# The Avalon Funeral Trust No. 3 Solvency Assessment Report as at 30 June 2023

**Date: 6 October 2023**

**Prepared by:** David Downie BSc FIA



WBR ACTUARIAL

# Solvency Assessment Report of the Avalon Funeral Trust No.3 as at 30 June 2023

## Introduction and Executive Summary

I have been requested by Avalon Trustee Company Limited ("the Plan Provider") to perform an actuarial valuation of the Avalon Funeral Trust No. 3 ("the Trust") and to provide a Solvency Assessment Report ("SAR") as required by the Financial Conduct Authority ("FCA") under section 3.2.2 of the Funeral Plan: Conduct of Business sourcebook ("FPCOBS"). The Trust is for the pre-arrangement and pre-funding of funeral services.

This report, in accordance with the Financial Services and Markets Act (Regulated Activities) Order 2001 act. 60(1)(b)(v), covers the determination, calculation and verification of the assets and liabilities of the Trust as at 30 June 2023 (the "Valuation Date"). The report is addressed to the Plan Provider but contains information that is also relevant to the Trustees. It describes the financial condition of the Trust at the valuation date and considers the funding appropriate to the Trust after the valuation date.

It is expected as required by the FCA for this report to be published on the Plan Provider's website.

In preparing this report we have complied with the Technical Actuarial Standard (TAS) - TAS 100 covering Principles for Technical Actuarial Work. It is expected that the Financial Reporting Council, who publishes the TAS's in consultation with the Institute and Faculty of Actuaries, will update TAS 400 (covering Funeral Trusts) to give specific guidance on contents of the SAR. This report complies with the principles of TAS 400, to the extent applicable.

We have also taken account of the following items produced by the Institute and Faculty of Actuaries:

- APS Z1 "Duties and responsibilities of actuaries working for UK Trust-based Pre-Paid Funeral Plans (effective 01.12.2015);
- APS X2 "Review of Actuarial Work" (effective 01.07.2015);
- Guide for Actuaries on UK Trust-Based Pre-Paid Funeral Plans;
- Guide for Trustees on UK Trust-Based Pre-Paid Funeral Plans.

The previous SAR on the scheme was carried out as at 30 June 2022 and my final report was dated 6 October 2022. The period under review is therefore twelve months.

This valuation does not take account of any future new business that may be written after the effective date of this valuation.

The results of the valuation show that the Trust has a Best Estimate funding level of 114.1% with an accrued surplus of £11.9m.

Further sensitivities to the above results are demonstrated under Appendix 4.

## Purposes of the Report

The main purpose of this SAR is to advise the Plan Provider of the position of the Trust relative to the liabilities as required by the FCA and as required under clause 11.3 of the Rules of the Trust and this is purely a "valuation exercise". The purpose of this SAR valuation is also to establish the level of security from within the Trust for a Plan Holder's contracted funeral service and to identify, as far as possible, the development of the Trust and the risks and issues that might affect the various stakeholders in the Trust in the future.

For this actuarial valuation, the liabilities have been calculated based on the settlements and disbursements due to be paid to the funeral directors that have contracted to conduct the funerals of policyholders.

The report includes elements required by FCA, namely:-

- the determination, calculation and verification of both the assets and liabilities of the Trust under a best estimate basis;
- the liabilities are to be measured against the amounts needed to provide the funeral
- the funeral plan Trust data should be shown into the following subcategories of payment method:
    - paid in full or single payments;
    - instalment payments fully paid;
    - instalment payments not fully paid.
- where the funeral costs increase with inflation this may be allowed for.

The purposes of the valuation are described above and the report is produced for the use of the Trustees and Plan Provider. Neither WBR Actuarial, nor I accept any liability to any third party in respect of the contents of this Report for its use for any purpose other than those set out as above.

# Trust and Operational Provisions

The operation of the Trust is governed by a Trust Deed prepared by Turcan Connell dated 29 November 2012 (amended and restated by a Deed of Amendment dated 1 August 2022). I have assumed that the reader of this Report has a reasonable knowledge of the operation of the Trust.

**Plans Available**

There are currently numerous main types of Avalon funeral arrangements which have been sold. Further details are available from Avalon Trustee Company Limited.

Each main plan has a specific set of terms and conditions that stipulate the funeral expenses that will be paid, the amount of the premium and the terms of payments.

