HYMANS ROBERTSON
The Spirit of Independence

CIPFA Pensions Network
CFO Actuarial Briefing

2013 Valuation and Employer Risk

- Douglas Green FFA

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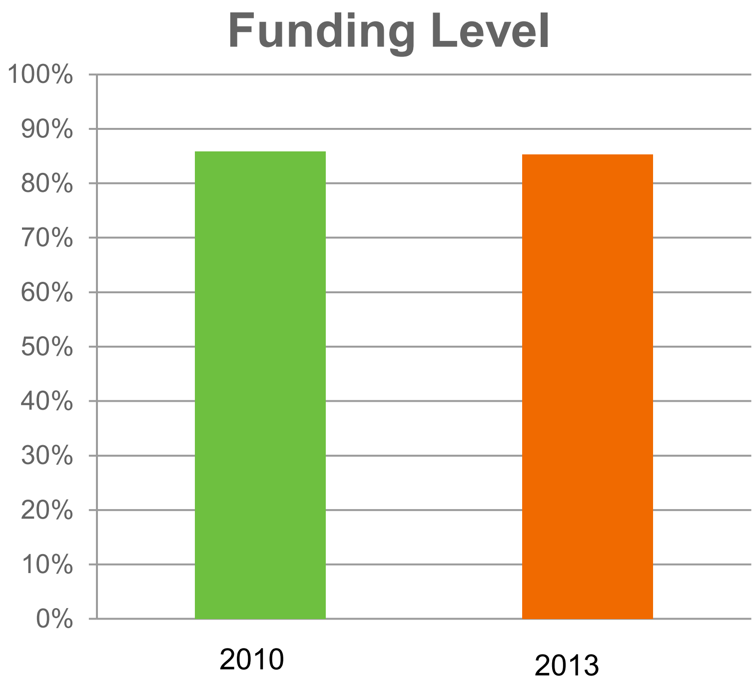
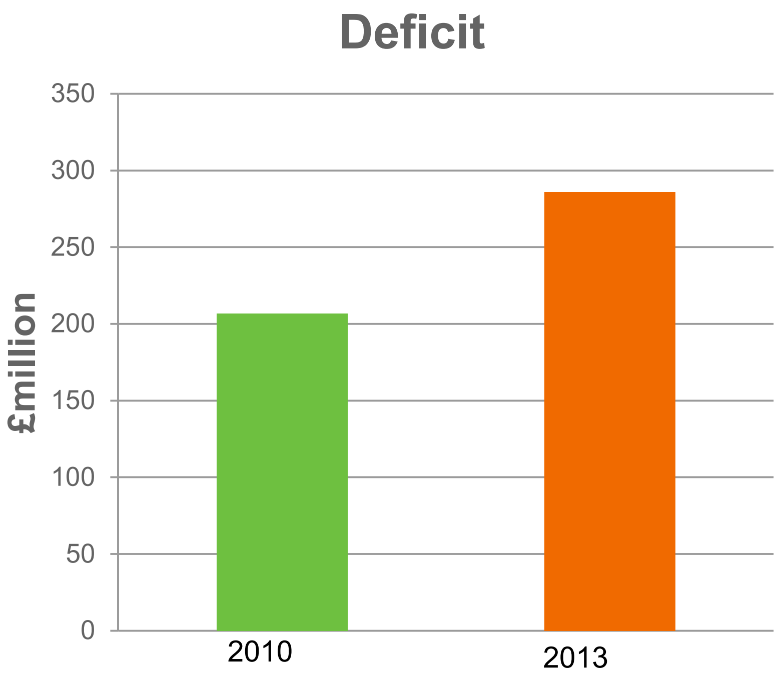
2013 Valuation results

What's happened since 2010?

