



With Profits Section of the Cheviot Pension

Actuarial Report as at 31 December 2019

12 August 2020

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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

'2017 valuation' refers to the formal valuation of the Section at 31 December 2017

Disclaimers, confidentiality and non-disclosure

This report has been commissioned by and is addressed to the Board of Cheviot Trustees Limited (the "Trustee") in its capacity as trustee of the Cheviot Pension of the Cheviot Trust (the "Scheme") for their exclusive use. Its scope and purpose is to provide the Trustee with information on the development of the funding position of the With Profits Section of the Scheme (the "Section") over the period since the last formal valuation as at 31 December 2017, and to set out information on the levels of bonuses on with profits funds to award. I am providing this report under the terms of our engagement and in my capacity as Scheme Actuary.

It is noted that this report may be shared with any of the employers with liabilities under the Section. This report may not be shared with any other party without our prior written consent, except to comply with statutory requirements. No parties other than the Trustee may rely on or make decisions based on this report (whether they receive it with or without our consent). XPS Pensions Group plc and its subsidiaries ("XPS Pensions Group") and any employees of XPS Pensions Group acknowledge no liability to other parties. This advice has no wider applicability. It is not necessarily the advice that would be given to another client or third party whose objectives or requirements may be different. This advice is up to date as at the date of writing and will not be updated unless we confirm otherwise. We retain all copyright and intellectual property rights.

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Executive summary

The Trustee has completed an interim valuation of the Section as at 31 December 2019. 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 2019, together with the positions at the formal valuation at 31 December 2017 and the interim valuation at 31 December 2018 were as follows:

The Section was
102% funded at
31 December 2019

£m	31 December 2017	31 December 2018	31 December 2019
Total Liabilities (L)	109.0	99.8	98.6
Value of Assets (A)	111.2	97.3	100.2
Surplus/(Shortfall) (A – L)	2.2	(2.5)	1.6
Funding Level (A / L)	102%	97%	102%

The above results do not take account of the market volatility seen since the onset of the COVID-19 pandemic. However, the Trustee has received frequent funding updates for the Section and is monitoring the development of the funding position closely. The funding position at 30 June 2020 was around 98%.

01 Introduction

This report provides an update of the funding position of the Section as at 31 December 2019 and is the second update report following the 31 December 2017 actuarial valuation

01.01 Background and purpose

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 2017 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 2019 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 2019 based on financial conditions and using membership data as at 31 December 2019.

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

The statement of funding principles dated 25 June 2018 sets out how the assumptions used to calculate the technical provisions are to be 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 swaps yield curve with a margin for expected investment out-performance advised by River & Mercantile from time to time. At 31 December 2019, the derived margins above the swaps curve were:
 - 2.3% p.a. until 31 December 2022, reflecting prudent outperformance based on expected returns from the Scheme's investments (compares to 2.5% at 31 December 2018 and 2.2% at 31 December 2017)
 - 0.7% p.a. thereafter, reflecting Trustee's intention to de-risk as the Scheme matures (the same assumption was used as at 31 December 2018 and 31 December 2017).
- To be consistent with the discount rate assumptions, the RPI inflation assumption has been derived from market expectations implied by swap yield curves. The pension increases and CPI inflation assumptions have been based on the above RPI inflation curve as described in the statement of funding principles.

Charts showing the swap curves at 31 December 2019, 31 December 2018 and 29 December 2017 are shown in Appendix A.

The derivations of all demographic assumption remain unchanged from those adopted for the 2017 formal valuation and are as recorded in the statement of funding principles. A summary of the funding valuation assumptions I have used in my calculations is given in Appendix B.

Swap yields at 31 December 2019 are lower than at 31 December 2017 resulting in an increase in the value of the liabilities

03 Results

£1.6m

Surplus at
31 December 2019

102%

Funding level at
31 December 2019

03.01 Funding results

An estimate of the Section's funding level as at 31 December 2019 is given below with the results of the last formal actuarial valuation in 2017 and the previous annual update in 2018 shown for comparison.