**Payment Methods**

Each plan may be paid for by way of an upfront single payment or by way of regular payments over a predetermined number of years.

**Inflation Protection**

The funeral arrangement costs are normally split into two parts; the funeral directors' costs and the disbursement costs. Each participating funeral director has agreed to perform its duties based on an agreed fee, increased by inflation up to the date of death. The additional element of disbursement costs will be met separately, and these will also increase on an agreed basis in line with inflation up to the time of death.

I have been advised by the Trustees that the future measure of inflation proofing will be linked to the Consumer Prices Index (CPI).

## Summary of Data

Avalon Trustee Company Limited has provided the data to enable me to perform this valuation. Although I have taken all reasonable steps to ensure that the data is of adequate quality for the purposes of this valuation, I have relied on the accuracy of the information provided by the Plan Provider. The responsibility for the accuracy of the data for the valuation is therefore ultimately that of the Plan Provider. I have no material uncertainty about the accuracy of the data.

| | 30 June 2023 | | | |
|---|---|---|---|---|
| | **Single Payment** | **Instalments Paid in Full** | **Instalments In force** | **Total** |
| Number of Male Plan holders | 5,334 | 6,533 | 6,721 | 18,588 |
| Number of Female Plan holders | 6,447 | 8,027 | 8,143 | 22,617 |
| Total Plan holders | 11,781 | 14,560 | 14,864 | 41,205 |
| Total Settlement £' 000's | 30,218 | 38,171 | 38,460 | 106,849 |
| Average Settlement | 2,560 | 2,620 | 2,590 | 2,590 |

In addition to the above plans there were 1,161 lapsed plans which still hold a small liability in the trust. Over the year there were 1,106 new plans and 1,690 funeral plans settled.

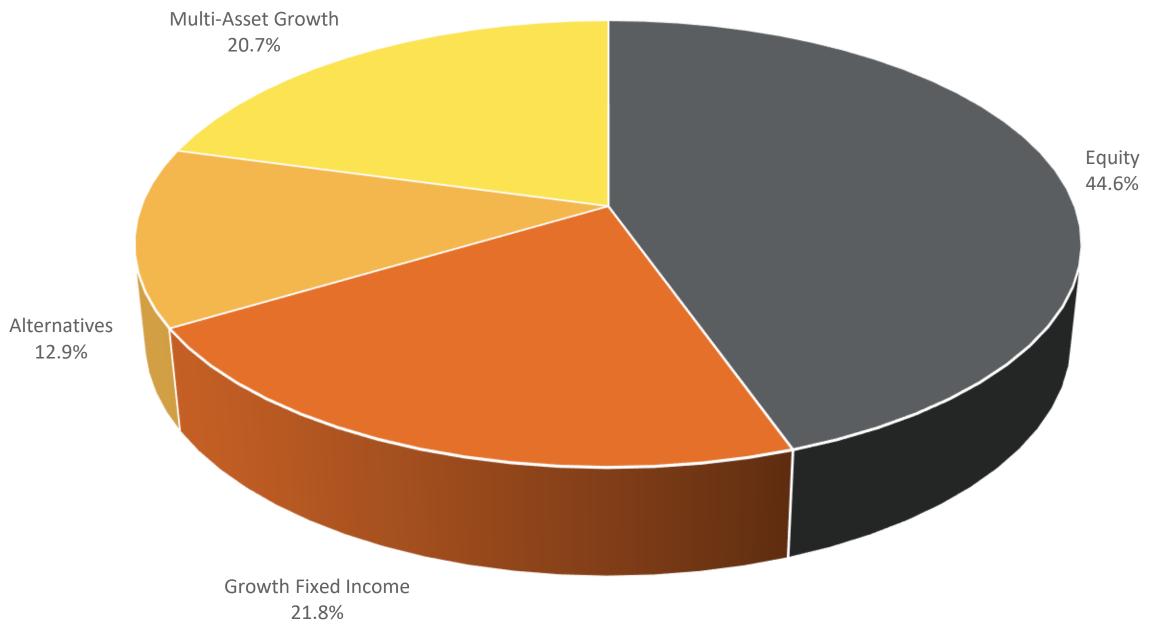
At this valuation there is a total of 11,781 single payment plans and 29,424 instalment plans. Corresponding figures at the last valuation were 11,923 single payment plans and 33,068 instalments plans.

