# Hermes Group Pension Scheme

## Actuarial report as at 31 December 2018

**May 2019**

## Purpose

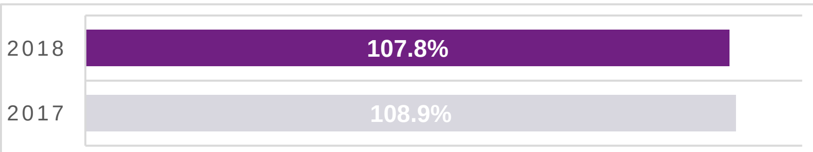
This is the actuarial report in respect of the Hermes Group Pension Scheme (the “Scheme”) as at 31 December 2018 and I have prepared it for Hermes Pension Trustees Limited (the “Trustee”). As noted in the limitations section of this report, others may not rely on it.

The actuarial report is required under Part 3 of the Pensions Act 2004 in years when a full actuarial valuation is not conducted; a copy of this report must be provided to the BT Pension Scheme Trustees Limited (the “Employer”) within seven days of its receipt.

The main purpose of the actuarial report is to provide an approximate update of the development in the financial position of the Scheme relative to its statutory funding objective since the latest actuarial valuation and any subsequent actuarial reports. It should be considered in conjunction with the report dated 29 November 2018 on the actuarial valuation as at 31 December 2017, which forms a component communication for the purposes of this funding update.

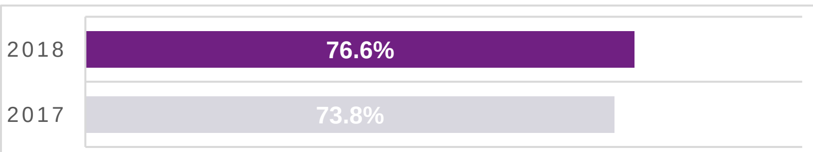
## Summary of results

I estimate that the technical provisions funding level as at 31 December 2018 has decreased by 1.1% to 107.8% over the year.




The reduction in funding level is primarily due lower than assumed investment returns over the year. However this was offset to a certain extent by contributions paid into the Scheme in line with the Schedule of Contributions dated 24 March 2016 agreed as part of the 2014 valuation, before the 2017 valuation was finalised. The effect of changes in market conditions was broadly neutral.

My estimate of the Solvency funding level as at 31 December 2018 has increased by 2.8% to 76.6% over the year.



The improvement in solvency level is primarily due to an improvement in the margin relative to gilts over the year underlying the solvency basis, which is set based upon our understanding of how insurance companies set assumptions to price annuities at 31 December 2018. In addition, contributions paid into the Scheme in line with the Schedule of Contributions dated 24 March 2016 agreed as part of the 2014 valuation, before the 2017 valuation was finalised also contributed to an improvement in funding level. However these improvements were slightly offset by poor investment returns over the year.

Details on the assumptions and approach used to produce this update are set out in the appendices.

## Next steps

The Trustee is required to disclose to members, in a summary funding statement, certain outcomes of this actuarial valuation within a reasonable period.  Members may also request a copy of this report.

The financial position of the Scheme and the level of Employer contributions to be paid will be reviewed at the next actuarial valuation, which is expected to be carried out as at 30 June 2020.

In intervening years the Trustee will obtain annual actuarial reports, such as this one, on developments affecting the Scheme's assets and technical provisions.  The next such report, must not have an effective date of later than 31 December 2019, must be completed by 31 December 2020. However we understand that the Trustee will be commissioning the next Actuarial Report with an effective date of 30 June 2019 in order to align with the date of the Trustee Report and Accounts.

E J Palfreyman

**Emma Palfreyman**
**Fellow of the Institute and Faculty of Actuaries**
**Towers Watson Limited, a Willis Towers Watson Company**
**15 May 2019**

**Willis Towers Watson**
**51 Lime Street**
**London**
**EC3M 7DQ**

QAS Institute and Faculty of Actuaries ®
Quality Assurance Scheme

# Appendix 1: Statutory funding objective

The Trustee's only formal funding objective is the statutory funding objective under the Pensions Act 2004, which is to have sufficient and appropriate assets to cover the Scheme's technical provisions.

The method and assumptions for calculating the technical provisions as at 31 December 2017 were agreed between the Trustee and Employer and documented in the Statement of Funding Principles dated 29 November 2018. The table below summarises the main financial assumptions used to estimate the Scheme's technical provisions for this actuarial report and the latest actuarial valuation.

