CIPFA Pensions Network

CFO Actuarial Briefing

Alison Murray

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Initial 2013 Valuation Results

Headlines

- Slight improvement in funding levels
- Future service cost broadly unchanged (despite new Scheme)
- Little/no change to aggregate employer contributions

Caveats

- Whole fund only
- Subset of funds we advise
- Assumptions / funding strategy not finalised

Looking beyond the headlines

Changes to assumptions

- Allowing for better information / anticipating behavioural changes
  – RPI-CPI differences
  – retirement patterns
  – increased allowance for longevity improvements
  – other demographic assumptions reviewed in light of recent Fund-specific experience

Strategy considerations

- Review level of funding risk
- Consider deficit recovery period
- Balancing risk/prudence with affordability constraints
- Employer-appropriate approach

Membership experience

Generally very positive (in funding terms!)

- Pay growth less than assumed

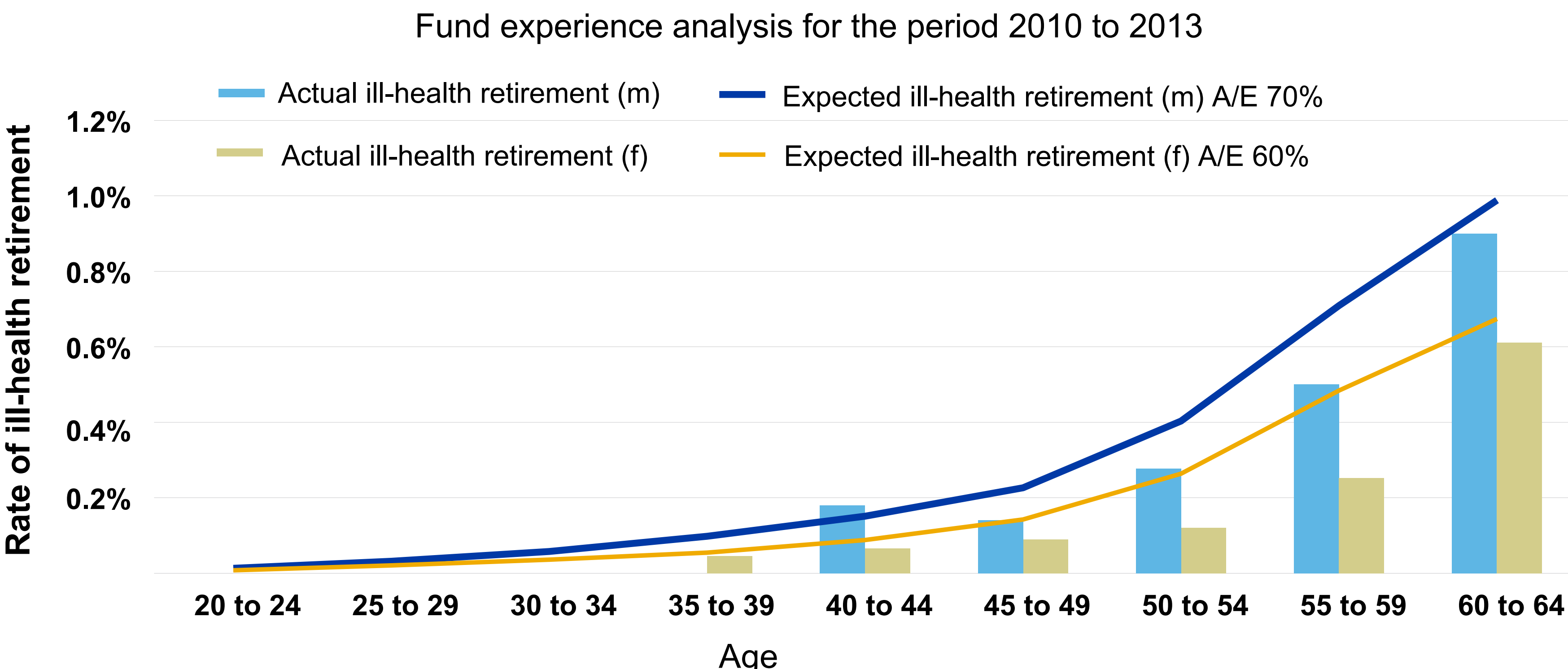
Percentage annual increase in Public Sector Median Gross Annual Earnings and CPI

Source: Patterns of Pay: Results from the Annual Survey of Hours and Earnings, 1997 to 2012, Aon Hewitt

Membership experience

Generally very positive

- Pay growth less than assumed
- Fewer ill-health early retirements than expected



Source: Sample Aon Hewitt client

Partially offset by faster assumed longevity improvement rates

Managing deficits

- Remit of Cost management sub-committee of the Shadow LGPS Scheme Advisory Board includes:

  To review, monitor and make recommendations to the Board regarding the effective management of deficits in local government pension funds