1. Funding levels are broadly unchanged
2. Deficits have increased
3. Employers will have to pay more

Stable funding levels, growing deficits



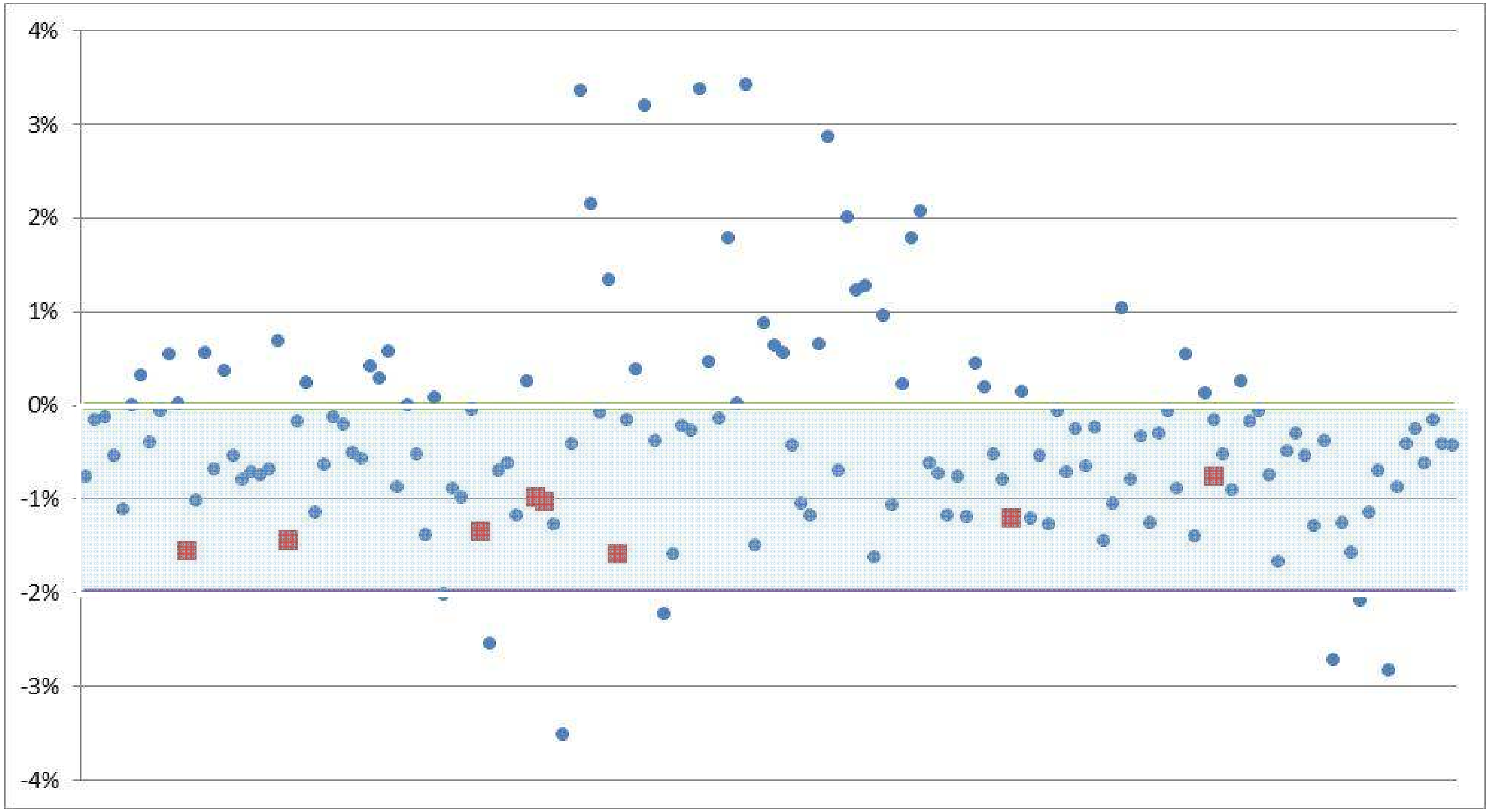


Why has the deficit increased?