## Asset Valuation

The following summarises the value of the Trust assets held at the valuation date as set out in the Trust accounts.

| | 2023 £000's | 2022 £000's |
|---|---|---|
| MERCER | 66,368 | |
| NINETY ONE | - | 14,097 |
| THREADNEEDLE | - | 26,038 |
| BAILLIE GIFFORD | - | 21,463 |
| CASH DEPOSITS | 254 | 612 |
| LESS CREDITORS | (768) | (672) |
| **TOTAL** | **65,854** | **61,538** |

The Avalon Funeral Trust No.3 covers all plans sold in the UK since 29 November 2012. The breakdown of the investment allocation by asset classes is shown below:-



## Valuation Assumptions

The construction of the valuation basis involves consideration not only of current economic factors and fund experience but also as to future trends in mortality, investment yield and the rate of growth in funeral costs. The basis adopted should be viewed with regard to relationships between the assumptions rather than to the absolute value of any components.

Most importantly, the relationship between the investment return and the assumed level of inflation gives an indication of the real yield (before tax) expected to be earned on the investments held within the Trust.

Allowance must also be made of the tax payable by the Trust as the actual return earned on the money held in the Trust will be net of tax and net of expenses. The Actuarial basis may be subject to change over time. I have detailed below a set of assumptions that I have utilised in my calculations. Details of the valuation method used for the determining the liabilities in the Trust are given in Appendix 1.

**Mortality**

The Trust is too small to warrant use of its own mortality experience and hence will have to incorporate the use of standard mortality tables with suitable adjustments which are deemed to be appropriate.

For the purposes of this review, the mortality rates have been chosen to reflect the general trend in improvement of mortality experience and the rates utilised are in accordance with standard tables published by the Office of National Statistics known as English Life Tables 17.

**Factors taken into account for Economic Assumptions**

In recommending the economic assumptions set out below, the following factors have been taken into account.

**Investment Growth**

At the date of the review the annualised yield available under UK Government 15 Year Gilt is 4.48% per annum. This will represent the risk free rate of return expected on the investments of the Scheme. The average yield on "AA" rated Corporate Bonds for durations of over 15 years is 5.14% p.a. The dividend yield on the FTSE All-Share was 3.74%.

However, the Statement of Investment Principles has allowed the Trustees to consider a degree of exposure in equity markets in an attempt to maximise the expected long term rates of return. The Trustees have a range of investments held within Mercer. The overall targeted investment return is measured as the Gilt yield plus an equity risk premium of 2.21% to give a gross yield of 6.69% p.a.

**Inflation Assumption - Funeral Directors Costs and Disbursement Costs**

Inflation as measured for the Retail Prices Index will be determined using the Bank of England Inflation yield curve of similar duration to that of the Trust's liabilities duration which is 13 years. At the review date the rate emerging is 3.55% p.a. After allowing for an inflation risk premium of 0.3% p.a. to reflect the supply issue of index linked gilts, the adjusted RPI assumption is 3.25% p.a.

As the link to inflation is CPI for both funeral directors' costs and disbursement costs, using the assumption of CPI being on average 0.3% below RPI over the Trust's duration gives an assumption of 2.95% p.a.

**Expenses**

The annual expenses of administering the Funeral Plans which is carried out by Avalon Trustee Company Limited and the including the investment management fees, are paid directly from the Trust. An explicit allowance has been made of £178,000 p.a. for a period of 13 years with allowance made for future CPI increases.

**Discount rate - Net Investment Return**

The discount rate used in valuing the liabilities of the Trust is the net return on investments after allowing for the payment of taxes. I have therefore taken the gross investment return of 6.69% and reduced it to 5.34% to reflect the expected after tax position assuming a tax rate of 20.2% over a 13 year time horizon. The net discount rate for valuing the liabilities is then taken as 5.34%.

**Cancellations**

Plan holders who have informed Avalon of their wishes to cease instalment payments will receive credit for all payments made after a deduction of an administration fee by Avalon Trustee Company Limited. An allowance for future cancellation rates has been incorporated in the valuation. The rates vary over the method of distribution.