- Call for Evidence - high level objectives of structural reform

  1. *Dealing with deficits*
  2. *Improving investment returns*

Private Sector – the Pension Regulator's Guidance

any shortfall should be eliminated as quickly as the employer can reasonably afford

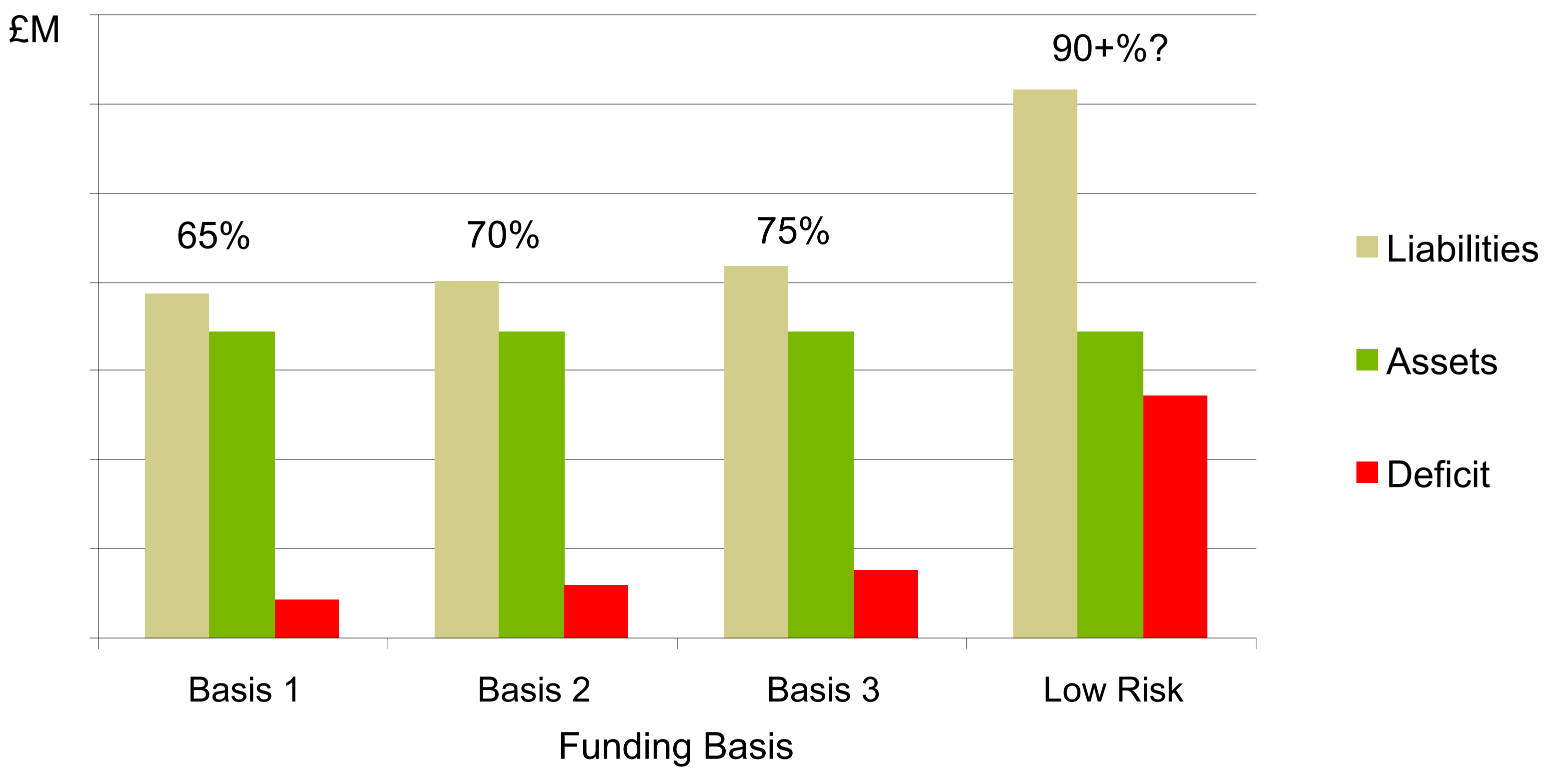
Matters to take into account when preparing a recovery plan

- effect of potential recovery plan on employer's future viability
- the scheme's membership profile
- the ability of employer to make good a deficiency in the event of a scheme wind-up
- the employer's expenditure commitments
- the value of any contingent security provided by the employer
- the likely benefits available to members on employer insolvency
- any impending member movements which would have a potentially significant effect on funding, e.g. major retirements or bulk transfers (in or out)
- the level and nature of any employer-related investment
- the effect of assumptions underlying the recovery plan not being borne out by experience

Source: Regulatory Code of practice 03 (Funding defined benefits)

Measuring the deficit

- Which of these figures is right?