£m	31 December 2017	31 December 2018	31 December 2019
Liabilities for:			
- pensioners	31.2	28.0	26.5
- non-pensioners	71.8	67.0	68.4
- expenses	6.0	4.8	3.7
Total Liabilities (L) ("technical provisions")	109.0	99.8	98.6
Value of Assets (A)	111.2	97.3	100.2
Surplus/(Shortfall) (A – L)	2.2	(2.5)	1.6
Funding Level (A / L)	102%	97%	102%

03.02 Reconciliation with the results of the previous formal valuation

Since 31 December 2017, the Section's funding position has therefore decreased slightly from a surplus of £2.2m to a surplus of £1.6m. 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 reduced the surplus.
- > Liability experience has been favourable over the period which has somewhat offset the lower than expected returns on the Section's assets.

Results

03.03 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 2017 valuation.

The following bonus recommendations based on the results in this report were agreed by the Trustee at its meeting on 10 March 2020

Pensioner members

- No bonus should be awarded in respect of 2019

Non-pensioner members

- No annual bonus should be awarded in respect of 2019
- No interim annual bonus should be awarded in respect of 2020
- No base bonus on any annual bonuses since 1 January 2000 should be awarded in respect of 2019
- No final bonuses should be awarded, other than the uplift on pre-88 funds
- The pre-88 uplift should be maintained at 68%
- Interest for all members over normal retirement age where this is at the Trustee's discretion and on delayed payment of benefits should be set in line with 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 2020 formal valuation.

04 Formal reassessment of funding

**31 December
2020**

Next formal
valuation due

The next formal actuarial valuation of the Section is due no later than 31 December 2020 when I will provide further details of how the Scheme's funding level has developed.

Signature



Date

12 August 2020

Name

Peter Black
Scheme Actuary

Qualification

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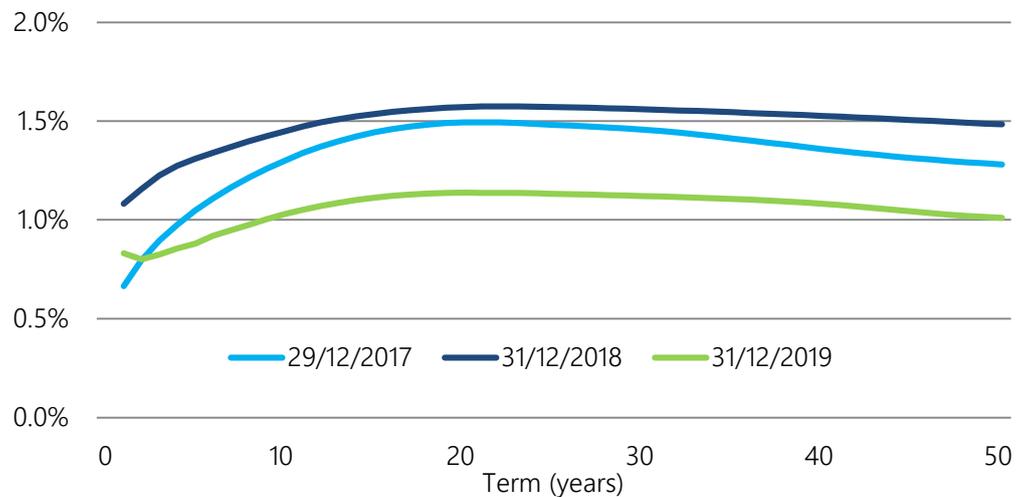
XPS Pensions

