Open Prepaid Funerals Trust

Solvency assessment Report

as at 5 April 2023

September 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 2023

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 (Principles of Actuarial work) and TAS 400 (Funeral plans), as far as they are material.

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
- 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 it is 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. The expectations of Planholders may not be met in these circumstances.

I understand, however, that Open Prepaid Funerals Limited do does not guarantee that the third-party costs redemption value will fully secure the intended funeral without additional payment. However, the Company should satisfy itself that Planholders are aware of potential additional costs.

It would also be sensible for the Company to monitor periodically the Pre-paid Sums with investment returns added by comparing these against the current costs of the relevant funeral plans to ensure that the Pre-paid Sums remain sufficient for the Nominated Funeral Director to carry out the funeral.

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 important that the Trustees are, as far as possible, always 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.

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 used 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 2023.

Payment method	Plans	Cancellation value (£m)	Value using income to be added to Plans up to April 2023 (£m)	Average Cancellation value (£)	Average value with income (£)
Single payment	4,928	16.41	17.97	3,329	3,646
Instalment payments fully paid	429	1.36	1.60	3,181	3,721
Instalment payments not fully paid	341	0.58	0.61	1,706	1,800
Total	5,698	18.35	20.18	3,221	3,541

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 2023 totalled £0.67m (an average over 341 Plans of £1,969, with an average 20 months remaining).

The audited April 2023 accounts show the LFUP at the valuation date to be £18.351m.

The values shown above with income to April 2023 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.

Assets

I have been provided with a copy of the audited accounts as at 5 April 2023.

The accounts show that the total assets at 5 April 2023 were £19.13m. 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 2023 between asset sectors and between investment managers was as follows:

Sector	(£m)
Equities	7.68
Bonds	6.69
Alternatives	2.16
Property	0.63
Cash	1.97
Total	**19.13**

Investment Manager	(£m)
Quilter Cheviot	18.59
Balance	0.54
Total	**19.13**

Valuation Methodology and Assumptions

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.

To value the liabilities we first estimate future cashflows using assumptions for probabilities of Planholder deaths and cancellation, expenses, and likely income that will be added on Plan redemption. To get a single present value for the liabilities, we discount those cashflows from the date of the projected payment back to the valuation date to allow for expected future investment returns. We then compare that value with the audited market value of the Trust's assets. To ensure consistency, the discount rate used reflects investment market conditions at the valuation date.

The calculations do not allow for new Plans taken out after April 2023, or payments into existing Plans made after that date.

	Assumption	Comment
Discount rate	4.9%	The expected future investment return, net of investment expenses, for the assets held at the valuation date.
Base mortality	132% 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.
Future mortality improvements	CMI_2022 with 1.25% long-term trend	CMI_2022 is the latest future mortality projection model produced by the Continuous Mortality Investigation.
Cancellation rate per year	0.2% (0.8% in the first 3 years)	Based on recent Trust experience. Once a Plan has been in place for a while it is less likely to be cancelled.
Expenses (non-investment)	Initially £260k per year	Based on recent experience. Expenses are assumed to increase annually by 3.4% per year. However, as future expenses will increasingly be met from Plans written in future years, the expense allowance has then been assumed to reduce in line with the estimated Plan cashflows.

More information on the assumptions is set out in the appendix.

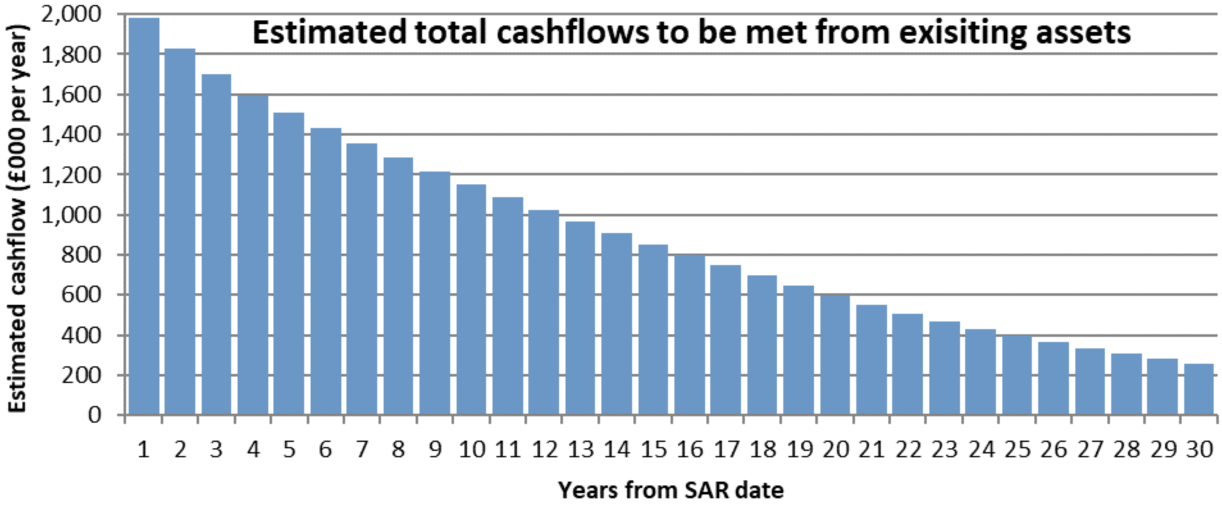
Income would be expected to be added to Plans being fulfilled. The level of income assumed to be added in the future should reflect the recent experience of the Trust's investments, the expected returns that might be achieved in the future and continuation of a conservative approach to the allocation of income.

