The Pearson Pension Plan

Actuarial Report as at 1 January 2020

July 2020

Contents

Disclaimers, confidentiality and non-disclosure

This report has been commissioned by and is addressed to the Trustee of the Pearson Pension Plan for its exclusive use. Its scope and purpose is to provide the Trustee with advice in relation to the ongoing funding position of the Plan. I am providing this report under the terms of our engagement and in my capacity as Plan Actuary.

We have used the asset and cash flow information provided in the Plan's accounts, which we have accepted without independent checking. We do not accept responsibility for any errors that may arise that are due to such information being incorrect.

It is noted that this report will be shared with Pearson Services Limited and the other participating companies. 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.

01 **Introduction**

This report provides an update of the funding position of the Plan as at 1 January 2020 and is the second update report following the 1 January 2018 actuarial valuation

01.01 Background and purpose

This report provides information on the development of the technical provisions of the Pearson Pension Plan ('the Plan') over the period since the last formal actuarial valuation as at 1 January 2018 in line with the requirements of Section 224 of the Pensions Act 2004. As such, this report constitutes an 'actuarial report'.

This report provides a comparison of how the value of the Plan'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 only relates to the progress made by the Plan relative to the statutory funding objective.

Legislation requires the Trustee to make this report available to Pearson Services Limited and other participating companies ("the Company") within seven days of receiving it.

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 (other than simply deciding not to bring forward the effective date of the next valuation) will not be based on its contents. Appropriate advice should be obtained before any follow up actions are taken.

02 **Approach adopted**

1.15%

Gilt yields at 1 January 2020 are lower than at 1 January 2018 resulting in an increase in the value of liabilities

02.01 Asset data

We have obtained the current market valuation of the assets, including AVCs and money purchase fund values, insured annuities and net current assets based on information from the audited Trustee's report and accounts for the year ended 31 December 2019.

02.02 Liability and data calculation methodology

For this update, we have performed full liability calculations as at 1 January 2020, based on membership data as at 1 January 2018. We have then made an approximate global allowance for membership movements since 1 January 2018 by adjusting the liabilities for cash flow information from the Plan's accounts.

The Trustee should note that the results of these calculations may differ from the actual position disclosed if we were to carry out more detailed calculations based on membership data at 1 January 2020. However, we consider the approach adopted to be adequate for the purposes of assessing the progression of the Plan's funding level since the last formal actuarial valuation.

02.03 Actuarial Assumptions

The statement of funding principles ('SFP') sets out how the assumptions to calculate the technical provisions are to be derived. Further details on the assumptions can be found in our paper 'Plan funding at 1 January 2020' that accompanies this report.

The main financial assumptions we have used, based on market conditions as at 1 January 2020, are summarised in the table overleaf (together with the assumptions used at 1 January 2018 and 1 January 2019).

Approach adopted
continued

3.20%

RPI inflation at 1 January 2020 is lower than at 1 January 2018 resulting in a decrease in the value of liabilities

	Assumption at 1 January 2018	Assumption at 1 January 2019	Assumption at 1 January 2020
Discount rate			
> Insured liabilities	1.70%	1.80%	1.15%
> Non-insured liabilities	2.38%	2.48%	2.00%
Future RPI	3.40%	3.40%	3.20%
Future CPI	2.40%	2.40%	2.20%
General salary escalation	3.90%	3.90%	3.70%
Pension increases			
> RPI max 5%	3.40%	3.40%	3.20%
> RPI max 5% min 3%	3.75%	3.75%	3.55%
> RPI max 3%	2.75%	2.75%	2.55%
> RPI min 0%	3.50%	3.50%	3.30%
> RPI min 4%	4.50%	4.50%	4.30%
Mortality for insured liabilities	As detailed in the 2018 SFP	2018 SFP except: CMI 2017 with 1.50% long term rate, 7.5 smoothing parameter and no initial addition	2018 SFP except: CMI 2018 with 1.50% long term rate, 7.5 smoothing parameter and no initial addition
Mortality for non-insured liabilities	As detailed in the 2018 SFP	2018 SFP except: CMI 2018 with 1.75% long term rate, 7.5 smoothing parameter and no initial addition	2018 SFP except: CMI 2019 with 1.75% long term rate, 7.5 smoothing parameter and no initial addition
Commutation	18% of pension	18% of pension	18% of pension
Proportion married at retirement	90% (M) / 60% (F)	90% (M) / 60% (F)	90% (M) / 60% (F)
GMP Equalisation	1% of liabilities	0.5% of liabilities	0.5% of liabilities

