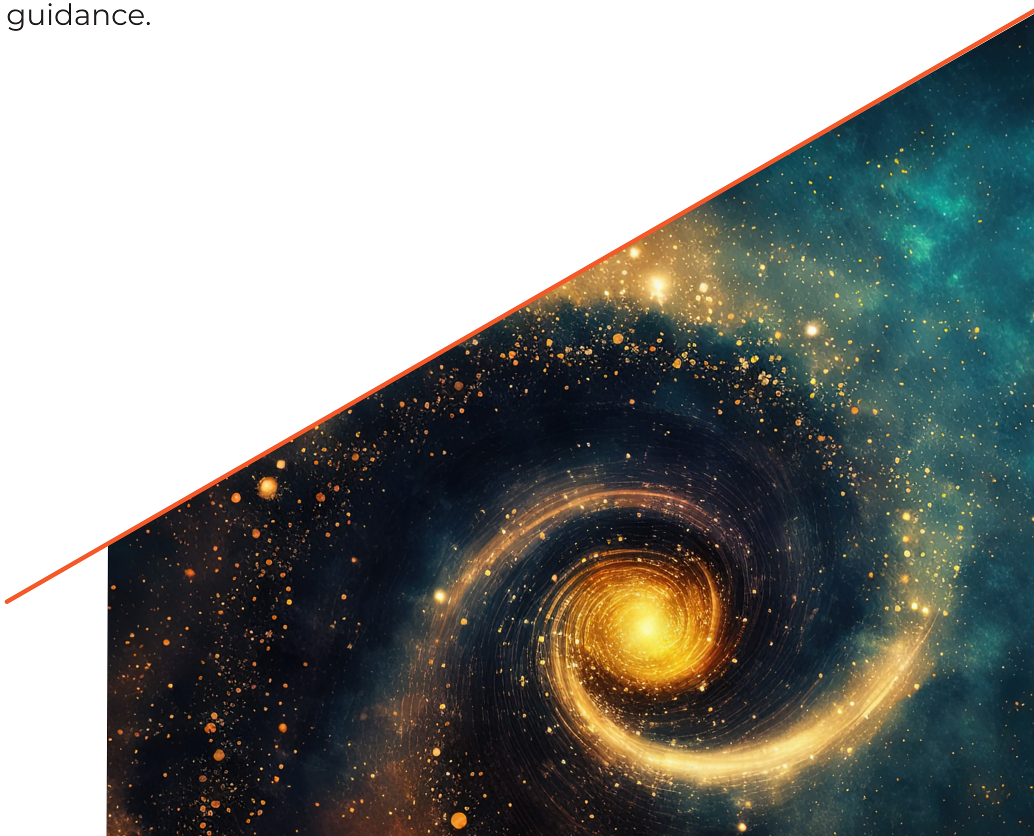
Buy-out readiness

Even without the gilt yield volatility we saw in Autumn of 2022 they've continued to rise and stay high meaning that in general funding positions of schemes have improved dramatically and buy-out in the near future is now a very real possibility.

Schemes that find themselves in this position will be looking at their membership data to get themselves in the right position to approach insurers. However, investment strategy also needs to be considered and schemes will want to ensure they have the right assets to reduce volatility in funding and protect any surplus which may be needed to protect against price fluctuations during the buy-out process.

LDI Guidance

The Pensions Regulator has issued guidance giving specific considerations for trustees who are using or considering the use of leveraged Liability Driven Investment (LDI), and we expect Trustees with investment strategies containing LDI to be reviewing their processes to ensure they comply with the guidance.



Some of the key actions for Trustees are:

Action points: investment strategy

- Review the investment strategy following recent changes in LDI strategies and document the key strategic outcomes.
- Obtain written advice on the use of LDI, its benefits and risks, and the processes in place to manage liquidity risks.

Action points: collateral resilience

- Ensure the LDI strategy holds enough supporting assets for both an ‘operational buffer’ and a ‘market stress buffer’.
- Record the agreed processes to top up the buffer in a ‘collateral management policy’.
- Carry out resilience testing of the LDI arrangements and collateral management policy.