As the investment strategy being followed uses a significant amount of potentially volatile return-seeking assets, the income ought to be set at a level that seeks to ensure that a reasonable margin between the value of the assets and the value of the liabilities is retained.

The value used for future income at the April 2022 SAR was 2% per year. We have continued to use 2% for this SAR. It should be noted that this return is lower than the assumed return on the assets (essentially the discount rate of 4.9%). However, we believe that this is a reasonable assumption given the desirability of increasing the margin between assets and liabilities.

It must be recognised that income allocated to Pre-paid Sums at this level is lower than the expected rate of future inflation (assessed by reference to market expectations embodied in the pricing of fixed and index-linked gilts). This, in turn, implies that the Pre-paid Sums will not keep pace with inflation and the potential problems that that this may cause (and the need for Pre-paid Sums from existing plans and current funeral costs to be monitored) have been highlighted earlier in this report.

Using these assumptions, the expected cashflows from the Trust for the 30 years after the valuation date are shown below.



Whilst, for clarity, we have only shown 30 years of cashflows in the graph (over 90% of the total cashflows), it would be expected that the actual cash flows would continue past 2080. The further into the future a cashflow is, the more time there is for investment returns to help meet it, and so require a smaller amount of the current assets. Allowing for this, the weighted average term of the liabilities is 8 years.

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.

Valuation Results

Solvency assessment of the Trust in respect of payments already received in respect of live Plans	
£m	**April 2023**
Total assets (market value)	**19.13**
Plan liabilities	15.46
Non-investment expenses	2.61
Total liabilities	**18.07**
Solvency level	**106%**

It should be noted that the value placed on the Plan liabilities is lower than the value of Plans with income allocated to date. This is because the Plan liabilities represent the discounted vale of future payments and the fact that these payments have been discounted at a higher rate than the assumed returns added to the Plans.

The solvency level reported at April 2022 was 108%.

We have analysed the reasons for the change in the solvency position.

Start	108%
Fall in asset value	(10%)
Change in discount rate	7%
Change to allowance for expenses	(3%)
Plan experience	4%
End	106%

Over the year since the April 2022 SAR, the mortality experienced was rather higher than assumed. However, the valuation is not particularly sensitive to the mortality assumption.

Sensitivities

The sensitivity of the results to changes in the most important assumptions are set out below.

Changes in assumption	*Impact on solvency*
0.1% reduction in the discount rate	-1.0%
0.1% increase in future income	-0.7%
10% rise in future mortality rates	-1.0%
0.5% increase in inflation applied to expenses	-0.6%

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Whilst the above table indicates the changes to solvency as a result of using different long-term assumptions, the solvency position would also be impacted by sudden changes in the value of the assets. It should be noted that a fall of more than 6% in the value of the assets (which is not beyond the realms of possibility) might reduce the solvency level to less than 100%. However, a fall in asset values would often be accompanied by at least some change in expected future returns, and so the fall in assets values would probably need to be rather larger than 6% to bring the solvency to 100%. The Company should consider what steps they might take in these circumstances, and this could include reducing the income being allocated on redemptions.

It should also be noted that, at the valuation date, the assets of the Trust were sufficient to cover just in excess of 104% of the total cancellation values of the Plans. As such, the Trust is vulnerable to the potential for the assets to fall to a level where all cancellation values could not be met. Whilst it may be felt that this is unlikely, a sudden loss of confidence in the Trust (as a result of events relating to the Trust or funeral plans more generally) might lead to significant surrenders. The Company should consider what arrangements they might put in place if there were a large number of surrenders.

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Risks

The main risks that we would highlight are:

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SUDDEN RISE IN CANCELLATION

This is unlikely to be a problem for the Trust, so long as the value of the assets remains above the cancellation value of the Plans. Generally, an increase in cancellation will improve the solvency position, particularly in respect of more mature Plans. However, it is important to try and build up the margin of assets over cancellation value (and/or have mitigation plans in place) to protect against the potential for a fall in asset values and the possibility of mass surrenders.

LIQUIDITY OF ASSETS

There have typically been significantly more payments into the Trust in respect of new Plans, than there have been payments out of the Trust in respect of redemptions, cancellations and expenses. This could change, for example, from a sudden rise in cancellations or if there is a significant drop in the level of new Plans. It would then be more important that the assets can be disinvested quickly and without depressing their value. However, I would not expect that there would be a problem meeting the expected cashflow in the year from the April 2023 even if no new Plans were taken out.

