New foundations

LCP Ireland Pensions Accounting Briefing

2023

We would like to thank those from LCP who have made this briefing possible:

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Funding levels improved significantly over 2022, a trend that was maintained into 2023. This was principally due to a very sharp rise in bond yields. If they have not already done so corporates should be engaging with Trustees about how they can lock down these gains and ensure their schemes are more robust against market shocks.

Conor Daly
Partner

1. Introduction

Welcome to LCP Ireland's annual Accounting for Pensions Report analysing the 2022 disclosures of thirteen of the largest companies (by market capitalisation) listed on the Euronext Dublin Stock Exchange (formerly the Irish Stock Exchange) and other exchanges that have defined benefit pension arrangements in Ireland. Also included in this analysis are twelve semi-state/state-controlled companies with defined benefit pension schemes that have published pension accounting information.

LCP Ireland's Accounting for Pensions Report began in 2009 in a world still reeling from the shockwaves of the Global Financial Crisis. At the time average funding levels were around 81% and deficits posed a real challenge for pension schemes in the face of uncertain times. Throughout the 2010's average funding levels improved despite a prolonged period of low interest rates. These improvements can largely be attributed to a combination of strong performance in pension scheme assets, higher sponsor contributions and in many cases liability management exercises. As pension schemes entered the 2020's a whirlwind of exogenous shocks including a global pandemic, war on the European continent and much more has reshaped the pensions landscape that we had observed in the previous fourteen briefings that LCP Ireland have published to date. In this fifteenth issue we look forward from 2023 using our analysis of accounting disclosures as a gauge for the current health and likely future path of Irish Pension Schemes.

The companies analysed report under International Accounting Standards (such as IAS19) or the equivalent local standard (FRS102) in accordance with EU regulations. The information in this report is derived from a detailed analysis of the information companies have disclosed in their Annual Report for 2022 alongside other publicly available information. We did not approach companies or their advisers for additional information.

13

Number of companies listed on the Euronext Dublin and other exchanges included in this briefing.

12

Number of semi-state/state-controlled companies included in this briefing.

We may be about to see a surge in appetite among trustees for insurance transactions to secure liabilities. This would be a welcome enhancement to the security of members' benefits.

John Lynch
Partner

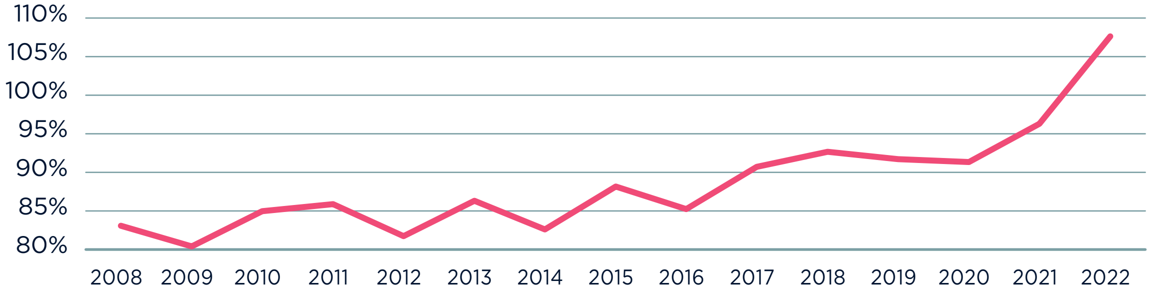
2. Scheme Dynamics

2.1 Reported funding levels

Funding levels improved overall in 2022 with only nine schemes reporting deficits compared to fifteen in 2021. These nine schemes were roughly equally distributed between the public and private sector.

The average funding level for the schemes analysed increased from 96% in 2021 to 108% in 2022. The following chart shows how funding levels have changed over the year for the companies analysed.

Average funding level



This marks the first time in the 15 years of the LCP Accounting Survey that the average funding level has been above 100%. The rise in funding levels can be attributed mainly to the increase in bond yields throughout 2021, which lowered liabilities. Strong equity performance and contributions from the company also played a significant role in this enhancement.

