The CIPFA LGPS Actuarial Summit

Managing your deficit

- Barry McKay FFA
- 14 January 2014

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Take home messages

Funding levels the same, deficits increasing

but …………..

- Keeping contributions affordable
- Demographics of funds are changing
- Growing need for bespoke investment strategies

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Keeping contributions affordable

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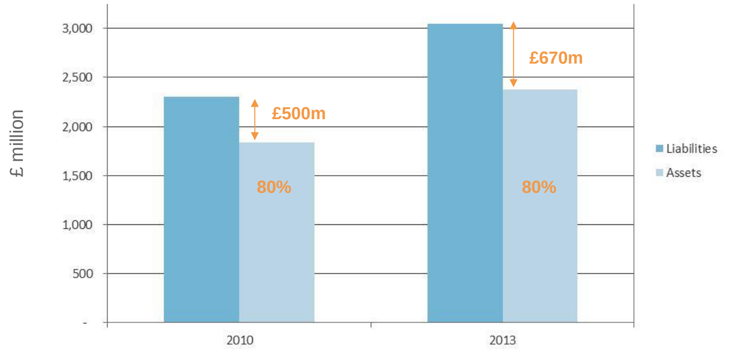
Funding levels similar …

2010 2013



….but deficits have grown

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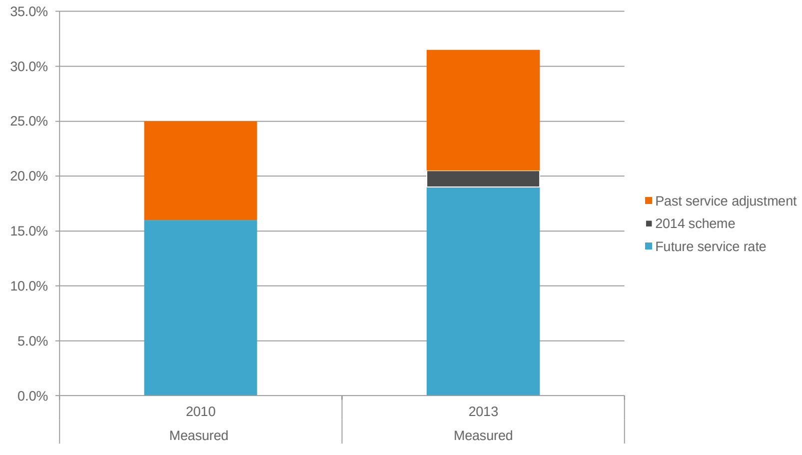
Impact on contribution rates



New scheme has little impact

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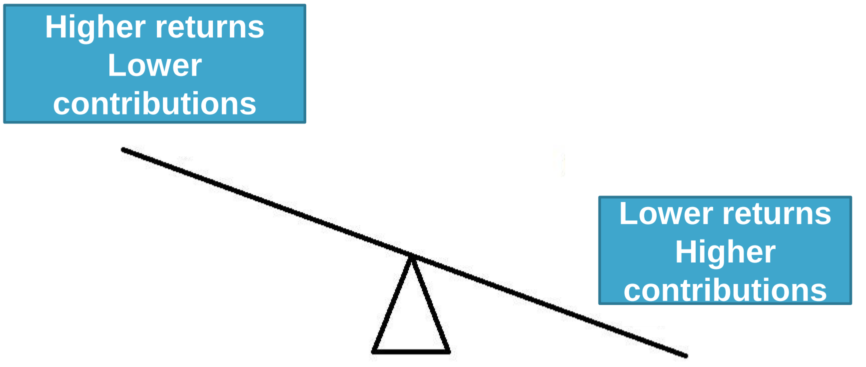
Filling the gap



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Required returns!

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?

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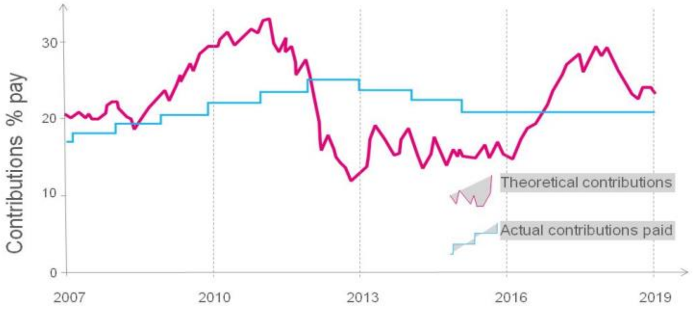
What does it take to repair deficits?