FALL IN ASSET VALUES

Generally, the value of liabilities and value of the assets held are in respect of medium to long term cashflows. The asset allocation aims to achieve higher returns for Planholders than could be achieved by investing purely in bonds to match the expected payments from the Trust. However, this does mean that the value of the assets is more volatile relative to fixed liability cashflows.

The liability cashflows are, however, not fixed and can be adjusted by changing the level of income allocated to Plans. In an extreme situation, it would also be possible to reduce income ‘accrued’ in an earlier period, since income is not formally allocated before a Plan is redeemed. A fall in asset values would not generally be an immediate problem to the solvency, given the flexibility in the allocation of income.

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SIGNIFICANT DROP IN NEW PLANS BEING WRITTEN

The high levels of new business recently have improved the solvency position (although the margin over cancellation values is reduced).

A large drop in the level of new business would mean the level of Trust expenses would become more significant, as more of the future expenses would have to be met from the existing Plans, and this would be expected to reduce the solvency position. For example, if expenses continued in line with recent experience and expected inflation, but no new Plans were taken out, allowing for the expenses for the next 20 years would be sufficient to reduce the solvency level by 10%.

PRE-PAID SUMS INSUFFICIENT TO COVER FUNERAL COSTS

There is a danger that the Pre-paid Sums may, over time, be insufficient to cover the cost of the funeral arrangements that the Planholder expects. Although not a direct risk to the Trust, the potential implications for the Trust of an inability of funeral providers to provide funeral without extra cost to the Planholder should be considered by the Company.

OTHER RISKS

Whilst there are risks that may affect the Trust that we cannot comment upon, such as regulatory or legislative change, or if problems arise in the administrative processes, there are some specific risks we think should be mentioned.

- A reduction in investment returns from future taxation would reduce the amount that could be allocated as income, but if taxation is applied retrospectively then this might have more serious implications. The Trustees may wish to verify that tax has and continues to be assessed appropriately.

- The Plan liabilities are in sterling. We understand that there is not a currency risk from the investment.

- Climate change might affect the Trust. As there may be investment risk for the Trust in the transition to a lower carbon economy, the implications of climate change should be considered and potentially a policy put in place.

- Increased inflation not met with an increase in investment returns and income given, may increase the cost of funerals relative to the payments from the Trust. As noted above, this would not be a direct problem for the Trust itself. However, higher levels of inflation will increase the future expenses that will need to be paid.

- The SAR relies on the accuracy of the administration data. If there are additional liabilities that we were not aware of then the solvency funding would reduce. We perform checks, and there is an annual audit for the Trust, which should reduce this risk.

Next Steps

This SAR must 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.

C M ATKIN **29 September 2023**
Fellow of the Institute and Faculty of Actuaries

Appendix – Further comment on assumptions

MORTALITY

Past mortality experience for the Trust has been compared against the ELT17 table, and Continuous Mortality Investigation ("CMI") tables on how mortality has been changing. We have used the latest tables available. If the Trust's past experience is assumed to be consistent with mortality being a multiple of mortality from those tables, there is a 95% chance of that multiple being between 127% and 138%, with 132% being the most likely. The assumed mortality is higher than was used last year. It seems that the Trust's mortality experience has increased over the last few years, and this will be considered further if this is a trend that continues. (More weight has effectively been given to recent experience because of the large growth in the Trust over recent years.)

The socio-economic background of new Planholders might also change with time. We do not expect there will be a significant difference for this Trust between Plans taken out before and after 29 July 2022, when FCA regulation of the funeral plan market commenced.

Future mortality improvements are assumed to be in line with CMI_2022 with a 1.25% long-term trend. 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.

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.

EXPENSES

To allow for non-investment expenses, we have taken the average value from the last five years in the Trust accounts (£260k) and assumed these expenses are met annually but increasing at 3.4% per year. On best estimate assumptions assumes that 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 been reduced in line with the pattern of Plan cashflows. This is consistent with future Plans starting at the same rate they have done in the past, although this is less than half the average over the last three years.

MARKET DERIVED DISCOUNT RATE

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

	Market indicator	5 April 2023
Government fixed interest bond yield	Bank of England – 8 year nominal spot rate	3.31%
Market inflation expectations (RPI)	Bank of England – 8 year spot rate	3.44%
Dividend yield	FTSE All-Share dividend yield	3.58%

We have used a term of 8 years above as this is the weighted average term of the discounted Plan liabilities.

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 3.6% 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 2023 market conditions.

Dividend yield	3.58% p.a.	FTSE All Share dividend yield
RPI inflation	3.44% p.a.	Bank of England 8 year spot rate
Allowance for dividend growth	0.50% p.a.	
Total	7.5% 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 2.0% p.a.

The expected rate of returns for each asset class have then been applied to the asset allocation, to give a single investment return.

The resultant rate, after deduction of 0.7% to allow for investment charges (based on recent actual charges), is 4.9% p.a. The discount rate used in April 2022 was 4.2% p.a.