Open Prepaid Funerals Trust

Solvency assessment Report

as at 5 April 2022

January 2023

Introduction

REPORT	Solvency assessment report ("***SAR***")
PURPOSE	To provide information required by the Financial Conduct Authority ("***FCA***") in accordance with the Funeral Plan Conduct of Business Sourcebook ("***FPCOB***")
ADDRESSEE	Open Prepaid Funerals Limited ("***the Company***")
ARRANGEMENT	Open Prepaid Funerals Trust ("***the Trust***")
DATE OF VALUATION	5 April 2022

This report is addressed to the Company and is not intended to assist any other user in making decisions. Neither I, nor Atkin Pensions, accept any liability to third parties in respect of this report.

This report and the underlying data and calculations comply with Technical Actuarial Standards TAS 100 and TAS 400, as far as they are material. We have allowed for existing guidance from the FCA on Solvency Assessment Reports (SARs). It should be noted that TAS400 predates SARs and further guidance is needed to ensure such reports are written consistently, and in the way the FCA intend.

Background

The Trust was established by Open Prepaid Funerals Limited and the then Trustees and was governed by a Trust Deed dated 10 June 2004. A Deed of Variation was executed on 15 March 2019 and the Trust is now governed by the provisions set out in the Deed of Variation.

Under the provisions of the Trust, a pre-payment is received from Planholders for funeral services to be provided by a Nominated Funeral Director. This pre-payment is known as a Pre-paid Sum.

A Nominated Funeral Director, acting as an agent for Open Prepaid Funerals Limited and who will be arranging the funeral, sells a funeral plan to a Planholder. On death of the Planholder, the Pre-paid Sum and all accrued or allocated income and gains on it are paid to the Nominated Funeral Director.

Income on the Pre-paid Sums is calculated by agreement of the Trustees using data provided by the Actuary and in consultation with the investment managers and may be affected by investment conditions and market performance. Under the Trust provisions prior to the Deed of Variation, income would be calculated by reference to a formula provided by the Actuary.

The provisions of the Trust require that the Trustees apportion income and gains (and losses) between each Pre-paid Sum on a regular basis at their discretion. However, the Trustees are required to act under the recommendation of the Actuary in making any such apportionment.

If the assets exceed liabilities then the Trustees, having taken advice from the Actuary and with the consent of Open Prepaid Funerals Limited, may:

- Carry forward any surplus
- To use the surplus to
    - Make a payment to Open Prepaid Funerals Limited
    - Credit an additional amount to Planholder's Pre-paid Sums
    - Pay additional amounts in respect of past funerals
    - Pay introduction fees to Nominated Funeral Directors

If liabilities exceed assets or the Actuary advises that is it likely that this will be the case at a future actuarial valuation then the Trustees may:

- Obtain an injection of capital from Open Pre-Paid Funerals Limited
- Suspend acceptance of new plans
- Wind-up the Trust

Overview

A person is able to take out a contract whereby they pay in advance for funeral services. The payment is paid to the Trust and is termed a Pre-paid Sum. Fees, as detailed in the information provided to prospective plan holders, are paid direct to Open Prepaid Funerals Limited.

When a Planholder dies, the Pre-paid Sum, with accumulated income, is paid to a Nominated Funeral Director. Income is intended to reflect investment returns over the period that the Pre-paid Sum is held by the Trust.

The expectation of the Planholder and the Nominated Funeral Directors is that the payment of the Pre-paid Sum on death will be sufficient for the Nominated Funeral Director to carry out services agreed with the Planholder in respect of the funeral.

If, as a result of inflation or rising costs, funeral costs exceed the Pre-paid Sum, the expectation is that funeral would still go ahead as planned. Whilst this may not be a direct risk within the Trust itself, it must be noted that there is a risk that Nominated Funeral Directors may not be willing or able to carry out funerals because of low amounts of money being paid from the Trust. Although the expectations of Planholders may not be met in these circumstances, I understand that Open Prepaid Funerals Limited do not guarantee that the third party costs redemption value will fully secure the intended funeral without additional payment.

A Planholder is entitled to cancel their Plan and receive a refund of payments made, though an administration fee may be deducted if they are cancelling after 60 days.

It is, therefore, important that the Trustees are in a position to pay full refunds, should these be requested, either from the existing assets of the Trust or from a capital injection.

The provisions regarding the addition of income and gains (or losses) to Pre-paid Sums are set out in the document governing the Trust.

The Trustees have interpreted these provisions by applying a stable annual return over the term of each plan and have not adjusted proceeds to reflect day to day movements in investment markets. The return over the term of matured policies has not, therefore, precisely mirrored the return on the Trust over the period of investment. When investment markets are depressed, the proceeds could exceed the amount that the Planholder should receive based on a strict allocation of all income, gains and losses over the period of investment, and vice versa.

However, the smoothing of investment returns means that the Nominated Funeral Directors do not receive a lower amount when investment markets are depressed; a situation that might mean that it would become more likely that the Nominated Funeral Director would be unable to provide the agreed funeral services solely from the Pre-paid Sum.