Typical fund (FL of 75%)		
Required return	5%	7%
Required contributions	26%	15%

Managing deficit contributions

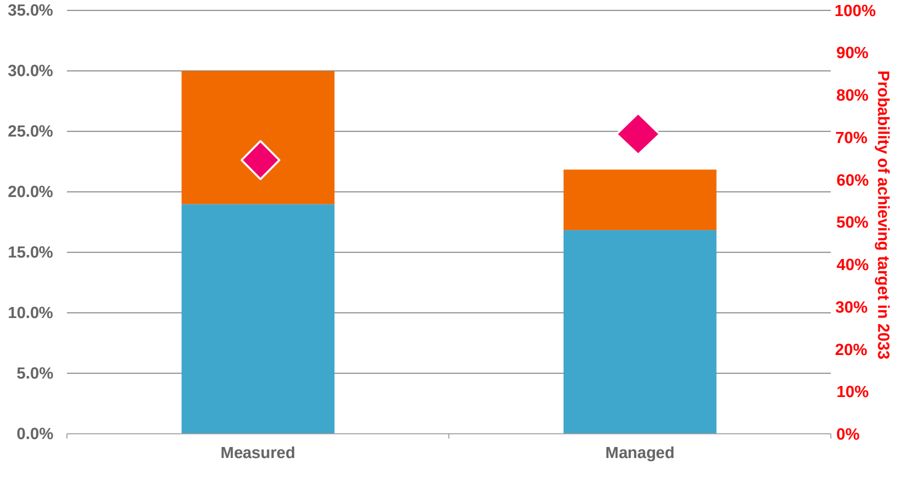
- Limit increases and future decreases (e.g. +1 and -1% p.a.) without harming expected long term funding level
- Underpay in bad times, overpay in more favourable conditions



More affordable contributions, greater budgeting certainty

Note: Figures are illustrative only and do not represent valuation results

Managed contribution rate



Credibility of funding plans: key questions

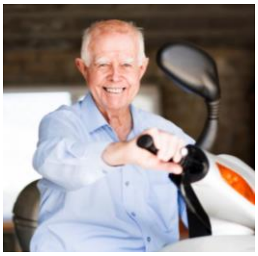
- Is your assumed investment return realistic?
- What if interest rates don't rise?
- Are your cash contributions sufficient?
- Combinations of low funding level and low contributions?

How likely is it that your funding strategy will work?

Changing demographics

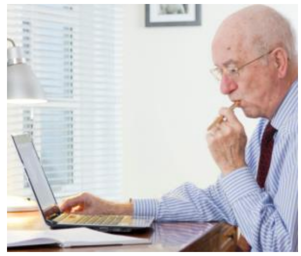
Changing demographics

People living longer



More part-time workers

Employees retiring later



Fall in active membership

Redundancy exercise

Increasing maturity

Maturity and why it matters

Council	Before outsourcing	After outsourcing
Deficit (say 20 yrs spread)	£200m	£200m
Payroll	£250m	£125m
Total liabilities	£1,000m	£1,000m
Gearing (Liabs / Payroll)	4x	8x
Deficit repair payments	£10m pa (**4%** of pay)	£10m pa (**8%** of pay)

Deficit repair contributions higher for mature employers

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Signs of increasing maturity

	2010	2013	Change
Cashflow			
Contributions (£)	+115m	+100m	-13%
Pensions (£)	-75m	-90m	+20%
Net cashflow (£)	+40m	+10m	-75%
Net cashflow (% of assets)	+2%	+0.5%	-75%

Cashflow deteriorating

Illustrative. Assets 774m in 2010; 1006m in 2013.

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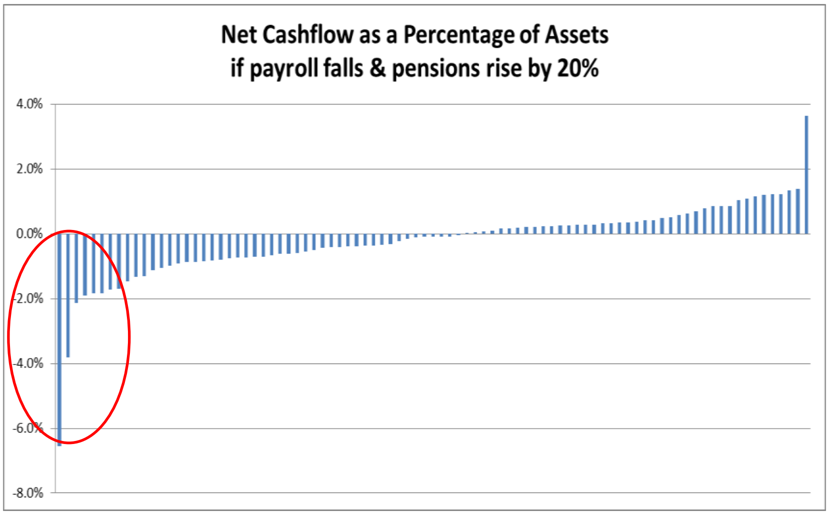
Cashflow – does it matter?



