With Profits Section of the Cheviot Pension

Actuarial Report as at 31 December 2022

December 2023

Contents

Throughout the report:

'Scheme' refers to the Cheviot Pension of the Cheviot Trust

'Section' refers to the With Profits Section of the Scheme

'Trustee' refers to the Board of Cheviot Trustees Limited

'2020 valuation' refers to the formal valuation of the Section at 31 December 2020

Executive summary

The Section was 88% funded at 31 December 2022

The Trustee has completed an interim valuation of the Section as at 31 December 2022. This report sets out the approach adopted by the Trustee, the results obtained and the actions taken in the light of those results.

The funding position of the Section at 31 December 2022, together with the position at the formal valuation at 31 December 2020 and interim valuation at 31 December 2021, were as follows:

£m	31 December 2020	31 December 2021	31 December 2022[1]
Total Liabilities (L)	**95.5**	**88.1**	**72.9**
Value of Assets (A)	**95.9**	**90.0**	**64.5**
Surplus/(Shortfall) (A – L)	**0.4**	**1.9**	**(8.4)**
Funding Level (A / L)	**100%**	**102%**	**88%**

The Trustee has received frequent funding updates for the Section and is monitoring the development of the funding position closely. The funding level was estimated to be around 89% at 31 August 2023[1].

The results in this report allow for expenses at the levels set out in the Statement of Funding Principles which reflect the general level of running expenses for the Section, and do not allow for any potential exceptional expenses.

[1] The liabilities from 31 December 2022 make allowance for refined insurers' pricing of cash balance benefits. This improves the position by around £0.5m compared to the unadjusted assumptions set out in the Statement of Funding Principles.

01 **Introduction**

01.01 Background and purpose

This report provides an update of the funding position of the Section as at 31 December 2022 and is the second update report following the 31 December 2020 actuarial valuation

This report has been commissioned by and is addressed to the Trustee. The intended user of this report is the Trustee and it is for its exclusive use. Its scope and purpose is to provide information on the development of the funding position of the Section over the period since the last formal actuarial valuation as at 31 December 2020 in line with the requirements of Section 224 of the Pensions Act 2004 and also as required by the Scheme's rules. As such, this report constitutes an 'actuarial report'. A further purpose of this report is to set out information on the levels of bonuses to award on with profits funds.

I have already provided the Trustee with all of my advice in relation to the content of this report, including the results and levels of bonuses to award, in a number of previous reports and presentations. The purpose of this report is to set out in one place the final results of the valuation and to satisfy the legislative requirement of an actuarial report. This report should not be relied upon for any other purpose without seeking further advice.

Legislation requires the Trustee to make this report available to those employers who were contributing to the Section when it closed on 31 December 2002 within 7 days of receiving it. In practice, the Trustee makes the report available to all employers with liabilities under the Section.

This report, and the work undertaken to produce it, is compliant with TAS 100 and TAS 300, set by the Financial Reporting Council. No other TASs apply. The report has been written on the basis that decisions will not be based on its contents. Appropriate advice should be obtained before any decisions are made.

This report provides a comparison of how the value of the Section's assets compares to the value of its accrued liabilities (otherwise known as its 'technical provisions'), using the scheme funding assumptions and so the information provided shows the progress made by the Section against the statutory funding objective.

02 **Approach adopted**

02.01 Asset and cashflow data

The Cheviot Trust has provided me with the Scheme's 2022 accounts which include details of the Section's assets and cashflows over the year. Details of the cashflows can be found in Appendix C; please note this information is audited.

02.02 Liability data and calculation methodology

To calculate the liabilities, I have carried out full valuation calculations as at 31 December 2022 based on financial conditions and using membership data as at 31 December 2022.

The membership data was provided by the Cheviot Trust. I have carried out some reasonableness checks and I am satisfied it is adequate for the purpose of this update. A summary of the membership data used for this valuation is provided in Appendix D.

02.03 Actuarial assumptions

Gilt yields at 31 December 2022 are higher than at 31 December 2020 resulting in a significant decrease in the value of the liabilities

The statement of funding principles dated 18 February 2022 sets out how the assumptions used to calculate the funding liabilities[2] are derived.