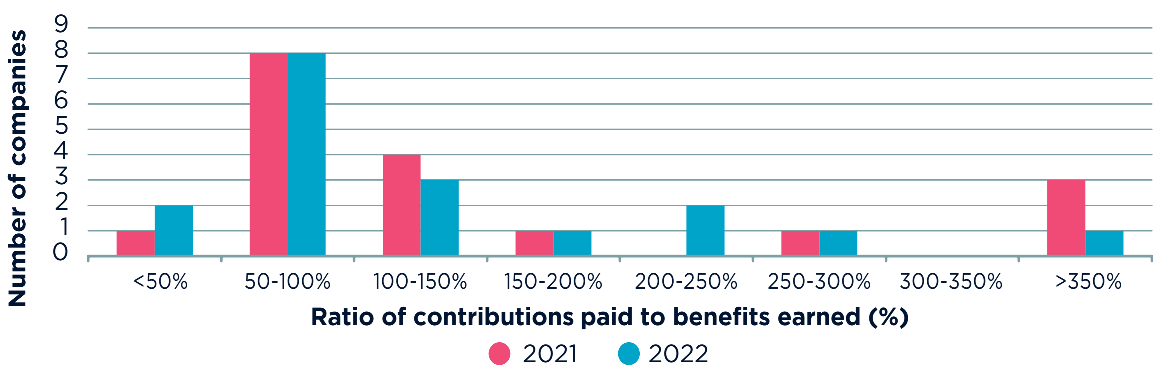
2.2 Contributions

Overall total contributions decreased slightly from €0.7 billion in 2021 to €0.6bn in 2022. This decrease is representative of improved scheme funding positions. Additionally, inflation and the lingering expectation of recessions may have meant that companies prioritised other areas of their businesses.

Our analysis of the accounting disclosures reveals that a majority of companies make contributions that exceed the cost of benefit accrual under IAS19. On average, companies contributed more than 1.3 times the cost of benefit accrual according to the accounting standards. While we expect this ratio to decrease further as discount rates rise it is still a notable decrease from 3.1 times in 2021.

We expect this level of contribution compared to the cost of benefit accruals to continue to fall over 2023 as deficit contributions continue to fall away.

Employer contributions compared to benefits earned



The increasing cost of ensuring that defined benefits pension schemes comply with IORPII and regulatory requirements will mean that employers may reconsider their support for legacy pension arrangements and wind up may increasingly be an option.

Martin Haugh
Partner

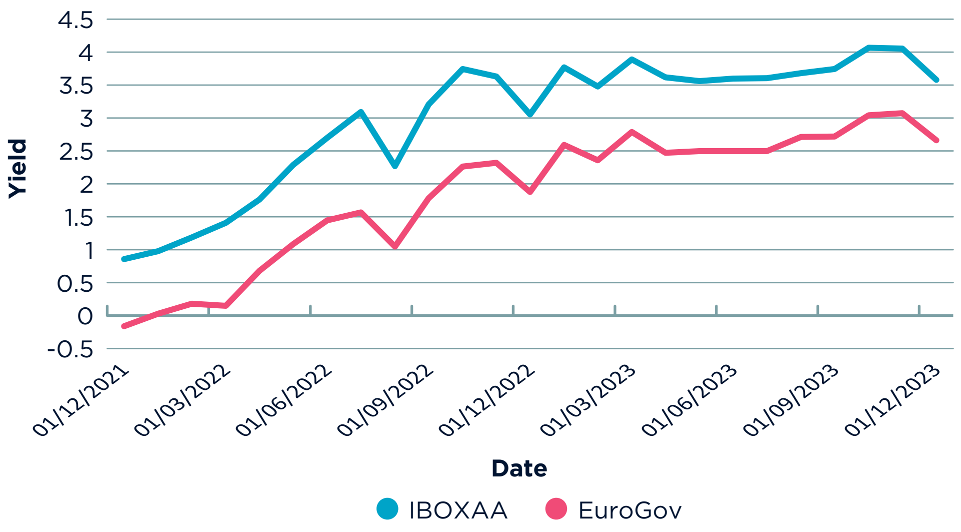
3. Our analysis

3.1 Discount Rates

Discount rates play an important role in IAS19 assumptions due to the direct impact they have on liability values. 2022 saw a stark increase in the yields on bonds across the world as central banks raised rates in their fight against inflation.