Please note that the assumptions shown in the table below represent approximate single equivalent rates at each date. The single equivalent rates shown are at durations appropriate to the liabilities subject to the relevant assumption. This differs from the approach used for the valuation report as at 31 December 2017, where assumptions were shown at the same duration.

| **Financial assumptions** | | **31 December 2018 % pa** | 31 December 2017 % pa |
|---|---|---|---|
| Discount rate | **Gilts + 0.75% pa** | **2.50** | 2.41 |
| Pensionable salary increases | **CPI curve** | **2.29** | 2.12 |
| Deferred pension revaluation | | | |
| - Former HPS members | **CPI curve** | **2.26** | 2.09 |
| - Other members | **CPI curve (max 5% pa cumulative)** | **2.45** | 2.37 |
| Pension increases: | | | |
| - Former HPS members | **CPI curve uncapped (floor of 0%) with a volatility of 1.9% pa.** | **2.58** | 2.59 |
| - Other members | **RPI curve capped at 5% pa with a volatility of 2.4%.** | **3.03** | 3.04 |
| - Post-1988 GMP | **CPI curve capped at 3% pa with a volatility of 1.9%.** | **2.01** | 2.01 |

I regard the financial assumptions adopted for this actuarial report as consistent with those used for determining the Scheme's technical provisions at 31 December 2017, adjusted for changes in market conditions, and in my view they are appropriate for the purpose of this actuarial report.

The demographic assumptions used for the purposes of this update are consistent with those adopted for the actuarial valuation as at 31 December 2017, as set out in the Scheme's Statement of Funding Principles dated 29 November 2018.

However, if the Trustee and Employer were to consider all the assumptions in detail as part of a formal valuation process, some of these assumptions may change.

There is no allowance in the assumptions underlying the technical provisions for any future discretionary increases to benefits.

I have included an allowance of £1,000,000 in my calculations for the potential cost of equalising GMPs. This is consistent with the approach adopted for the 2017 valuation. I have not undertaken any additional calculations to determine a more accurate estimate following on from the High Court ruling on the Lloyds case in October 2018.

The table below compares the estimated technical provisions as at the effective date of the actuarial report with the market value of the Scheme's assets and the corresponding figures from the latest actuarial valuation:

| **Valuation statement** | **31 December 2018 £m** | 31 December 2017 £m |
|---|---|---|
| Amount required to provide for the Scheme's liabilities in respect of: | | |
| Defined benefits | **207.5** | 211.3 |
| Reserves | **4.0** | 4.0 |
| Technical provisions | **211.5** | 215.3 |
| Market value of assets | **228.1** | 234.5 |
| Past service (deficit)/surplus (technical provisions less assets) | **16.6** | 19.2 |
| Funding level (assets ÷ technical provisions) | **107.8%** | 108.9% |

The reserves include £1m for GMP Equalisation and £3m as an allowance for expenses to be incurred by the Scheme over 5 years from the valuation date.

**Developments since the latest valuation**

The funding level is estimated to have reduced from 108.9% at the previous valuation to 107.8% as at 31 December 2018. The main factors contributing to this change are shown below:

| **Surplus at 31 December 2017** | **£19.2m** |
|---|---|
| Interest on the surplus | **£0.2m** |
| Lower investment returns than assumed | **(£7.3m)** |
| Employer Deficit Reduction Contributions with interest | **£4.6m** |
| Change in actuarial basis to reflect economic conditions | **£0.2m** |
| Expenses paid in excess of Employer Expense Contributions | **(£0.3m)** |
| **Surplus at 31 December 2018** | **£16.6m** |

The main reason for the deterioration in funding position are the investment returns being lower than assumed. However this has been offset to a certain extent by Deficit Reduction Contributions paid in line with the Schedule of Contributions dated 24 March 2016 agreed as part of the 2014 valuation, before the 2017 valuation was finalised.

# Appendix 2: Solvency

The method and assumptions for calculating the value of the Solvency liabilities have been selected based on our understanding of how insurance companies set assumptions to price annuities at 31 December 2018.

The tables below summarise the main assumptions used to calculate the value of the Scheme's Solvency liabilities for this actuarial report and the previous actuarial valuation. For any assumptions not shown I have used the same assumption as used to calculate the technical provisions liabilities:

| Financial assumptions | **31 December 2018 % pa** | 31 December 2017 % pa |
|---|---|---|
| Pensioner discount rate | **Gilts + 0.25% pa** | Gilts + 0.20% pa |
| Non-Pensioner discount rate | **Gilts – 0.25% pa** | Gilts – 0.40% pa |
| CPI Inflation | **RPI curve – 0.70% pa** | RPI curve – 0.70% pa |
| Deferred pension revaluation | | |
| - Former HPS members | **RPI curve** | RPI curve |
| - Other members | **Solvency CPI curve** | Solvency CPI curve |
| Pension increases: | | |
| - Former HPS members | **RPI curve** | RPI curve |
| - Other members | **RPI curve** | RPI curve |
| - Post-1988 GMP | **Solvency CPI curve capped at 3% pa** | Solvency CPI curve capped at 3% pa |

| Demographic assumptions | **31 December 2018** | 31 December 2017 |
|---|---|---|
| Mortality base tables: | | |
| - Male pensioners | **99% of S2NMA_L** | 99% of S2NMA_L |
| - Female pensioners | **88% pf S2NFA** | 88% pf S2NFA |
| Future improvements in longevity | **CMI 2016 projections with a long term rate of 1.50% pa from 2007** | CMI 2016 projections with a long term rate of 1.50% pa from 2007 |
| Proportion of pension exchanged for a lump sum at retirement (on current conversion terms) | **No allowance** | No allowance |