The derivation of the main financial assumptions is set out below:

- The discount rate uses a 'dynamic funding' approach: this is based on a gilt yield curve with a margin for expected investment out-performance advised by Schroders from time-to-time. At 31 December 2022, the derived margins above the gilt curve were:
    - 2.4% p.a. until 31 December 2029, reflecting prudent outperformance based on expected returns from the Scheme's investments (compares to 2.8% at 31 December 2020 and 2.6% at 31 December 2021)
    - 0.0% p.a. thereafter for non-pensioners, reflecting Trustee's intention to buy-out the Scheme with an insurer (the same assumption was used at 31 December 2020 and 31 December 2021).
    - 0.35% p.a. thereafter for pensioners, reflecting Trustee's intention to buy-out the Scheme with an insurer (compares to 0.1% at 31 December 2020 and 0.15% at 31 December 2021).
- The RPI inflation assumption has been derived from market expectations implied by swap yield curves. The CPI inflation and pension increases assumptions are derived consistently with the RPI inflation assumption.

Charts showing the nominal gilt and swap RPI curves at 31 December 2022, 31 December 2021 and 31 December 2020 are shown in Appendix A.

The derivations of all demographic assumptions remain unchanged from those adopted for the 2020 formal valuation. A summary of the funding valuation assumptions I have used in my calculations is given in Appendix B.

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[2] Described as 'technical provisions' in legislation

Approach adopted

02.04 Refining estimated insurers' pricing

The Trustee's long-term intention is to buy-out the Section with an insurer. This is reserved for in the funding liabilities, with the long-term assumptions reflecting general pricing terms offered by insurers.

The Trustee has sought to refine the estimated pricing that might be obtained from an insurer reflecting the Section's cash balance benefits, which is expected to lead to cheaper pricing of non-pensioner benefits and expense reserves than for a 'typical' pension scheme.

The Trustee therefore also tracks 'updated' liabilities calculated using the assumptions set out in the Statement of Funding Principles but with:

- Non-pensioner discount rate after 31 December 2029 increased to reflect insurers' expected pricing of cash balance benefits - gilts + 0.55% per year at 31 December 2022 (compares to gilts +0.0% per year in the Statement of Funding Principles)
- Wind-up costs when transacting in 2029 of £0.5m (compares to 2.5% of the outstanding liabilities on windup in 2029)

These assumption changes will be considered formally as part of the formal valuation due at 31 December 2023.

03 Results

£8.4m

Deficit at 31 December 2022

03.01 Funding results

An estimate of the Section's funding level as at 31 December 2022 is given below with the results of the last formal actuarial valuation in 2020 and interim valuation in 2021 shown for comparison.

£m	31 December 2020	31 December 2021	31 December 2022	31 December 2022 updated[1]
Liabilities for:				
- pensioners	23.0	21.5	17.0	17.0
- non-pensioners	63.8	59.1	50.6	50.3
- expenses	8.7	7.5	5.8	5.6
Total Liabilities (L) [2]	**95.5**	**88.1**	**73.4**	**72.9**
Value of Assets (A)	**95.9**	**90.0**	**64.5**	**64.5**
Surplus/(Shortfall) (A – L)	**0.4**	**1.9**	**(8.9)**	**(8.4)**
Funding Level (A / L)	**100%**	**102%**	**88%**	**88%**

88%

Funding level at 31 December 2022

03.02 Reconciliation with the results of the previous formal valuation

Since 31 December 2020, the Section's funding position has therefore weakened from a surplus of £0.4m to a deficit of £8.4m at 31 December 2022. The most significant influences on the funding position have been as follows:

> Returns on the Section's investments were lower than expected (net of the hedge), which resulted in the Section falling into a deficit at the interim valuation.

> The impact of rising gilt yields has resulted in lower value being placed on the liabilities over the period, which was mostly offset by consistent falls in the Section's hedging assets.

The refinements to estimated insurers' pricing of non-pensioner cash balance benefits and to expected expenses on wind-up has then improved the position by around £0.5m.

[1] These results make allowance for refined insurers' pricing on cash balance benefits and wind-up expenses
[2] 'technical provisions'

03.03 Sensitivity of results to change in assumptions

At 31 December 2022 changing the assumptions would have had the following impacts on the assessed deficit of £8.4m:

Assumption	Change	Impact on funding position
Discount rate	Reduce by 1.0% p.a. in the period before 31 December 2029	-£2.6m
	Reduce by 1.0% p.a. in the period after 31 December 2029	-£0.7m
Expenses	Reduce annual expenses reserved for by £100k each year	+£0.6m
Inflation	Increase by 1.0% p.a. at all terms	-£0.5m
Mortality	Increase initial addition to improvements by 0.2% p.a. (to 0.5% p.a.)	-£0.2m
	Reduce long-term rate of improvement by 0.25% p.a. (to 1.25% p.a.)	+£0.1m
	Retain CMI_2020 instead of updating to CMI_2021	£0.0m

For example, decreasing the discount rate by 1.0% p.a. in the period to 31 December 2029 would increase the deficit of £8.4m at 31 December 2022 by £2.6m to a deficit of £11.0m.