Appendix A

Change in market conditions

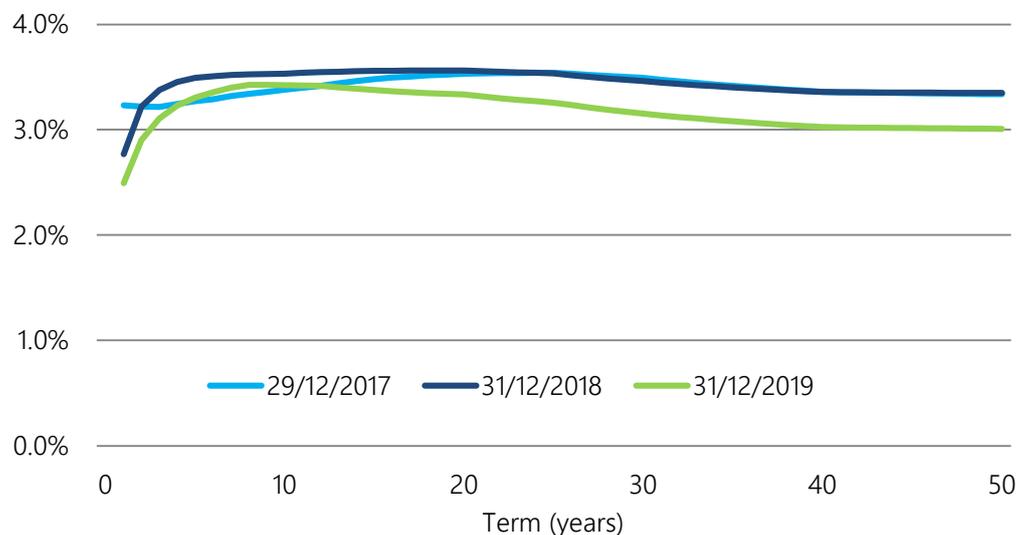
1. Swap interest yield curve

The graph below shows the swap interest spot yield curve at 31 December 2019, 31 December 2018 and 29 December 2017 (the last working day prior to 31 December 2017). As can be seen, the 31 December 2019 interest rate curve has fallen at almost all durations compared to 29 December 2017 which has served, in isolation, to increase the liabilities and hedging assets.



2. Swap inflation curve

The graph below shows the swap RPI inflation spot curve at 31 December 2019, 31 December 2018 and 29 December 2017. As can be seen, the 31 December 2019 inflation curve has fallen at the shorter and longer durations compared to 29 December 2017 which will have decreased the liabilities and hedging assets, in isolation.



Appendix B

Assumptions

The material assumptions on which my calculations at 31 December 2019 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 25 June 2018. The assumptions used for the liabilities at 31 December 2017 and 31 December 2018 can be found in Jonathan Punter's scheme funding report for the 2017 valuation and Peter Black's actuarial report at 31 December 2018 respectively.

General assumptions

Asset valuation method	Market value (bid basis)
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Key financial assumptions

Discount interest rate	Swap curve + 2.3% p.a. 31/12/2022, Swap curve + 0.7% p.a. thereafter
RPI inflation	Swap inflation curve
CPI inflation	RPI inflation less 0.8% p.a.
Pension increases in retirement	Consistent with CPI inflation curve Calculated using the term-dependent Black Scholes model with inflation volatility of 1% p.a.
Final bonus on pre-1988 funds	68% on solvency basis
Future bonuses (other than final bonus on pre-1988 funds)	No allowance
Expenses	£1.3m p.a. until 31/12/2022

Key demographic assumptions

Mortality (post-retirement)	106% (males)/99% (females) S2PA tables CMI_2018 improvements with a long-term rate of 1.5% and an initial addition of 0.5%
Early retirement	No allowance
Family statistics	100% married with husbands 3 years older than their wives

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 2019:

	31 December 2019 £000
Net assets	100,233

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

	1 Jan 2018 – 31 Dec 2018 £000	1 Jan 2019 – 31 Dec 2019 £000
Pensions paid	3,346	3,186
Commutation of pensions	799	499
Payments on death	98	179
Individual transfers to other schemes	3,838	2,695
Purchase of annuities	87	62
Administrative expenses	1,545	1,492

Appendix D

Membership data

A summary of the data used at 31 December 2019, together with the corresponding data at 31 December 2018 and 31 December 2017, is set out below.

Active members¹	31 December 2017	31 December 2018	31 December 2019
Number	258	228	2
Total account balances ²	£10,206,000	£8,754,000	£123,000

1. Members still paying contributions under the Money Purchase Section

2. Including accrued interest and bonuses to each date of valuation

Deferred members³	31 December 2017	31 December 2018	31 December 2019
Number	2,439	2,345	2,449
Total account balances ⁴	£51,865,000	£50,793,000	£58,343,000

3. Members no longer paying any contributions

4. Including accrued interest and bonuses to each date of valuation

Pensioner members	31 December 2017	31 December 2018	31 December 2019
Number	958	908	858
Total annual pension	£3,454,000	£3,285,000	£3,140,000



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