The accounting standards (IAS19) and their local equivalents require that the discount rate used to value pension liabilities is determined by reference to market yields at the end of the reporting period on high quality corporate bonds of a currency and term consistent with the currency and term of the pension scheme's liabilities. This is generally interpreted as a discount rate derived from the yield on AA-rated corporate bonds of appropriate duration. The following chart shows how government and AA-rated corporate bond yields have moved in line with each other over 2022.

Bond movements over 2022.



The companies with December 2022 year-ends are analysed in the following chart. As we would expect, there was a significant increase in the discount rates disclosed compared with last year.

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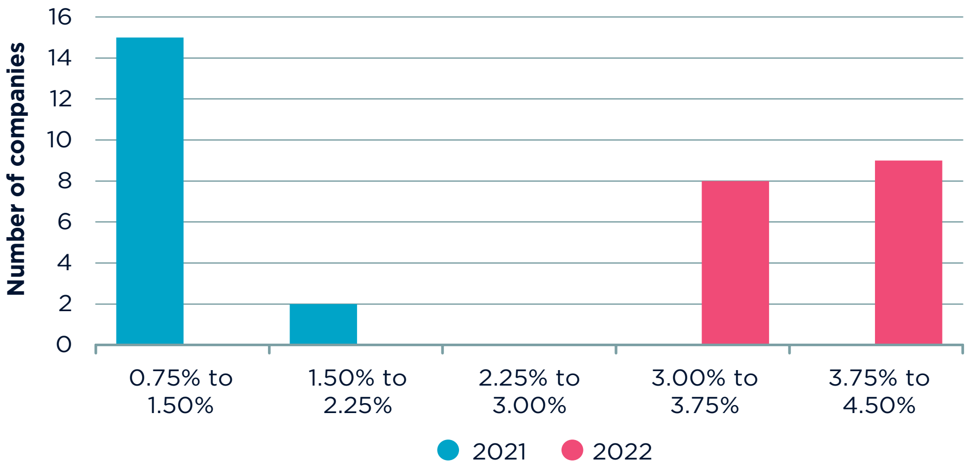
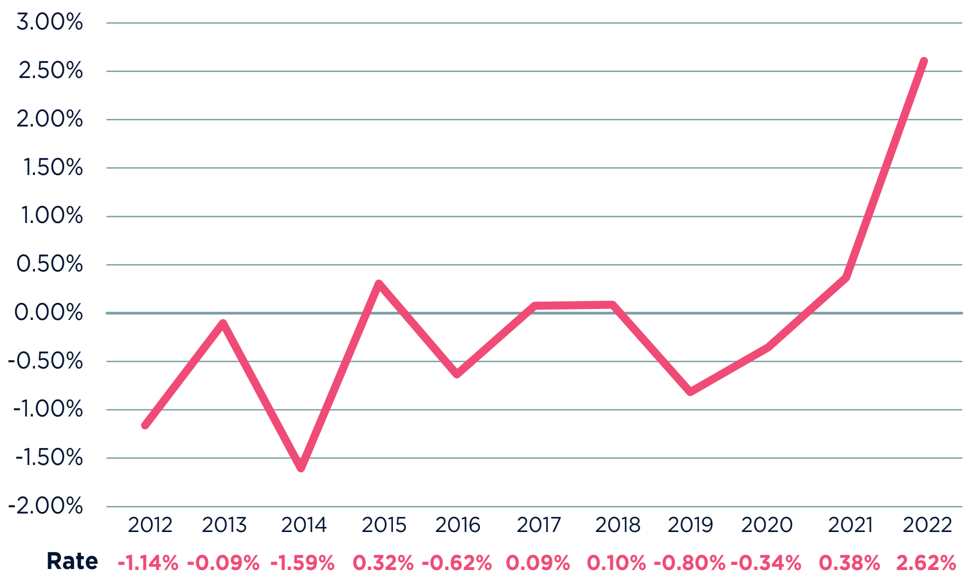
Discount rates used 31 December 2021