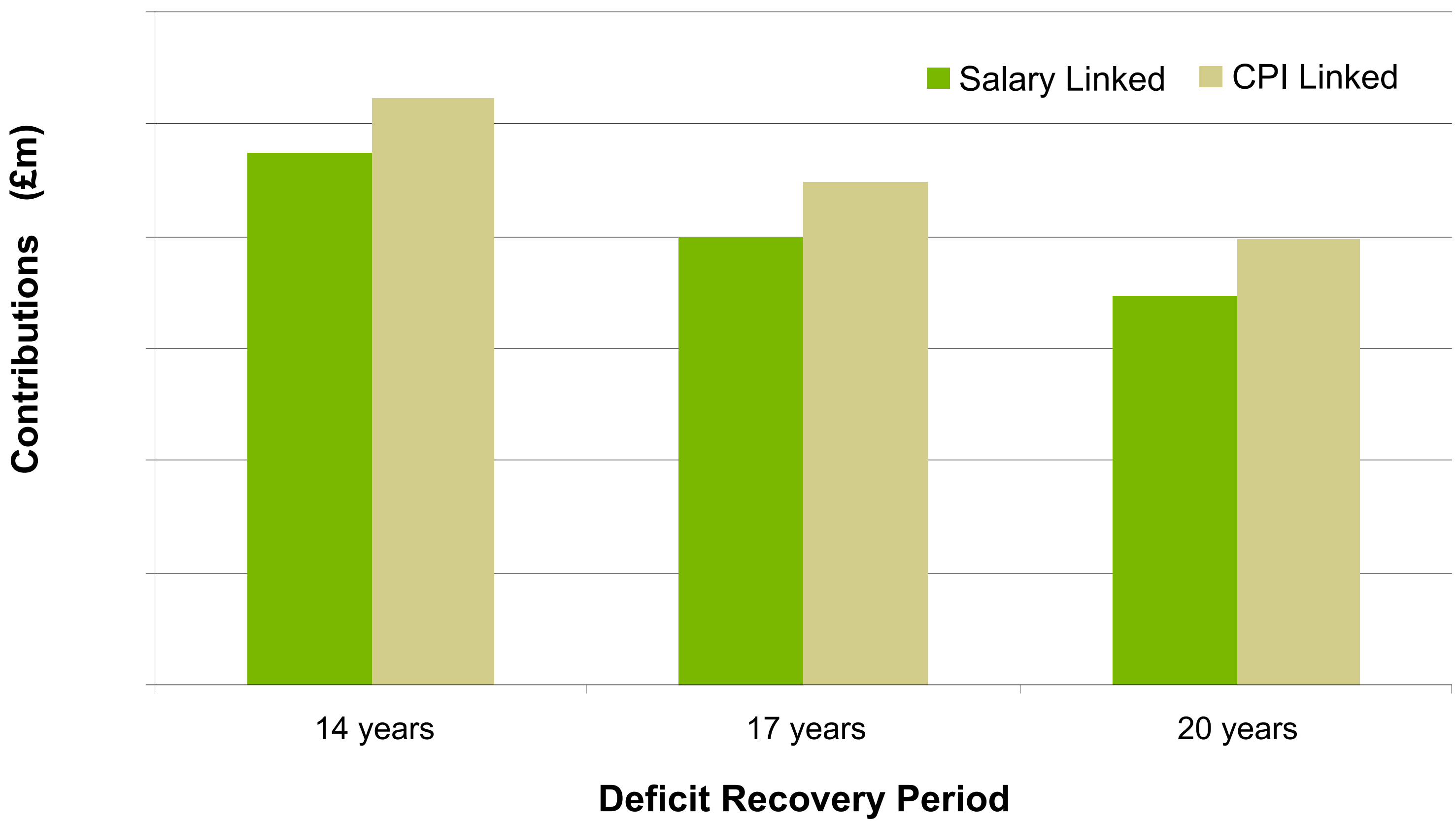


Source: Aon Hewitt, illustrative based on initial results for a sample client

Depends upon the level of risk you want to take

Managing the deficit

- Deficit contributions depends upon recovery period



Source: Aon Hewitt, illustrative based on net discount rate of 1.5% p.a. (salary-linked) and 3% p.a. (CPI-linked)

What is NOT managing the deficit

- Increasing the level of risk to “make the deficit go away”
- Continually increasing the deficit recovery period
- Paying less than the interest on the deficit
- Ignoring expected future changes to membership profile

Applies at whole fund level but equally to employers

In conclusion

- Greater scrutiny of LGPS funding plans is on its way

Administering Authorities should

- focus on balancing affordability/stability and prudence/level of risk
- have an audit trail justifying their approach
- consider reducing risk / shorten recovery plans if achievable
- be wary of contribution reductions and/or increasing risk in funding strategy