The actual assumptions used are based on full gilt yield curves and inflation yield curves. The figures quoted in the table above are the approximate single equivalent rates and are shown for indicative purposes only.

No allowance for climate-related risk is made in the assumptions in the statement of funding principles, and therefore are not allowed for in the figures in this report.

03 Results

£250m

Surplus at 1 January 2020

106.4%

Funding level at 1 January 2020

03.01 Results of the funding update

The Trustee's target reserve (known as 'technical provisions') represents a prudent estimate of the amount needed at the valuation date to meet the projected benefit payments as they fall due. The technical provisions and the resultant funding position at the valuation date are set out in the following table. The corresponding results from previous years are shown for comparison purposes.

	Funding position at 1 January 2018 £m	**Funding position at 1 January 2019 £m**	**Funding position at 1 January 2020 £m**
Plan liabilities in respect of:			
> Defined benefits	3,196	3,031	3,156
> Expenses	90	90	90
> AVCs and other money purchase benefits	529	522	635
Technical Provisions (L)	3,815	3,643	3,881
Value of Assets (A)	3,978	3,894	4,131
Surplus/(Shortfall) (A – L)	163	251	250
Funding Level (A / L)	**104.3%**	**106.9%**	**106.4%**

Please note that the liability figure shown for AVCs and other money purchase benefits consists of the Defined Contribution Sections figure from the Plan accounts of £538m, £77m we have calculated in respect of the money purchase underpin and a £20m reserve, consistent with the 2018 valuation, for death-in-service lump sums, ill-health retirement and spouses' benefits in respect of Money Purchase 2003 members.

The results shown are based on the same membership data as for the last formal actuarial valuation adjusted for cash flows and overall changes in pensionable payroll. These details have been supplied by the Pearson Pensions team or taken from the Plan's accounts.

The value of insured annuities in the Plan accounts at 31 December 2019 is £1,726m. We have used this figure as the insured asset and liability in our funding assessment at 1 January 2020, so that there is no item of surplus or deficit relating to the insured population.

Results
continued

£207m

Asset gain over the year due to investment returns higher than assumed

£222m

Increase in liabilities over the period due to changes in the market conditions

03.02 Reconciliation with prior years

Since 1 January 2018, the Plan's surplus has increased from £163m to £250m. The main factors that have combined to produce this change in the position since the last formal actuarial valuation are:

> A higher than assumed return on the Plan's investments over the period.

> A reduction in the assumed life expectancies of Plan members and, therefore the liabilities of the Plan, due to the adoption of the more recent mortality improvements models.

> A reduction in the estimated impact on liabilities of GMP Equalisation.

> The changes in financial conditions underlying the actuarial assumptions used to value the liabilities have placed a higher value on the liabilities and hence have partially offset the increase in surplus.

A more detailed breakdown of the increase in surplus since 1 January 2019 is provided below:

	Year to 1 January 2020 £m
Surplus at start of year	**251**
Expected return on assets less interest on liabilities	10
Contributions less cost of accrual & expenses	(8)
Asset returns in excess of discount rate (including LDI and annuity revaluation)	207
Willis Towers Watson's estimate of gain due to buy-in	19
Reduction in surplus due to RST underpin pensions	(3)
Other	(8)
Changes in assumptions	4
Changes in market conditions	(222)
Surplus at end of year	**250**

04 Formal reassessment of funding

The next formal actuarial valuation of the Plan is due no later than 1 January 2021 when we will provide further details of how the Plan's funding level has developed.

1 January 2021

Next formal valuation due

Signature

Date

July 2020

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