Most companies reported discount rates in the range 3.6% p.a. to 4.3% p.a. (average 3.94% p.a.) compared to 1.0% p.a.to 1.6% p.a. (average 1.32% p.a.) at the end of 2021. All schemes reported increases in their discount rates. The sharp rise in discount rates has resulted in some very material reductions in the value of liabilities disclosed in accounts. The highest discount rate was disclosed by **NTMA** (4.3%).

2023 saw the largest annual increase in discount rates seen in the last decade.

Change in average reported discount rate

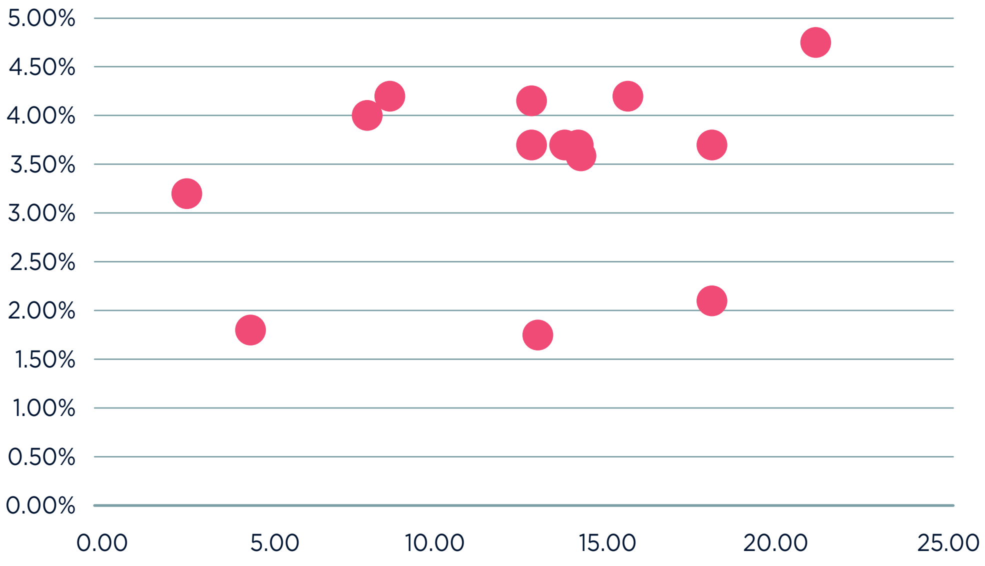


While in theory, pension schemes with similar durations should be valued using similar discount rates at a particular point in time, in practice, the lack of a deep market in long duration corporate bonds can result in different modelling techniques and some divergences in discount rates.

As pension schemes tend to have a long-time horizon, a small change in the discount rate can have a very large impact on the balance sheet position. For example, **Kerry Group** reported that an increase of 0.5% pa in the discount rate would decrease the scheme liabilities by 7.2% at the accounting date. Similarly, **Ervia** reported that an increase of 0.25% in the discount rate would decrease the pension scheme liabilities by approximately 4.3%.

The discount rates used by the 14 companies that have a 31 December 2022 year end are charted below. This clearly shows some divergences in approach. We have used the duration for the Irish pension scheme when this is separately identified.