**Deaths under Instalment Plans**

A balancing payment is assumed to be made in respect of the discounted value of the outstanding instalments, thereby creating no strain on the Trust Fund. Where services set out in customers plans are guaranteed in the event of customers dying prior to completing their instalment plans ("known as the Avalon Promise") no balancing payment is assumed and therefore any potential strain is already reflected in the discounted value of future premiums expected to be received into the trust.

**Taxation**

I have been advised by the Plan Provider that the expected average rate of tax payable is 20.2% p.a. In addition there is a tax provision from historical events of £31,000 which had the effect of increasing the Trust's liability. A comparison of the assumptions adopted for this valuation and last year's best estimate valuation is shown below:-

| | **2023** | **2022** |
|---|---|---|
| **Net Discount Rate** | 5.34% | 4.75% |
| **CPI inflation** | 2.95% | 2.50% |
| **Expense allowance** | £178,000 p.a. | £215,000 p.a. |
| **Tax allowance** | 20.2% | 20.2% |
| **Mortality Allowance** | ELT 17 | ELT 17 |
| **Average Cancellation rates** | 3.0% p.a. after year 1 reducing to 0.5% p.a. after year 12 | 3.0% p.a. after year 1 reducing to 0.5% p.a. after year 12 |

## Inter-valuation Experience

We have carried out a mortality investigation on the deaths of all policyholders of the Trust over the year to 30 June 2023. This investigation revealed that the number of deaths was approximately 105% of the number that would have been expected if experience had been in accordance with the English Life Table number 17 (ELT17).

The rate of mortality in the year to 30 June 2023 (i.e. 105% of ELT17) is worse than that assumed at the previous valuation (i.e. 97% of ELT17) and this has had a negative effect on the finances of the Trust. Volatility in the mortality experience is to be expected as the membership is relatively small and one year is a short time period to consider. Mortality experience will continue to be reviewed at each valuation and adjustments made where deemed to be appropriate. The table below summarises the results from this year's investigation and the previous 2 years:-

| Period | Experience (% of ELT17) |
|---|---|
| July 2020 to June 2021 | 101% |
| July 2021 to June 2022 | 97% |
| July 2022 to June 2023 | 105% |

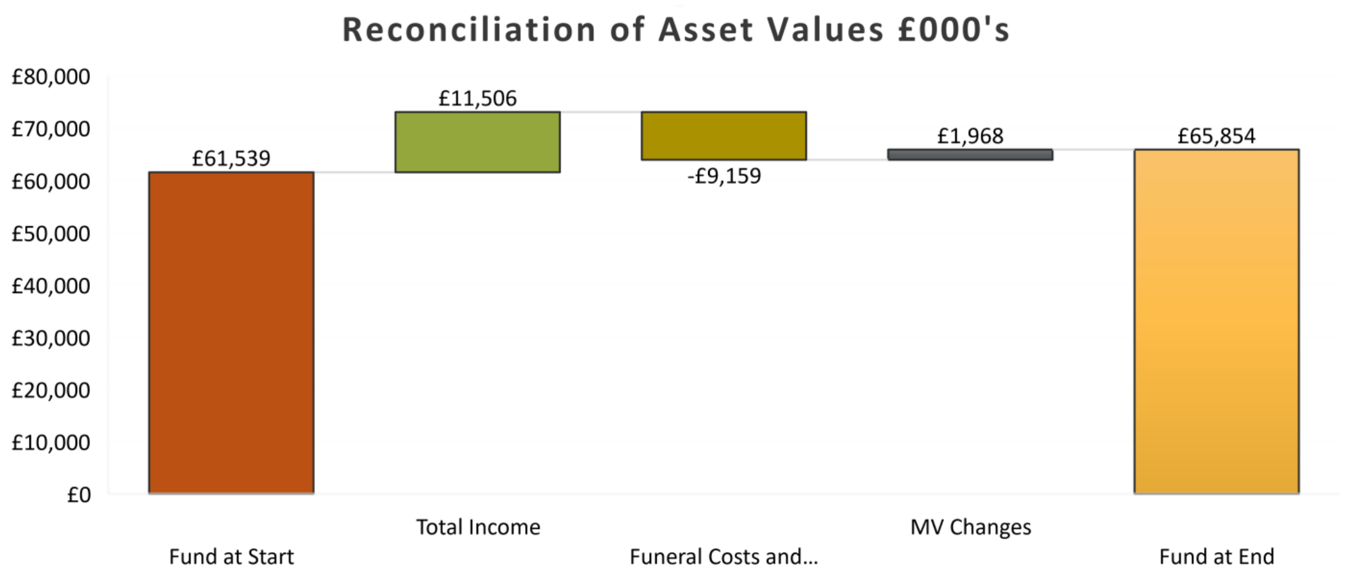
For the purposes of this review I have continued to use the loading factor to 100% of the mortality table ELT 17.