Membership data

We have been provided with details of the membership by Luckmans Duckett Parker Limited, the Auditors for the Trust. This Solvency Assessment Report has been based on this data, which is summarized below for Plans still in force at April 2022.

Payment method	Plans	Cancellation value (£m)	Value using income to be added to Plans up to April 2022 (£m)	Average Cancellation value (£)	Average value with income (£)
Single payment	3,898	12.90	14.30	3,309	3,667
Instalment payments fully paid	345	1.09	1.30	3,147	3,781
Instalment payments not fully paid	324	0.48	0.50	1,487	1,557
Total	4,567	14.47	16.10	3,168	3,526

The cancellation values shown above are based on the amounts that would be paid to Planholders on cancellation if no income were given, and if no cancellation fee were charged. The accounts refer to this amount as the 'Liability for unfulfilled plans' (LFUP).

Where a Planholder was paying regular instalments over a fixed term, and that term extended past the valuation date, those payments were excluded from the accounts, and have not been included in the table above. The remaining instalments for Plans at April 2022 totalled £0.74m (an average over 324 Plans of £2,276, with an average 23 months remaining).

The audited April 2022 accounts show the LFUP at the valuation date to be £14.454m.

The values shown above with income to April 2022 are what would have been paid if all Plans were paid out at that point, with treatment consistent with deaths in the preceding month.

Whilst we have not carried out a full audit of the data, I am reasonably happy that the data is sufficiently accurate for the purpose of this SAR.

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Assets

I have been provided with a copy of the audited accounts as at 5 April 2022.

The accounts show that the total assets at 5 April 2022 were £16.78m. This is a fair value. It excludes instalments due after the relevant date.

We have been advised that the split of the assets as at 5 April 2022 between asset sectors and between investment managers was as follows:

Sector	(£m)
Equities	10.66
Bonds	1.80
Alternatives	2.42
Property	0.40
Cash	1.50
Total	**16.78**

Investment Manager	(£m)
Aegon	13.12
Thesis	2.68
Balance	0.98
Total	**16.78**

A new investment manager has been appointed and the assets are in the process of being switched. The target weighting is currently:

Sector	Revised Target %
Equities	39.5
Bonds	39.0
Alternatives	14.0
Cash	7.5
Total	**100.0**

Timing of cashflows

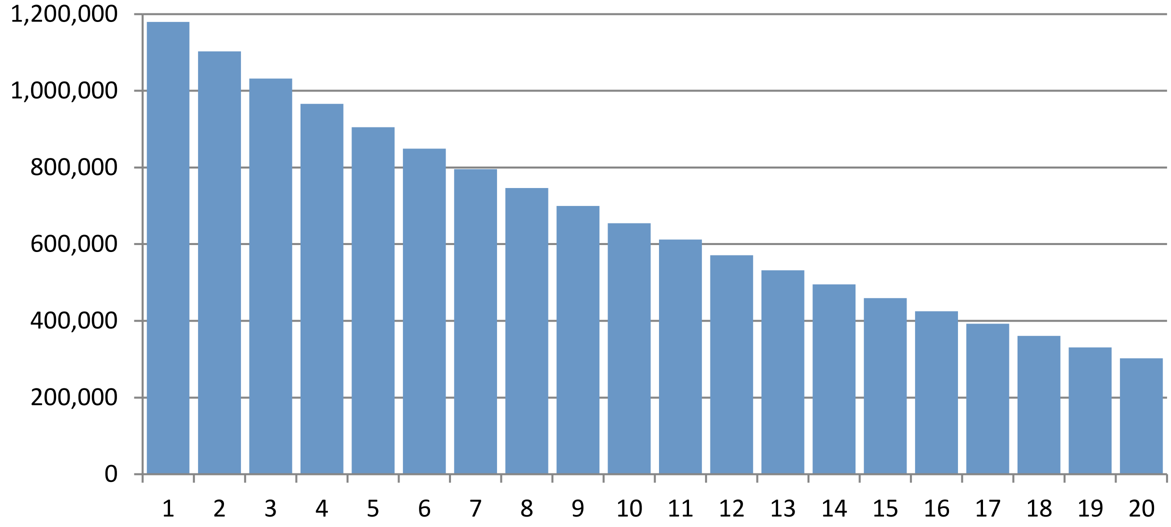
We have considered the likely timing of payments from the Trust, and this depends on a number of assumptions as shown in the table below:

	Assumption	Comment
Base mortality	125% ELT17	The ELT17 table is the latest table based on general population experience. We have scaled the mortality which gives earlier deaths. This adjustment is based on the Trust's past experience (if the mortality had been subject to a multiple of ELT17 then, statistically, there is a 95% chance of the multiple being between 121% and 132%, with 126% being the most likely). However the socio economic background of new Planholders might change with time so this is just a rough approximation.
Future mortality improvements	CMI_2021 with 1.25% long-term trend	This is the future mortality projection model produced by the Continuous Mortality Investigation ("CMI"). The long-term improvement observed over the 20th century was around 1% per year. The rate of improvement increased for much of the last 50 years though there are indications that the improvement has slowed down, at least temporarily. The 2021 version used is the latest version and has no weighting for additional COVID-19 deaths.
Temporary adjustment to mortality after Plan taken out.	Ignored	It is possible that new Planholders will have different mortality experience, particularly in the short-term, compared with other people who do not take out plans. We have made no allowance for such an effect.
Cancellations	Ignored	Whilst they do occur, occasional cancellations at the level seen, often on small, new Plans does not affect the financial position of the Trust.
New Plans	Ignored	We have considered only plans in force at 5 April 2022, and have ignored remaining future instalments.