03.04 Bonus declaration

One of the purposes of this valuation is to provide information and recommendations to the Trustee on the level of bonuses to grant on the with profit benefits in the Section. More details on the various types of bonus which are considered can be found in the scheme funding report for the 2020 valuation.

The following bonus recommendations based on the results in this report were agreed by the Trustee at its meeting on 23 March 2023.

Pensioner members

- No bonus should be awarded in respect of 2022

Non-pensioner members

- No annual bonus should be awarded in respect of 2022
- No interim annual bonus should be awarded in respect of 2023
- No base bonus on any annual bonuses since 1 January 2000 should be awarded in respect of 2022
- No final bonuses should be awarded, other than the uplift on pre-88 funds
- The pre-88 uplift should be maintained at 29% (the Trustee has since updated the pre-88 uplift level following further reviews reflecting market movements during 2023)
- Interest for all members over normal retirement age where this is at the Trustee's discretion and on delayed payment of benefits should be considered against the Bank of England's prevailing base rate.

The pre-88 uplift should be monitored on a monthly basis with a formal review if the agreed trigger moves outside the tolerance range. The interest rate on late retirement and delayed payments should be reviewed biannually. All other bonuses should continue to be reviewed on an annual basis and should next be reviewed following the 31 December 2023 formal valuation.

04 Formal reassessment of funding

31 December 2023

Next formal valuation due

I have discussed the contents of this actuarial report with the Trustee. The Trustee will continue to monitor the funding position of the Section, and is consulting with the employers to determine how the deficit will be addressed at the next formal actuarial valuation.

The next formal actuarial valuation of the Section is due no later than 31 December 2023 when I will provide further details of how the Scheme's funding level has developed.

Signature

P. Black

Date

18 December 2023

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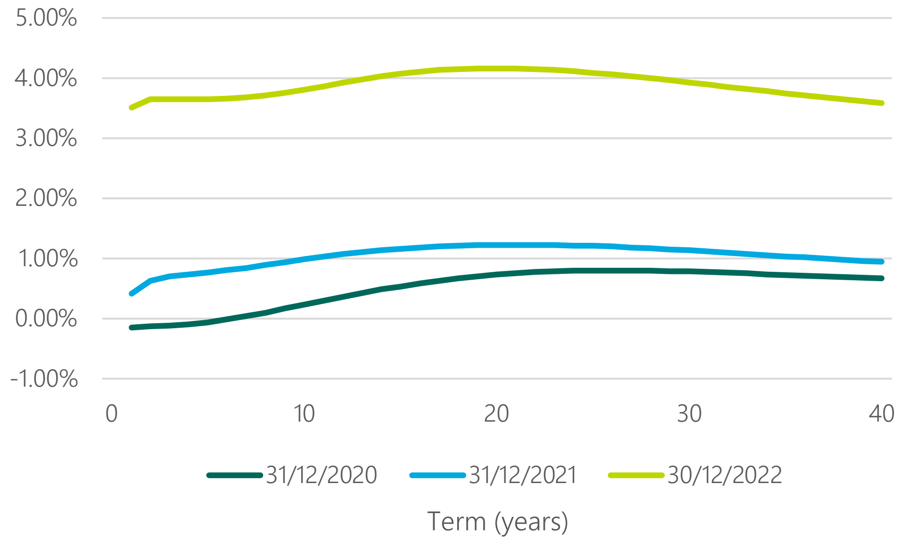
Appendix A
Change in market conditions