Discount rates used 31 December 2022 by duration

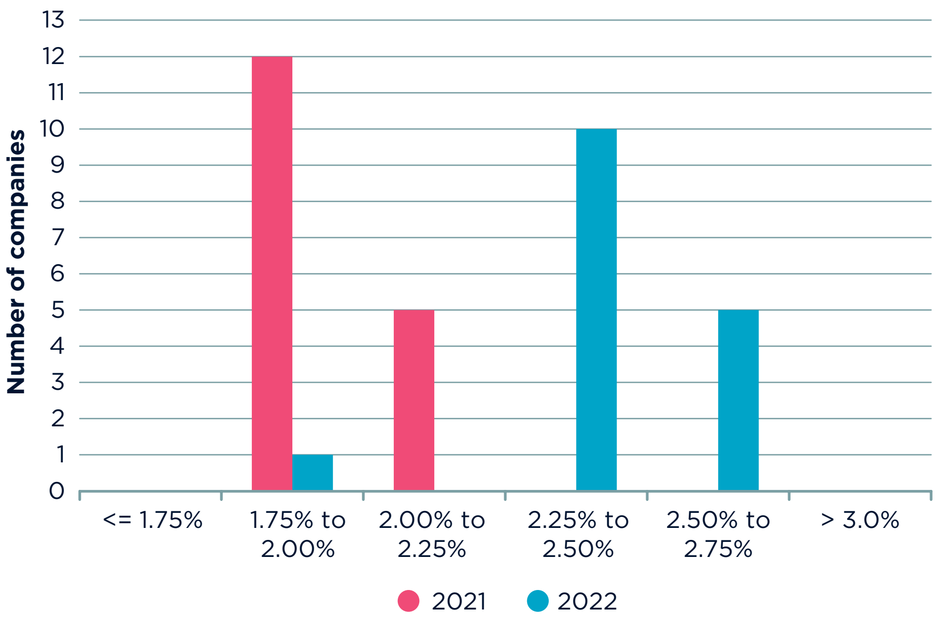


3.2 Inflation

Inflation has been a significant part of the 2022 and 2023 news cycle due to sustained upward pressures caused by macroeconomic events, such as, enhanced fiscal spending and continued post pandemic supply chain disruptions. As we near the end of 2023 there are indications that the worst may be over from an inflationary perspective.

The below graph shows the change in inflation assumptions disclosed by companies reporting at 31 December 2022.

Inflation assumptions used at 31 December (% pa)

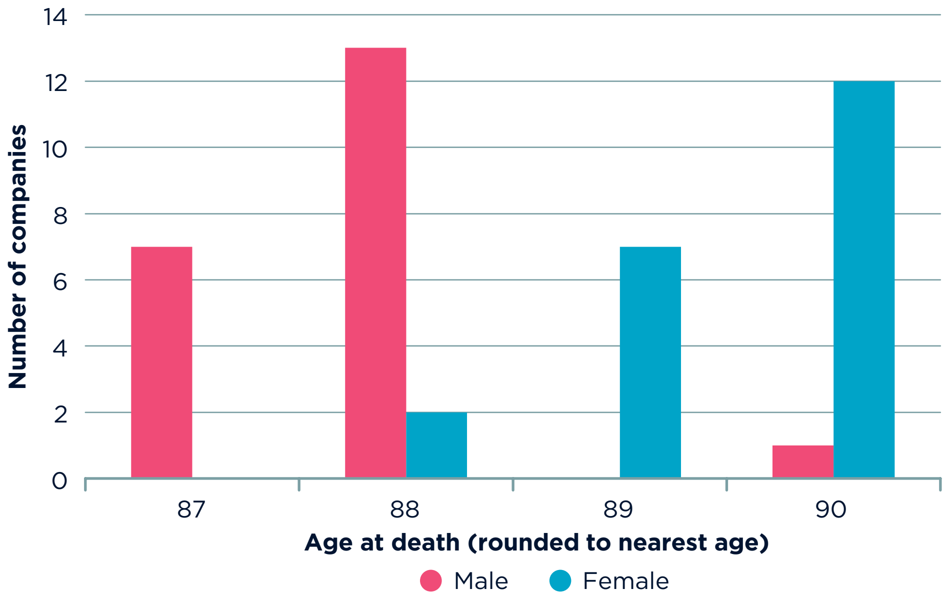


The rise in inflation expectations has prompted most companies to adjust their inflation assumptions upward. It is worth noting that this shift in expectations has pushed assumptions significantly beyond the central bank's 2% target. The average inflation assumption was 2.5% (2.0% at 31 December 2021).