The estimated annual investment return earned on the assets as shown in the Trust accounts to 30 June 2022 has been calculated to be approximately 3.1% for the year compared to 4.75% p.a. assumed net of tax and expenses at the previous valuation. This has not been favourable to the Trust and reflects market movements during the inter valuation period.

The average increase in the settlement costs due to the Consumer Prices Index ("CPI") over the year was 0.5% p.a. compared to 2.50% p.a. assumed at the previous valuation, thus being beneficial to the Trust.

The expected total of future outstanding annual premiums from the existing active instalment plans has been calculated to be £39.2 million as at the valuation date. The premiums to follow are a calculation based on the monthly premiums expected to be received from all Active plans over the remainder of the outstanding term of the plans.

A reconciliation of assets during the 12 months to the Review Date is set out below:



## Funding Position – Best Estimate Basis

The liability of the Trust fund arises from the two main categories of plans held, Instalment Plans and Single Payment Plans. Based on the membership data and assumptions set out elsewhere in this report, I calculate that the value of the liabilities for the funeral plans including future projected inflation increases is as summarised below.

| | **2023 £000's** | **2022 £000's** |
|---|---|---|
| Value of Investments | 65,854 | 61,538 |
| Present Value of Future Instalments | 30,627 | 42,515 |
| **Total Value of Assets (A)** | **96,481** | **104,053** |
| Value of Funeral Costs | (82,565) | (89,124) |
| Tax Provision | (31) | 69 |
| Expense Reserve | (1,993) | (2,742) |
| **Total Value of Liabilities (L)** | **(84,589)** | **(91,797)** |
| **Surplus (A – L)** | **11,892** | **12,256** |
| **Funding Level (A/L)** | **114.1%** | **113.4%** |

The sensitivity of the above results due to changes in the actuarial assumptions and the impact due to future potential adverse events is highlighted in Appendix 4.

## Funding Position – Previous Valuation Basis

The valuation assumptions we have used at this valuation are different to those used in the 2022 valuation. On the 2022 set of assumptions, the 2023 valuation result would have given a funding level of 112.9%. It is prudent to continue improving the funding level of the Trust and this can be achieved from improved investment returns as well as a cautious approach to the expenses being paid out of the Trust and the payments made from the Trust fund at the time of death.

## Reconciliation of Results

In order to obtain a greater understanding of the ongoing results, I have carried out an analysis to reconcile the surplus emerging at this valuation date with the previous year's results. The table below shows a reconciliation of the surplus with the position disclosed by the previous valuation and quantifies the financially material items of actuarial gain or loss.

| | **Favourable/(Unfavourable)** |
|---|---|
| | **£000's** |
| Surplus at previous valuation | 12,256 |
| Expected investment return less interest on the liabilities | 581 |
| Investment Return lower than expected return | (1,022) |
| Membership Experience Gains / (Losses) | 2,996 |
| Cashflows Impact over the year | (3,707) |
| Change in valuation assumptions | 788 |
| Surplus at this valuation | 11,892 |

A profile of the liability of the funeral plans is shown in Appendix 2. The profile highlights the age distribution of the funeral plans and the distribution of the liability of the Trust spread over the age range of the plan members. This will be useful information when considering and reviewing the investment strategy of the Trust.

**Future Cashflows**

The table below shows the future projected cashflow payments out of the Trust over the next five years. A full cashflow forecast is shown in Appendix 3. These cashflows represent only the expected funeral plan payments for all plans held at the valuation date. No allowance is made for any future premiums due from the existing instalment plans.

| | **Total Future Expected Cashflows<br>£ 000's** |
|---|---|
| **Year 1** | **£4,073** |
| **Year 2** | **£4,279** |
| **Year 3** | **£4,482** |
| **Year 4** | **£4,679** |
| **Year 5** | **£4,867** |

## Risks

It is important to appreciate the various risks inherent in the valuation of the liabilities of the Trust. In particular, the main risk is that the valuation assumes a net real return of 2.39% p.a. will be earned on the investments within the trust after allowance for elements of inflation and tax.