The table below compares the estimated liability value on the Solvency basis as at the effective date of the actuarial report with the market value of the Scheme's assets and the corresponding figures from the latest actuarial valuation:

| Valuation statement | **31 December 2018 £m** | 31 December 2017 £m |
|---|---|---|
| Amount required to provide for the Scheme's liabilities in respect of: | | |
| Defined benefits | **292.7** | 312.7 |
| Reserves | **5.1** | 5.1 |
| Total value of liabilities on Solvency basis | **297.8** | 317.8 |
| Market value of assets | **228.1** | 234.5 |
| Past service (deficit)/surplus (Solvency liabilities less assets) | **(69.7)** | (83.3) |
| Funding level (assets ÷ Solvency liabilities) | **76.6%** | 73.8% |

The reserves include £1m for GMP Equalisation and also an allowance for expenses incurred on wind up of the Scheme.

The main factors contributing to the improvement in Solvency position are the contributions paid by the Employer and terms used by insurance companies to price annuities becoming more favourable. However the impact of these was slightly offset by the negative investment returns over 2018.

# Appendix 3: Data, calculation approach and limitations

## Cashflow data

A summary of the data provided by Inside Pensions for this actuarial report is presented below.

| Cashflow data for preceding year | 31 December 2018 £'000 |
|---|---|
| Employer Deficit Reduction Contributions (in line with the Schedule of Contributions dated 24 March 2016 agreed as part of the 2014 valuation) | **4,583** |
| Employer Expense Contributions (in line with the Schedule of Contributions dated 24 March 2016 agreed as part of the 2014 valuation) | **767** |
| Benefits Paid over the year (including transfers out) | **(6,054)** |
| Administrative and investment management expenses | **(1,045)** |
| Net cashflows over the year | **(1,749)** |

Please note that the cashflows above for the period 1 January 2018 to 30 June 2018 have been taken from the Audited Trustee Report and Accounts as at 30 June 2018. Information for the second half of the year was taken from the monthly Cashflow statements produced by the Scheme's Administrator, Capita, and provided to us by the Scheme Secretary, Inside Pensions via email on 3 April 2019.

We have allowed for the transfers paid out of the Scheme in our rollforward calculations on an approximate basis. Pension payments and commutation lump sum payments were broadly in line with our expectations, and as such we have not allowed for the difference in actual versus expected pension and commutation lump sums paid in the calculations.

## Asset information

The asset valuation as at 31 December 2018 was provided to us by the Scheme Secretary via email on 3 April 2019 (subsequently clarified on 9 May 2019) and the value of the Trustee Bank Account balance was taken from the Cashflow statements. Based on the information supplied as at 31 December 2018, the market value of the Scheme's assets was £226.96 million and the Trustee Bank Account balance was £1.15 million. This excludes any Additional Voluntary Contributions (AVCs). The asset values provided were collated from asset manager statements and have not been audited by the HGPS auditor.

## Calculation approach

In carrying out the estimates of the updated financial position of the Scheme, I have not carried out full liability valuation calculations. Instead, I have estimated how the position may have moved over the year to 31 December 2018 using approximate methods based on cashflow data provided.

The approach taken to calculate the estimates will not be as robust as the calculations performed as part of a full actuarial valuation, but should be sufficient, in normal circumstances, to obtain a reasonable indication of how the funding position might have moved.

## Compliance

This report and the work involved in preparing it are within the scope of and comply with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 300: Pensions (TAS 300) published by the Financial Reporting Council. However, as this report has been produced solely to meet a legislative requirement and no decisions are expected to be taken on the basis of the information set out in it, I have taken a proportionate approach when considering and applying the requirements contained within TAS 100 and TAS 300.

## General limitations

This report has been prepared for the Trustee for the purpose indicated. It has not been prepared for any other purpose. As such, it should not be used or relied upon by any other person for any other purpose, including, without limitation, by individual members of the Scheme for individual investment or other financial decisions, and those persons should take their own professional advice on such investment or financial decisions. Neither I nor Towers Watson Limited accepts any responsibility for any consequences arising from a third party relying on this report.

Except with the prior written consent of Towers Watson Limited, the recipient may not reproduce, distribute or communicate (in whole or in part) this report to any other person other than to meet any statutory requirements.

The Trustee bears the primary responsibility for the accuracy of the information provided, but will, in turn, have relied on others for the maintenance of accurate data, including the Employer who must provide and update certain membership information. Even so it is the Trustee's responsibility to ensure the adequacy of these arrangements. I have taken reasonable steps to satisfy myself that the data provided is of adequate quality for the purposes of the investigation, including carrying out basic tests to detect obvious inconsistencies. These checks have given me no reason to doubt the correctness of the information supplied. It is not possible, however, for me to confirm that the detailed information provided, including that in respect of individual members and the asset details, is correct.

This report has been based on data available to me as at the effective date of the actuarial report and takes no account of developments after that date except where explicitly stated otherwise.

The funding of the Scheme is subject to a number of risks and it is not possible to make an allowance for all such risks in providing our advice. Unless stated, no explicit allowance has been made for any particular risk. In particular, no explicit allowance has be made for climate-related risks.