Key driver	Deficit	Contribution rate
Market conditions	↑	↑
Investment returns	↓	↓
Life expectancy	↑	↑
Member experience	↓	↓
New LGPS 2014	↔	↓
Overall Impact	↑	↑

But we have tools to manage contribution rate increases

LGPS 2014 has unintended consequences



Effect of new scheme between 0% and 2% of pay for most but not all

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Employer issues

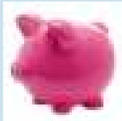
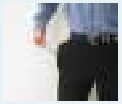
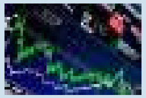
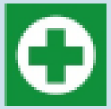
Employers and managing risk

1. Differences between employers
2. What risks do employers face
3. What employers can do to avoid them

Employers are different

	Main Councils	Closed charities
		
Member-ship profile	Mixed	Mature, mainly deferreds and pensioners
Time horizon	20 years	5 to 15 years
Funding Level	Medium to well funded, but variable	Wide variation
Cashflow	Contributions more than benefits	Contributions nearly equal to or possibly less than benefits
Covenant strength	Strong	Medium to weak
Size	Large	Small to medium

What are the risks?

The Risk		Consequence
Insufficient contributions		Deficit gets bigger
Affordability		Employers leaving the fund and cessations
Inappropriate investment strategy		Potential difficulty recovering deficit in time horizon if fall in assets or loss of surplus
Pay growth		Increased cost to provide benefits
Ill health retirement		Potentially very large financial impact and the strain may fall back to the fund
Outsourcings		Less security with a smaller membership and impact on maturity

Can we do anything about it?

Asset return matches interest on liabilities

A= £70 +£14 c20% +£6 → A = £90

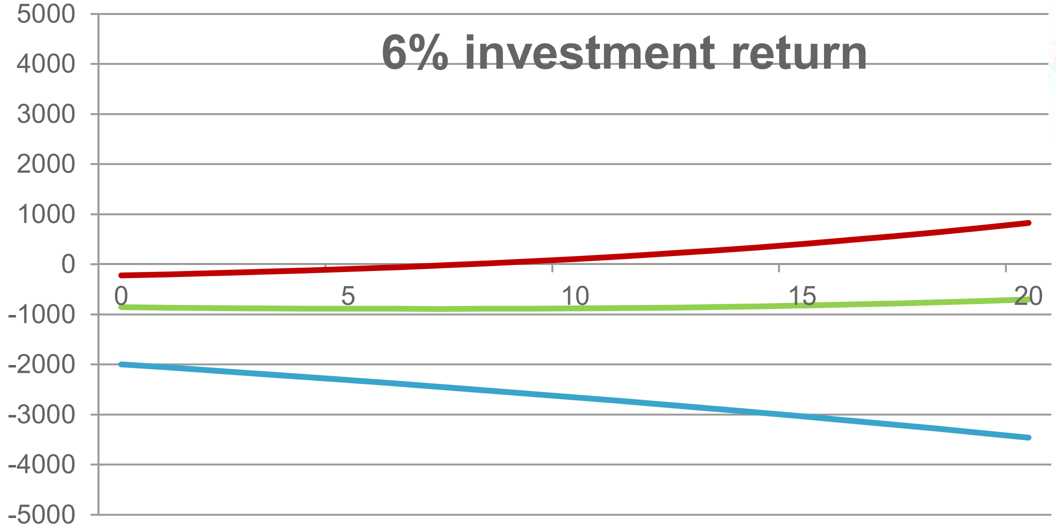
ASSETS AT 2010	INVEST. RETURN	NEW CASH FLOW