Should any one of these elements increase at a higher rate than assumed thereby reducing the net real investment return earned on the assets then the level of future surplus will be lower and indeed the Trust could potentially emerge with a deficit. The degree of sensitivity of the results was shown above and therefore due care is needed when agreeing any non funeral plan payments out of the Trust.

The Trust has incorporated up-to-date rates of mortality. Should plan members die sooner than assumed then the Trust will pay out before it is expected leading to a reduction in future levels of surplus.

The success of Avalon Trustee Company Limited to maintain its new business levels has a direct impact on the ability of the Trust fund to continue meeting the expenses of administering the funeral plans. Should there be a fall in new business without a corresponding reduction in the administration expenses will lead to lower levels of future surplus.

## Conclusion

The Trust's assets are sufficient to cover 114.1% of the liabilities at the valuation date on the basis of the best estimate assumptions adopted.

The Trust's investment strategy should be kept under regular review.

**Material Changes**

I am not aware of any further changes that will have materially altered the results of this report at the date of signing.

**Date of Next Review**

The next formal valuation should be carried out as at 30 June 2024.

David Downie BSc FIA
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6 October 2023

**46 – 50 Castle Street**
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## Appendix 1 -Valuation Method

**Valuation Method - General**

The approach adopted for the valuation consists of projecting future cashflows of expected payments from the Trust and then discounting back these cashflows to produce a total net present value liability.