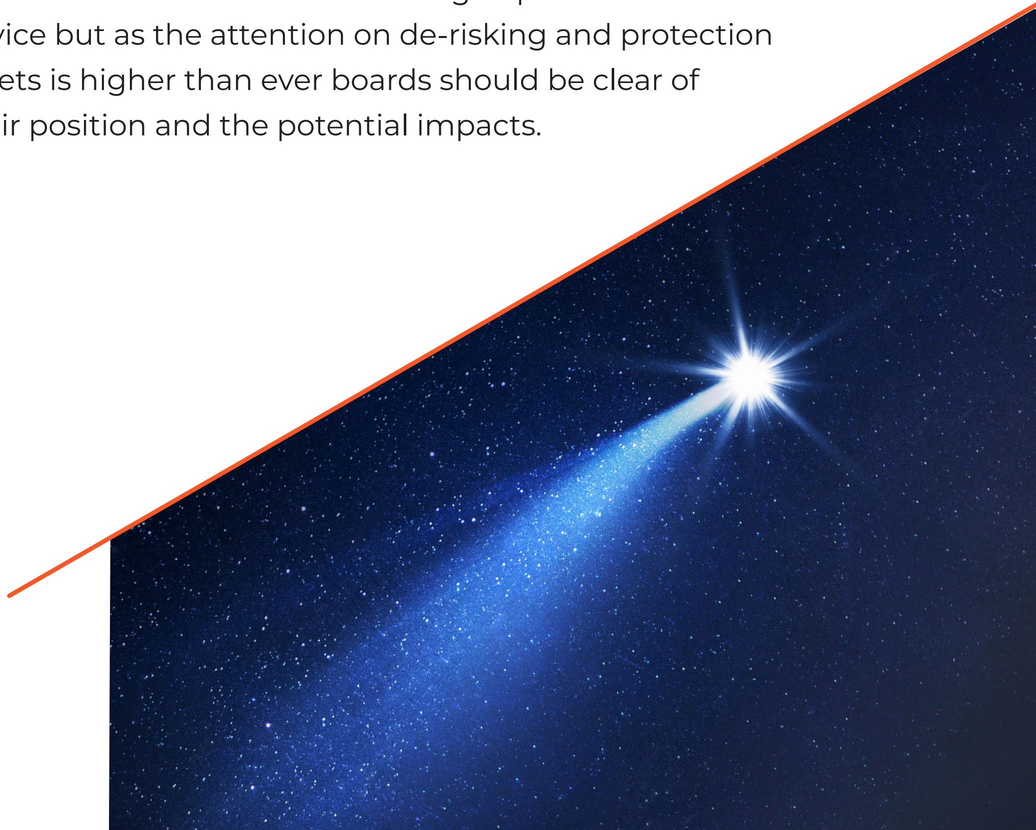
Action points: governance and monitoring

- Ensure the responsibilities and delegation in your arrangements are appropriate for your scheme.
- Review your LDI reporting to ensure you receive enough information to monitor your LDI arrangements and processes in a timely manner.

Market commentary/hedge or not

The argument to hedge interest and inflation rate risk could be the strongest it has ever been with interest rates as high as they have been for many years, as noted above. Trustees should be discussing with their actuary and investment consultant what level of risk coverage is right for them to protect improvements where they’ve occurred and reduce the risk of funding positions getting worse when interest rates fall.

We know schemes held an unhedged position without advice but as the attention on de-risking and protection assets is higher than ever boards should be clear of their position and the potential impacts.