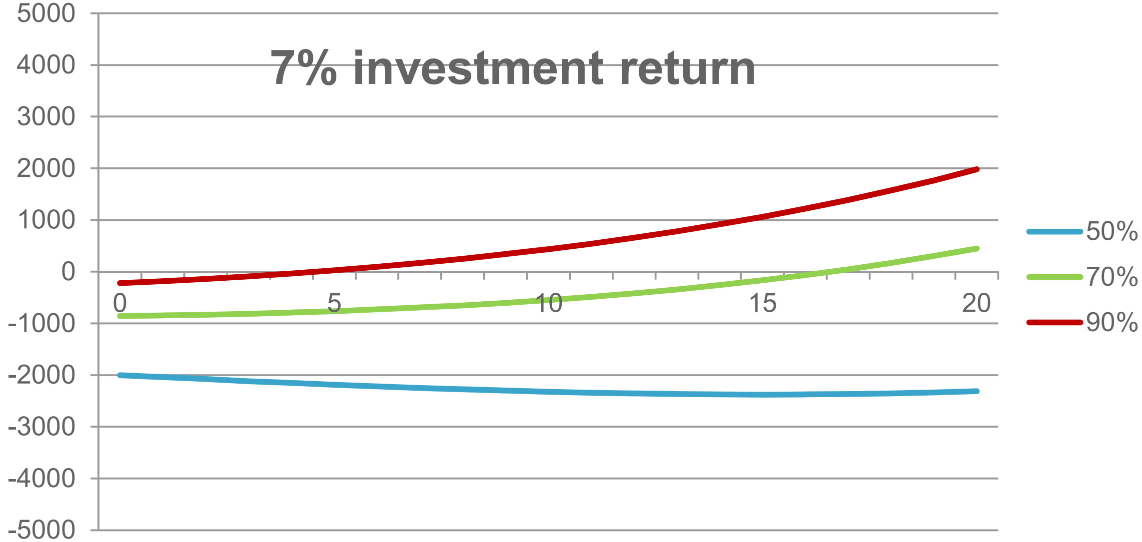
L= £100 +£20 c20% +£5 → L = £125

LIABILITIES AT 2010	INTEREST ON LIABS	NET NEW LIABS

But deficit has grown from £30 to £35

Can we delay?