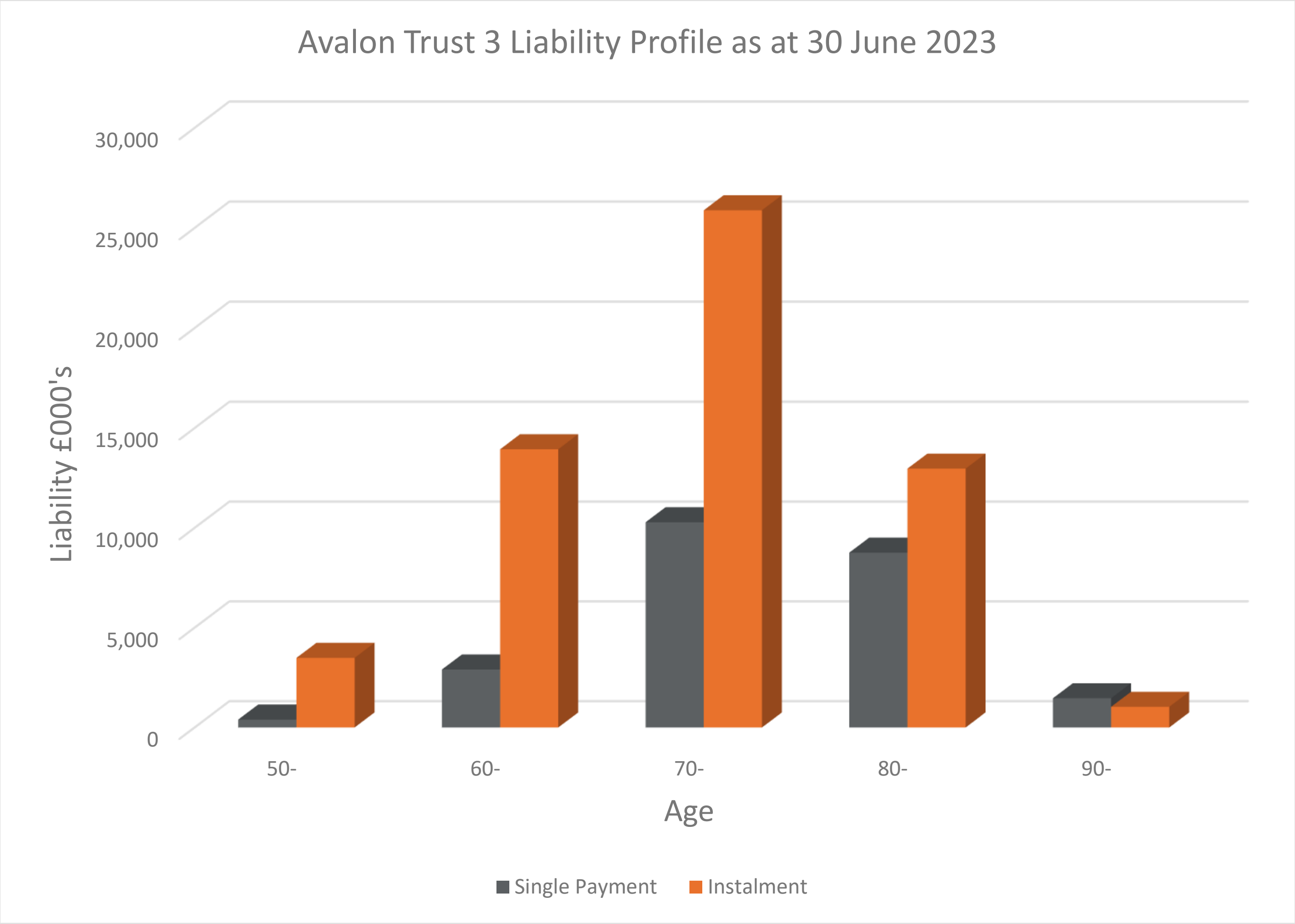
**Valuation Method - Liabilities**

For the purposes of my calculations I have adopted a cashflow funding method to determine the value of the future expected funeral costs. This method involves projecting the funeral plan payments into the future until the assumed life expectancy of the plan holder. Allowance is also made of the possibility of the cancellation of the plans (where applicable) and the projection will allow for future increases on the funeral payments in line with the assumed rate of inflation. The funeral plan payments consist of both the Funeral Directors Fees and the Disbursement Costs. The individual projected expected funeral payments are then discounted back at the net of tax discount rate to the valuation date and then added together to give the total liability. The liability is then compared with the actuarially valued assets of the Trust to determine the level of any shortfall or surplus arising.