We have, for each Plan, considered the probability of the Planholder surviving until each future year. We have then multiplied that probability by their Plan value.

We have not allowed for any future income at this stage.

Using these assumptions, the expected payments in respect of funerals for the 20 years after the valuation date are shown below. More than half of the cash flows are in the first nine years. The sum of cash flows over all years is £16.10m.



Whilst we have shown 20 years of cashflows in the graph, it would be expected that the actual cash flows would continue past 2075. The cash flows will not be as smooth as this method implies; by chance you would expect some years to have more or less people dying, and this effect is made more significant still by issues such as extreme weather and epidemics.

The average term of the full cashflows is 11 years.

Valuation Methodology

This SAR is required to 'determine, calculate and verify the assets and liabilities of the trust by applying a best estimate basis.'

The Trust liabilities are based on payment of the Pre-Paid Sum with accumulated income, rather than being based on the cost of providing funeral services including inflation.

We are taking the asset value as the audited market value of the Trust's assets. To ensure consistency, we should also use market information for an investment return assumption.

A sample of key financial market indicators is provided in the table below.

	Market indicator	5 April 2022
Government fixed interest bond yield	Bank of England – 11 year nominal spot rate	1.71%
Market inflation expectations (RPI)	Bank of England – 11 year spot rate	4.26%
Dividend yield	FTSE All-Share dividend yield	3.07%

Given that future income payments from bonds are generally fixed, and that the capital payment due at redemption is also usually known, expected future returns on bonds are generally based on current market yields. Allowing for expected outperformance of 0.25% from non-Government bonds being held, a return of 1.95% for bonds has been used.

Estimating future overall returns from return-seeking assets such as equities is a harder process. One possible method is set out below using 2022 market conditions.

Dividend yield	3.07% p.a.	FTSE All Share dividend yield
RPI inflation	4.26% p.a.	Bank of England 11 year spot rate
Allowance for dividend growth	0.50% p.a.	
Total	7.85% p.a.	

This has been used for investments in equities, property and alternatives.

The remaining assets held in cash have been given a nominal expected rate of return of 1.5% p.a.

The expected rate of returns for each asset class have then been applied to the target asset allocation, to give a single investment return. The resultant rate, after deduction of 0.9% to allow for investment charges, is 4.2%.

To allow for non-investment expenses, we have taken the average value from the last five years in the Trust accounts (£190k) and assumed this occurs annually, increasing at 4.3% per year. On best estimate assumptions there will be further Plans written. Whilst this SAR is an assessment for existing Plans at the valuation date, when considering future expenses it seems appropriate to recognise that those expenses will increasingly be shared over future Plans. To recognise this, the allowance for expenses has then been reduced in line with the pattern of cashflows from the previous section.

Income would be expected to be added to Plans being fulfilled, and the level of income would reflect both recent experience and the returns being earned on the assets. Because the investment strategy being followed uses a significant amount of return-seeking assets, it would be expected that the income would generally be set so as to try and retain some margin between the value of the assets and the value of the liabilities. Whilst this is not a recommendation that the Trustees declare income at this level, we believe an annual rate of income of 2.0% would be broadly consistent with the investment and expense assumptions. We have increased the cashflows shown in the previous section by 2.0% per annum to allow for assumed future income allocations.

To get a single present value for the liabilities, we have discounted the Plan and expense cashflows described in the previous two paragraphs at the assumed investment return of 4.2% (net of investment expenses). This gives a suitable value for comparing with the value of the assets.

Solvency assessment of the Trust in respect of payments already received in respect of live Plans	
£m	**April 2022**
Total assets (market value)	**16.78**
Plan liabilities	12.92
Non-investment expenses	2.57
Total liabilities	**15.49**
Solvency level	**108%**
ASSUMPTIONS	
Discount rate/investment return net of investment expenses	4.2% p.a.
Annual income allocated to Plans	2.0% p.a.
Mortality	125% ELT17 CMI_2021 with 1.25% long term trend
Non-investment expenses	Average expenses over last 5 years, increased at 4.3% p.a. but reduced to reflect share of some new business

Next Steps

This SAR must now be passed on to the FCA.

The next SAR should be carried out with effect from a date no later than 12 months from the date of this SAR. We suggest that an actuarial valuation for the Trustees is also carried out at that time.

C M ATKIN **30 January 2023**
Fellow of the Institute and Faculty of Actuaries

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