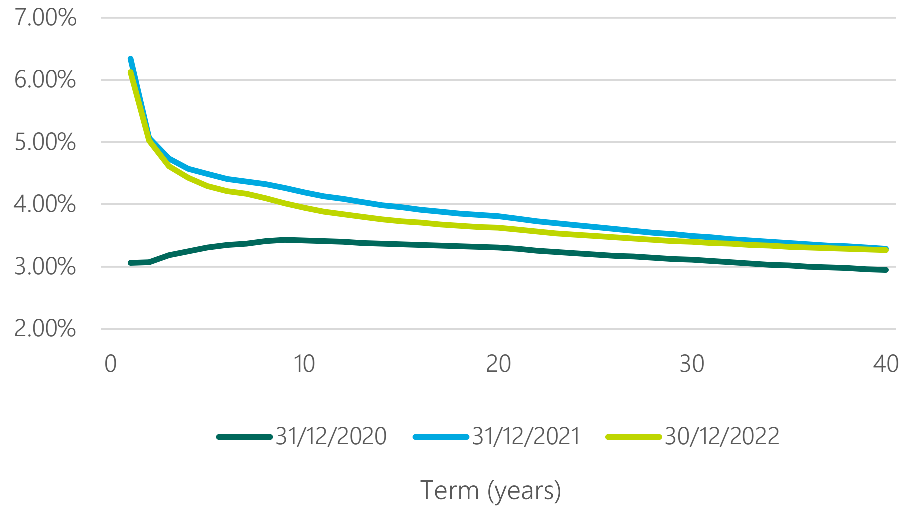
1. Gilt interest yield curve

The graph below shows the gilt interest spot yield curve at 30 December 2022, 31 December 2021 and 31 December 2020. As can be seen, the 30 December 2022 interest rate curve has risen at all durations compared to 31 December 2020 which has served, in isolation, to decrease the liabilities and hedging assets.



2. Swap inflation curve

The graph below shows the swap RPI inflation spot curve at 30 December 2022, 31 December 2021 and 31 December 2020. As can be seen, the 30 December 2022 inflation curve has risen at all durations compared to 31 December 2020 which will have increased the liabilities and hedging assets, in isolation.



Appendix B Assumptions

The material assumptions on which my calculations at 31 December 2022 are based are shown in the tables below. A full list of the assumptions used to derive the Technical Provisions can be found in the Statement of Funding Principles dated 18 February 2022.

The assumptions used for the liabilities at 31 December 2020 can be found in my scheme funding report for the 2020 valuation and the assumptions used for the liabilities at 31 December 2021 can be found in my actuarial report for the 2021 interim valuation.

General assumptions

Asset valuation method	Market value (bid basis)

Financial assumptions

Discount interest rate	Gilt curve + 2.4% p.a. to 31/12/2029, Gilt curve + 0.0% p.a. (non-pensioners)[1] / + 0.35% (pensioners) thereafter
RPI inflation	Swap inflation curve
CPI inflation	Before 2030: RPI inflation less 0.8% p.a. After 2030: RPI inflation less 0.0% p.a.
Pension increases in retirement	Consistent with CPI inflation curve with nil inflation volatility
Final bonus on pre-1988 funds	29% on solvency basis
Future bonuses (other than final bonus on pre-1988 funds)	No allowance
Expenses	£1.2m p.a. in 2023 reducing by £0.1m p.a. to £0.6m p.a. in 2029 Plus 2.5% of outstanding liabilities at 31/12/2029[2]

Demographic assumptions

Mortality (post-retirement)	106% (males)/99% (females) S2PA tables CMI_2021 improvements with a long-term rate of 1.5% and an initial addition of 0.3%
Early retirement	No allowance
Family statistics	100% married with husbands 3 years older than their wives

[1] Updated to gilts + 0.55% p.a. after allowing for refined insurers' pricing

[2] Updated to £0.5m of wind-up expenses at 31/12/2029 after allowing for refined insurers' pricing

Appendix C
Asset and cashflow data

The table below shows the relevant asset information for the Section's assets from the Scheme's accounts for the year ending 31 December 2022:

	31 December 2022 £000
Net assets	64,465

A summary of the Section's cashflow data from the Scheme's accounts information that I used in my calculations at both dates is shown below:

	1 Jan 2021 - 31 Dec 2021 £000	**1 Jan 2022 – 31 Dec 2022 £000**
Pensions paid	2,797	2,668
Commutation of pensions	641	715
Payments on death	297	237
Individual transfers to other schemes	2,870	2,320
Administrative expenses	1,455	1,816

Appendix D
Membership data

A summary of the data used at 31 December 2022, together with the corresponding data at 31 December 2021 and 31 December 2020, is set out below.

Deferred members	31 December 2020	31 December 2021	31 December 2022
Number	2,362	2,247	2,162
Total account balances[1]	£56,470,000	£54,570,000	£53,580,000

1. Including interest and accrued bonuses to each date of valuation. Money Purchase Funds are excluded.

Pensioner members	31 December 2020	31 December 2021	31 December 2022
Number[2]	763	709	663
Total annual pension	£2,882,000	£2,699,000	£2,604,000

2. Some pensioners have pensions in payment recorded under multiple records. The number of pensioners above represent the number of unique individuals receiving pensions.

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