3.3 Life expectancy

The following chart shows the range of life expectancies for males and females assumed by the companies analysed for members retiring at age 65 at the balance sheet date in 2022.

Life expectancy assumption. Individuals aged 65 on accounting date



The average assumption was that male members at age 65 at the accounting date would live to age 87.8 (89.5 for females). The life expectancy for males have increased slightly more than for females compared to 2021. This move sees the gender mortality gap continue to narrow.

While averages tend to hide individual movements, this year there was almost complete consensus with only one company reporting a decrease in male life expectancy (-0.15 years).

Life expectancy changes following the Covid-19 pandemic are the subject of an increasing number of academic studies and research papers. This increased level of research highlights the current uncertainty of the impact on mortality post pandemic. As the effects become more apparent, we may see changes to current mortality tables.

I would urge both Trustees and Employers to consider accelerating de-risking programs. In future we may look back on this period as one that presented a significant de-risking opportunity.

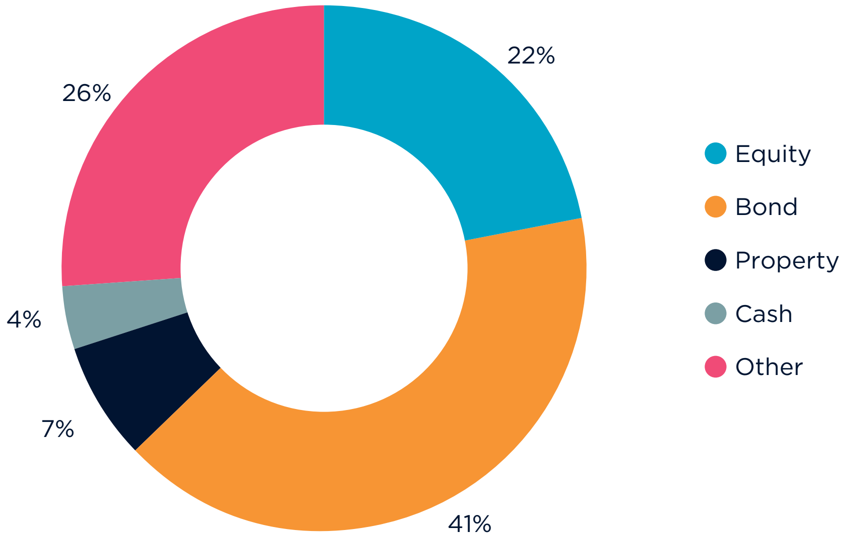
Oliver Kelly
Partner

4. Asset allocation alterations

2022 saw bonds and equities trend downwards for most of the year. Fears of recession played heavily on the minds of market participants as inflation continued to edge up.

The average portfolio for an Irish pension scheme can be seen in the chart below.

2022 Asset allocation



With higher interest rates leading to sharply discounted bond prices many schemes increased their holdings in fixed income. Overall, the allocation to fixed income in Irish Schemes has risen by 3% (or €1.2billion) despite a fall in capital value of bonds - suggesting material additions to fixed income holdings over the year.

Pension scheme trustees have a lot on their plate managing the enhanced governance requirements imposed by IORP II. Trustee meetings can be expected to be very busy for the foreseeable future.