*Figures relate to all English & Welsh LGPS Funds, **estimated** values based on 31 March 2010 published valuation data

Increasing maturity: key points

- % pay contributions higher
- Most funds have enough “available” income
- But may have less income to reinvest
- Implications for investment strategy

Less from investment returns, more reliance on contributions to repair deficits

Bespoke investment strategy

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Keep it simple

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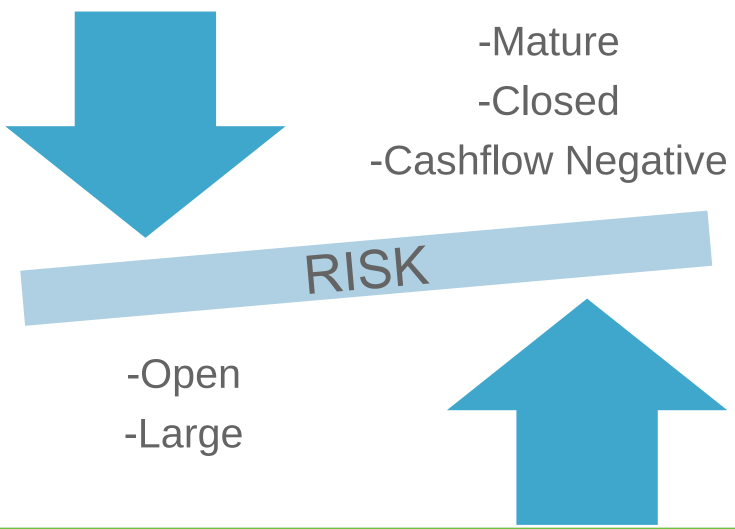
Investment



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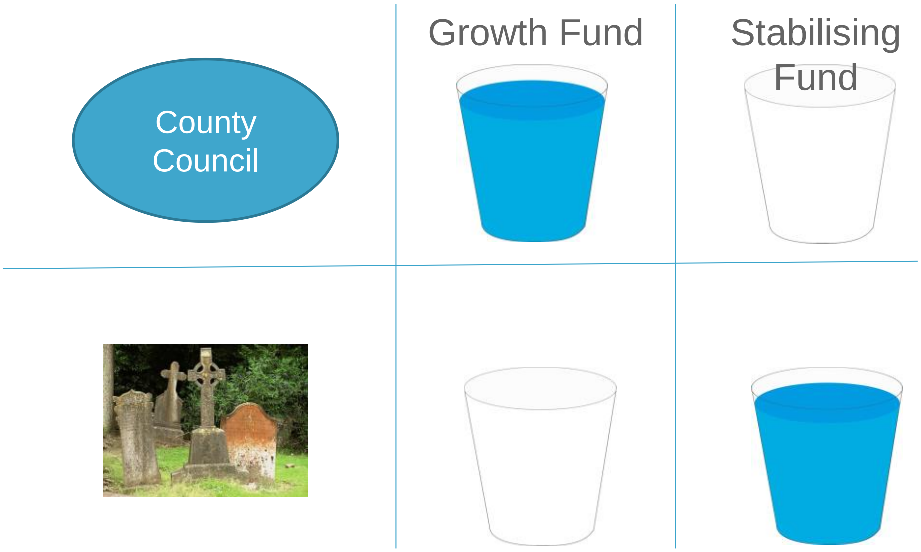
How does it work?



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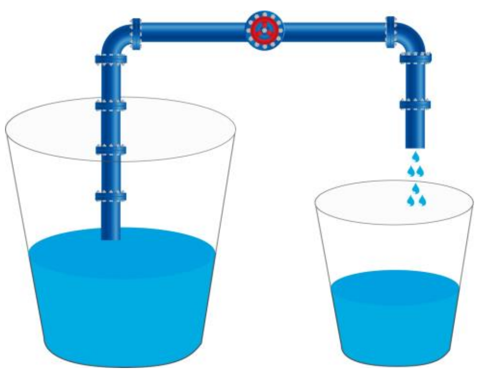
How does it work?

Growth Fund

Stabilising Fund



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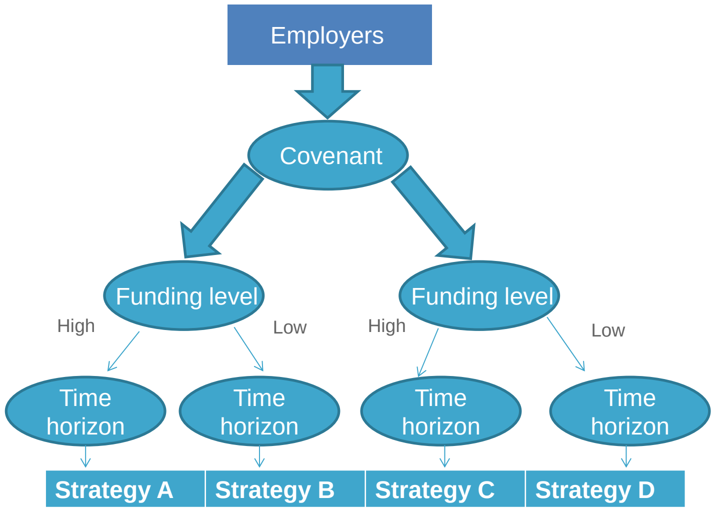
2013 – Putting it into practice



Transparent policies, tailored approach

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For 2013-16 consider

- Plan for reducing risk when affordable
- Multi-employer investment strategies
- Unitisation (asset tracking for individual employers)
- Regular review of opportunities

Governance to enable action

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Take home messages

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but …………..

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One size fits all increasingly untenable

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Thank you

Any questions?