Beware of the tipping point

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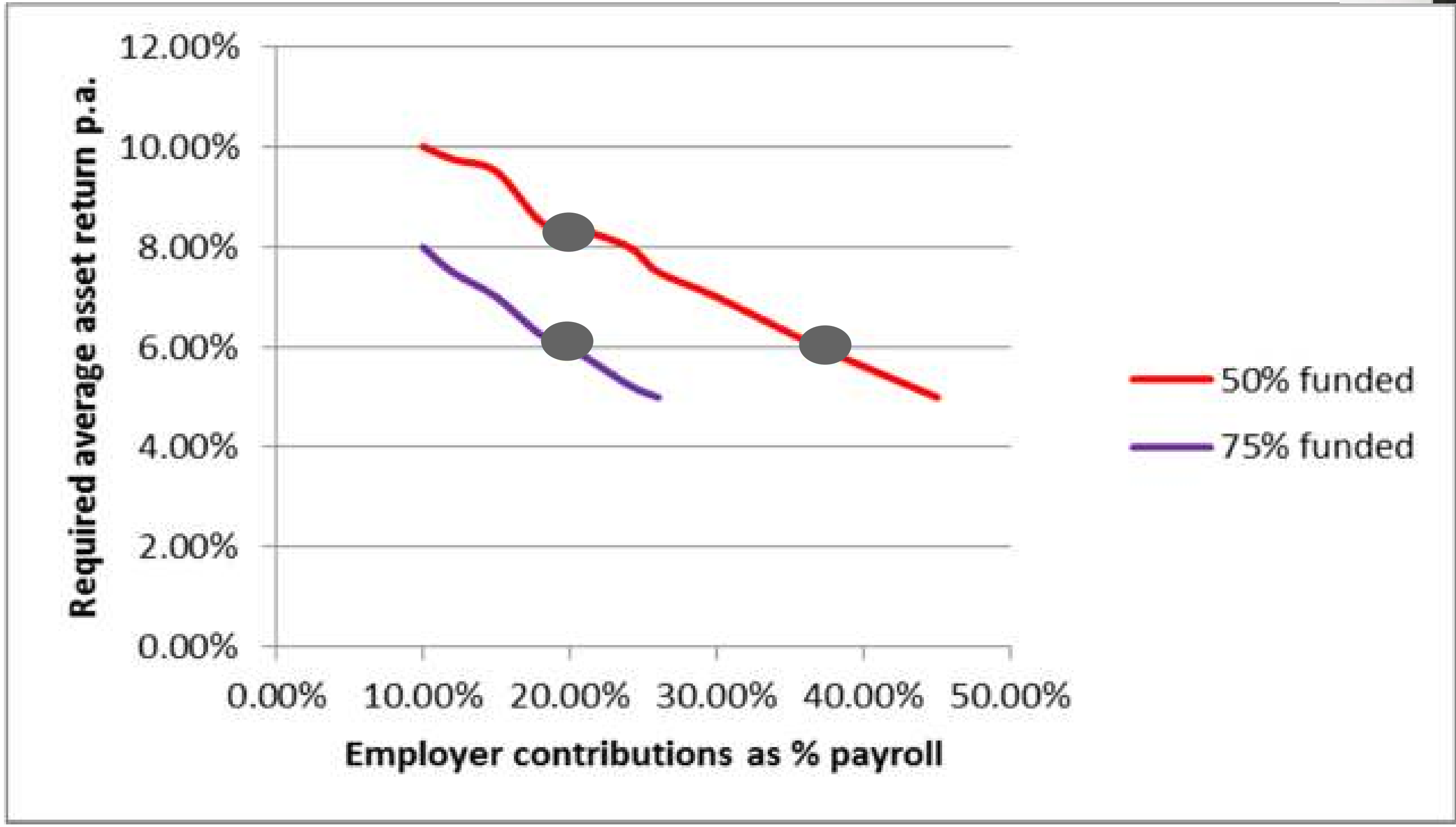
Required return to match interest on liabilities is greater when funding level low

Required investment return to match interest on liabilities				
Discount rate	**5%**	**6%**	**7%**	**8%**
FL = 100%	5%	6%	7%	8%
FL = 75%	7%	8%	9%	11%
FL = 50%	10%	12%	14%	16%

Is required annual return achievable indefinitely?

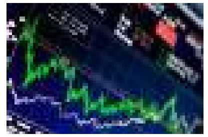
What does it take to repair deficits?



Balance contributions & (required) asset returns

FIGURES ILLUSTRATIVE

Investment strategy, one size doesn't fit all



- 2 fund approach
- Maintain freedom
- Better match
- Accountability
- Governance

The impact of pay increases

<u>Before Salary Award</u>

Salary of £40,000

Pension at retirement of £10,000

Cost of pension is £200,000

Service of 15 years

<u>After 10% Salary Award</u>

Salary of £44,000

Pension at retirement of £11,000

Cost of pension is £220,000

Increase in costs of £20,000!

Maintaining a healthy balance sheet

- 58 years old
- Salary of £26,276
- Works for a town council

- Strain of £73,229
- 77% of the employer's payroll

Solution? Internal pooling or Insurance

Outsourcing - a main council to a contract

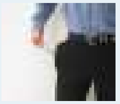
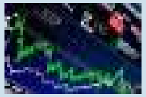
Increased contributions

Terms of transfer

Does the employer understand the risks?

Payment at end of contract

Some risks can be avoided

The Risk		Is there a solution?
Insufficient contributions		✓
Affordability		?
Inappropriate investment strategy		✓
Pay growth		?
Ill health retirement		✓
Outsourcings		✓

Thank you

Any questions?