Roma Burke
Partner

5. The Pensions landscape for the year ahead

5.1 IORP II: A Seismic Shift

The implementation of IORP II saw a range of enhanced governance requirements imposed on Irish pension schemes. The Pensions Authority have demonstrated their determination to ensure full compliance by the Irish pensions sector. The publication of supplementary guidance on new requirements such as Own Risk Assessments to accompany the existing 'Code of Practice' has provided some welcome clarity to the requirements.

Q1 2024 will be a very busy time for pension schemes as they look to complete Own Risk Assessments and Critical Reviews before the regulator's deadlines.

The Pensions Authoity has identifed the Own Risk Assessment as one of the key governance exercises for pension scheeme trustees.

Fergus Collis,
Risk Key function Holder

5.2 Auto-Enrolment

Auto-enrolment was introduced as a policy to ensure universal access to workplace pensions as a supplement to the basic state pension and improve the living standards of those in retirement in the face of longer life expectancies. In March 2022, the government approved the final design principles for the auto-enrolment (AE) retirement savings system.

The proposal mandates automatic enrolment in the new scheme for employees aged 23 to 60, earning €20,000 or more. Individuals earning below the €20,000 annual threshold and falling outside the 23-60 age range can opt into the system, provided they are not already enrolled in a pension scheme. Contributions will be introduced gradually to ease the transition into the new system without causing a significant impact on income. The scheme also seeks to provide a level of flexibility through the ability to exit or temporarily halt contributions under specific conditions, with automatic re-enrolment after two years if they remain eligible.

Employers also stand to benefit by taking care of their employees without the administrative hassle and cost of establishing a pension scheme. To oversee the scheme and safeguard participants' interests, an independent entity, the Central Processing Authority, will be established.

A lot of work remains to be completed before the system is ready to start accepting contributions, however employers should review their arrangements now to ensure they are ready for the rollout of the AE system.

Appendices

Appendix 1 - Methodology used
Appendix 2 - Companies analysed

Appendix 1 - Methodology used

These briefing analyses 13 companies of the largest 25 companies on the Euronext Dublin Stock Exchange with defined benefit pension arrangements. The briefing also analyses significant state/semi-state entities (where accounts were available) and five public companies that are listed on other exchanges but who operate significant defined benefit pension schemes in Ireland (C&C Group, DCC, Grafton and Greencore). We have excluded from our survey companies who had no evidence of significant defined benefit provision.

The 2022 figures are as at the end of the company accounting periods ending in 2022. The 2021 figures are as at the start of the accounting period. Some companies' 2021 figures may have been restated. All figures shown were taken from pensions accounting disclosures.

The assumptions for the discount rate and price inflation refer to those disclosed for the companies' main Irish or Eurozone schemes where available.

We have converted the figures provided in pounds sterling in the DCC, Diageo, Grafton and Greencore accounts using the Euro conversion rate applicable at each company's year-end.

The pension figures relate to the worldwide position of each company (not just their Irish pension schemes) but exclude healthcare and defined contribution pension arrangements where possible. Asset allocations are based on Irish or Eurozone schemes where disclosed.

The surplus/(deficit) figures are before allowing for deferred tax.

The source of market capitalisation figures is the Euronext Dublin and London Stock Exchange weightings as at the companies' year-ends.

All figures shown have been calculated using unrounded numbers. Therefore, some metrics shown may differ from those calculated using the rounded figures.

Appendix 2 - Companies analysed

This table shows the companies included in our analysis.

Irish Companies

Company	Year-end
Aryzta	July
Bank of Ireland	December
C&C Group	February
CRH	December
DCC	March
Diageo	June
Glanbia	December
Grafton	December
Greencore	September
Irish Continental Group	December
Kerry Group	December
Kingspan	December
Smurfit Kappa	December

Irish State-controlled Bodies

State-controlled Body	Year-end
AIB	December
An Post	December
Bord na Móna	December
Central Bank of Ireland	December
CIÉ	December
Coilte	December
Eircom	December
Ervia	December
Irish Aviation Authority	December
NTMA	December
Ornua	December
VHI	December

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