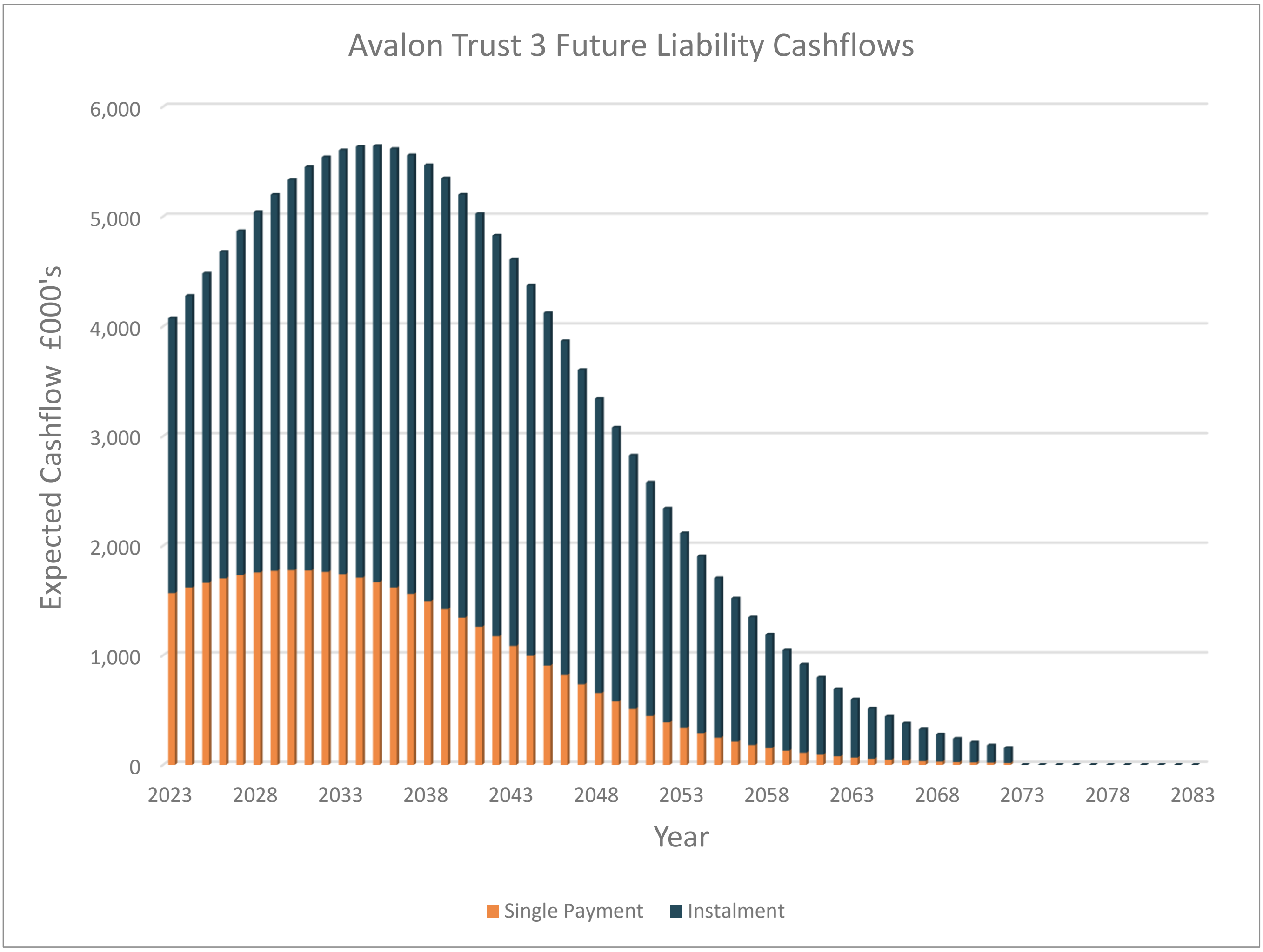
**Valuation Method - Assets**

For the purposes of this valuation the assets have been taken into account at their market value as shown in the Trust accounts.  In addition, the discounted value of the future outstanding instalment payments (after allowing for both mortality and cancellation rates) is included as an asset value as these are needed to meet the future funeral costs.

## Appendix 2 - Liability Profile



## Appendix 3 - Cashflow Profile



## Appendix 4 - Funding Position - Sensitivity Analysis

There is a requirement for enough information to be provided to the Trustees to demonstrate the sensitivity of the current financial position and development of the financial position of the Trust to risks arising from difference between the nature, term and characteristics of the liability cashflows and the assets of the Trust and any other material risks.

I have set out below details to demonstrate the sensitivity of the Best Estimate valuation of the Trust. It should be noted that the impact of the changes on the liabilities are considered in isolation. Changing more than one assumption at a time may not be equivalent to summing the changes below.

**Net Discount Rate**

The best estimate funding position above incorporates a net discount rate of 2.39% p.a. (after inflation and tax). Allowing for a change in the net discount rate by 0.5% p.a. will provide the following results:-

| | **Reducing by 0.5% p.a. £000's** | **Increasing by 0.5% p.a. £000's** |
|---|---|---|
| Value of Fund Assets | 96,914 | 96,060 |
| Less Value of Liabilities | (89,141) | (80,426) |
| **Surplus** | **7,774** | **15,634** |
| **Funding Level** | **108.7%** | **119.4%** |

The above change in discount rate can reflect either a change in the future expected investment return on the Trust assets, a change in tax treatment of the Trust or a change in future expected inflation - each change being considered in isolation.

**Mortality Sensitivity**

The ongoing funding position above allows for mortality as measured by 100% of ELT 17. If allowance is made for the mortality adjustment to alter by +/- 20% will adjust the funding level by -2.7%/+3.4%.

**High Inflation combined with increased longevity**

However, if we were to combine an increase in future expected inflation by 0.75% p.a. with a 20% reduction in mortality then the net result will be a fall in the funding level to 107.9%.

**Pandemic**

The Trustees should be aware of the risk associated with any future pandemic and the effect it could potentially have on the financial position of the Trust. I have therefore considered a scenario whereby 25% of all plans become enacted and the cost of associated funeral plans are paid out immediately.

I have assumed that the claims will be spread evenly across all plans. The liability of the Trust will therefore fall by 25% but when added to the value of the potential claim payments the total liability becomes £90,836,000. This leads to a funding level of 97.8% at the review date.

**Stress Testing – Inflation**

If we assume future funeral inflation is 4.20% p.a. (compared to 2.95% p.a. in the best estimate assumptions) then the solvency of the trust fails at being just under 100%. Even though recent inflation rates have been higher than this, the long term aim of the Government's policy of targeting inflation at 2% p.a. suggests that this risk is currently at a low probability.