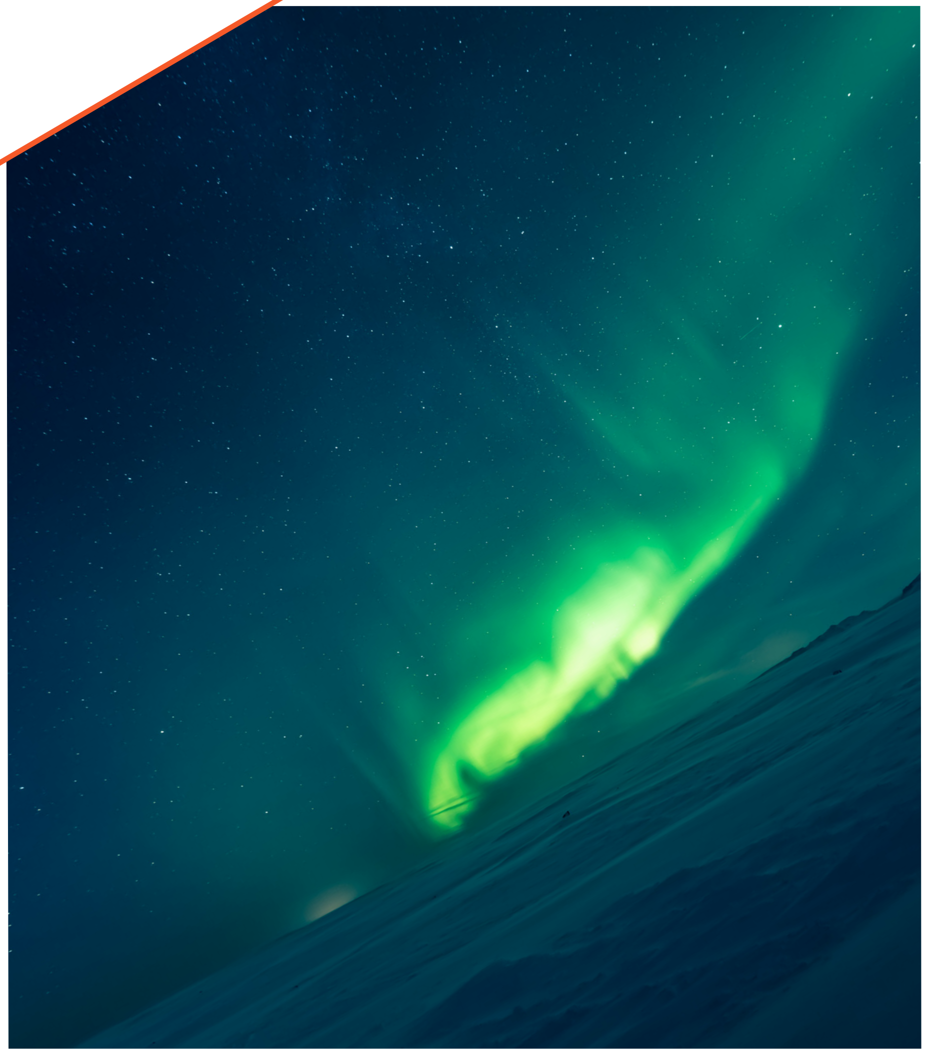


Broadstone Sirius Index – the Detail

Broadstone Sirius Index – Scheme make up and assumptions

Liability details at 31 December 2021	
Buy-out liabilities	£57m
Self sufficiency liabilities (gilt curve +0.25% pa)	£50m
Technical Provisions liabilities	£43m
Other details	50% deferreds, 50% pensioners Duration 19 years 60% of pension increases inflation linked Recovery plan £0.44m for 5 years

Asset details at 31 December 2021	Fully hedged	50% hedged
Assets	£40m	£40m
Allocation to diversified growth funds	50%	50%
Allocation to Gilts	-	35%
Allocation to corporate bonds	15%	15%
Allocation to LDI	35%	-

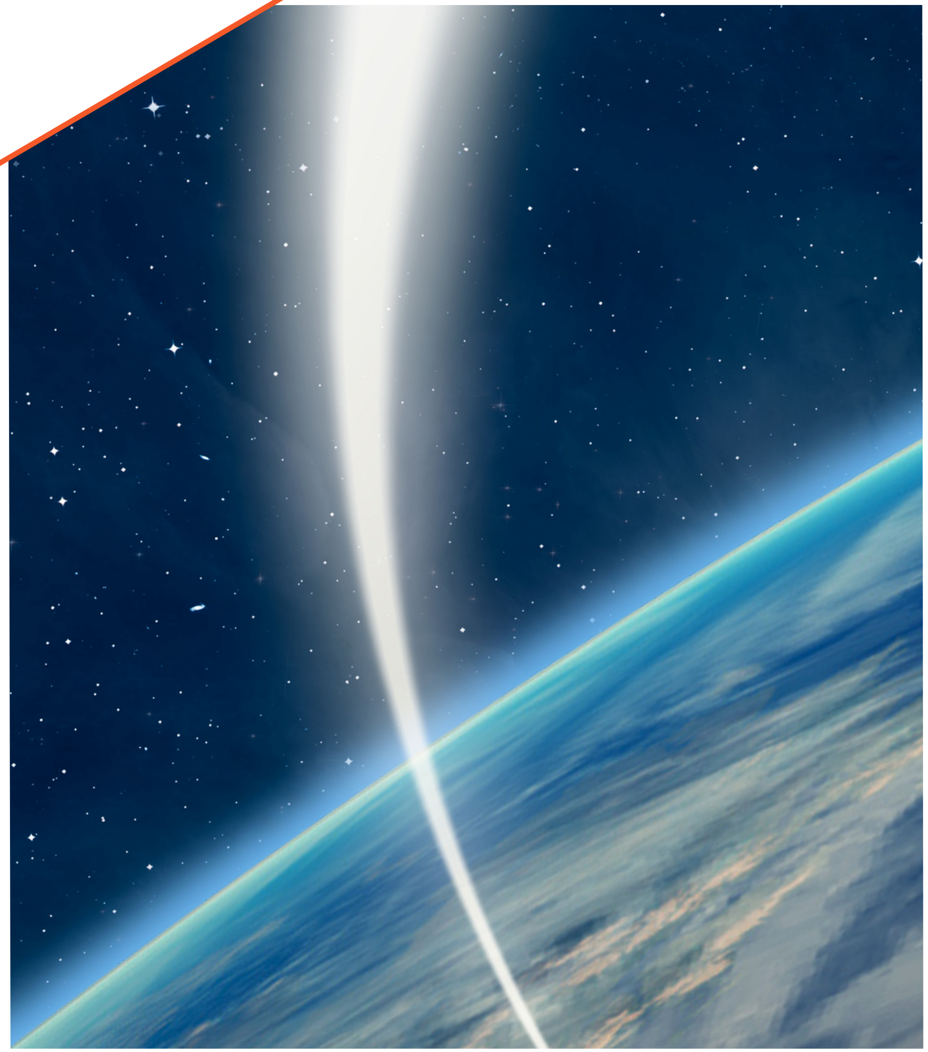


Find out more

For more information on how Broadstone can help you support your members at retirement, please contact us on:

020 3869 6900

corporate@broadstone.co.uk



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