London Borough of Harrow Pension Fund

2016 Valuation: Funding strategy considerations

- Gemma Sefton

- 9 March 2016

What are we going to cover?

- Actuarial valuation basics
- Valuing the Fund
- Recap of 2013 valuation funding strategy
- Developments for 2016 valuation

Intro to the valuation

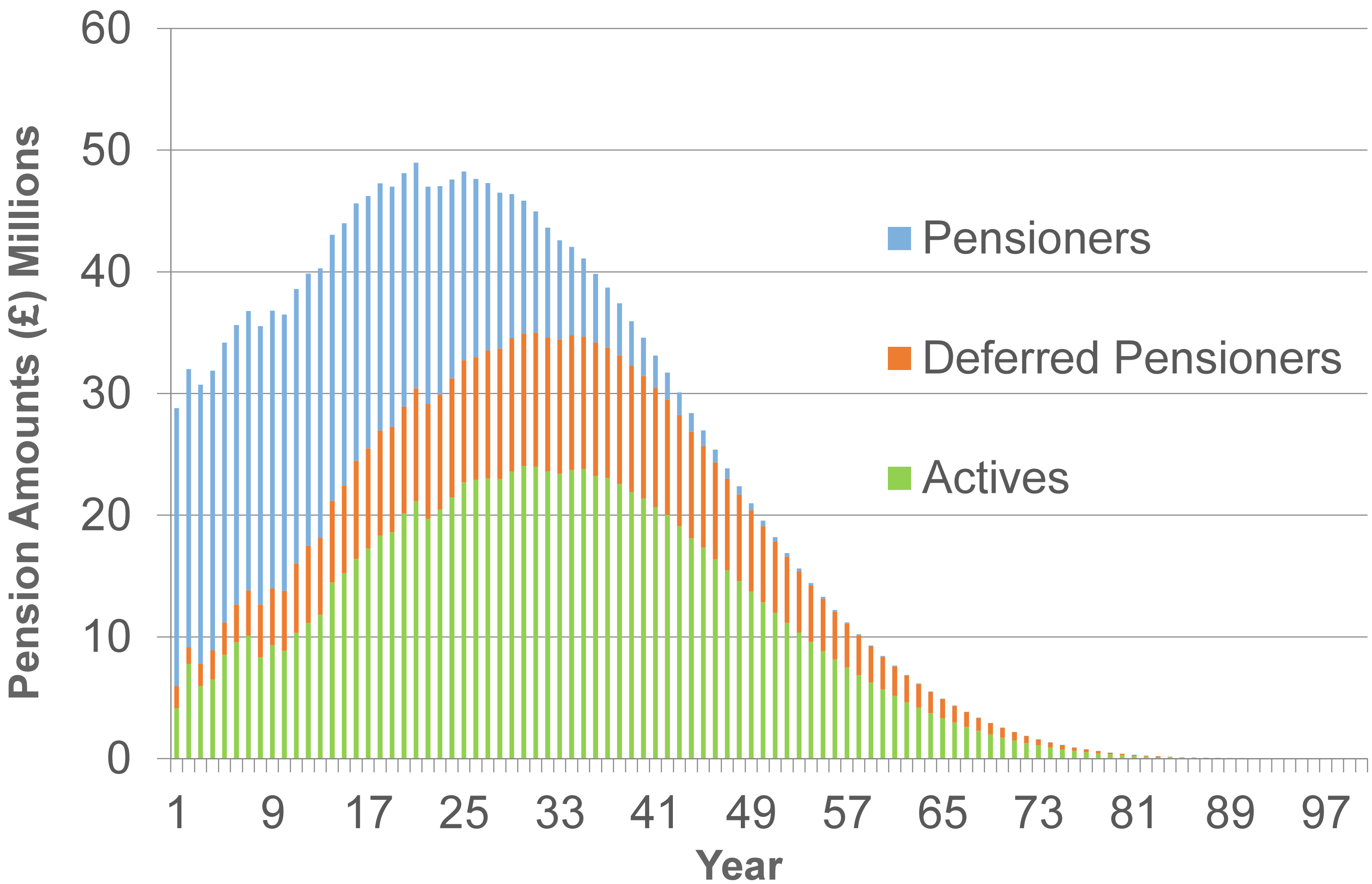
Why do we do a valuation?

- Compliance with legislation
- Set employer contribution rates
- Determine money needed to meet accrued liabilities
- Calculate solvency (“funding level”)
- Monitor experience vs. assumptions
- Manage risks to Fund and employers

Review the Funding Strategy Statement (FSS)

The Fund's ultimate objective

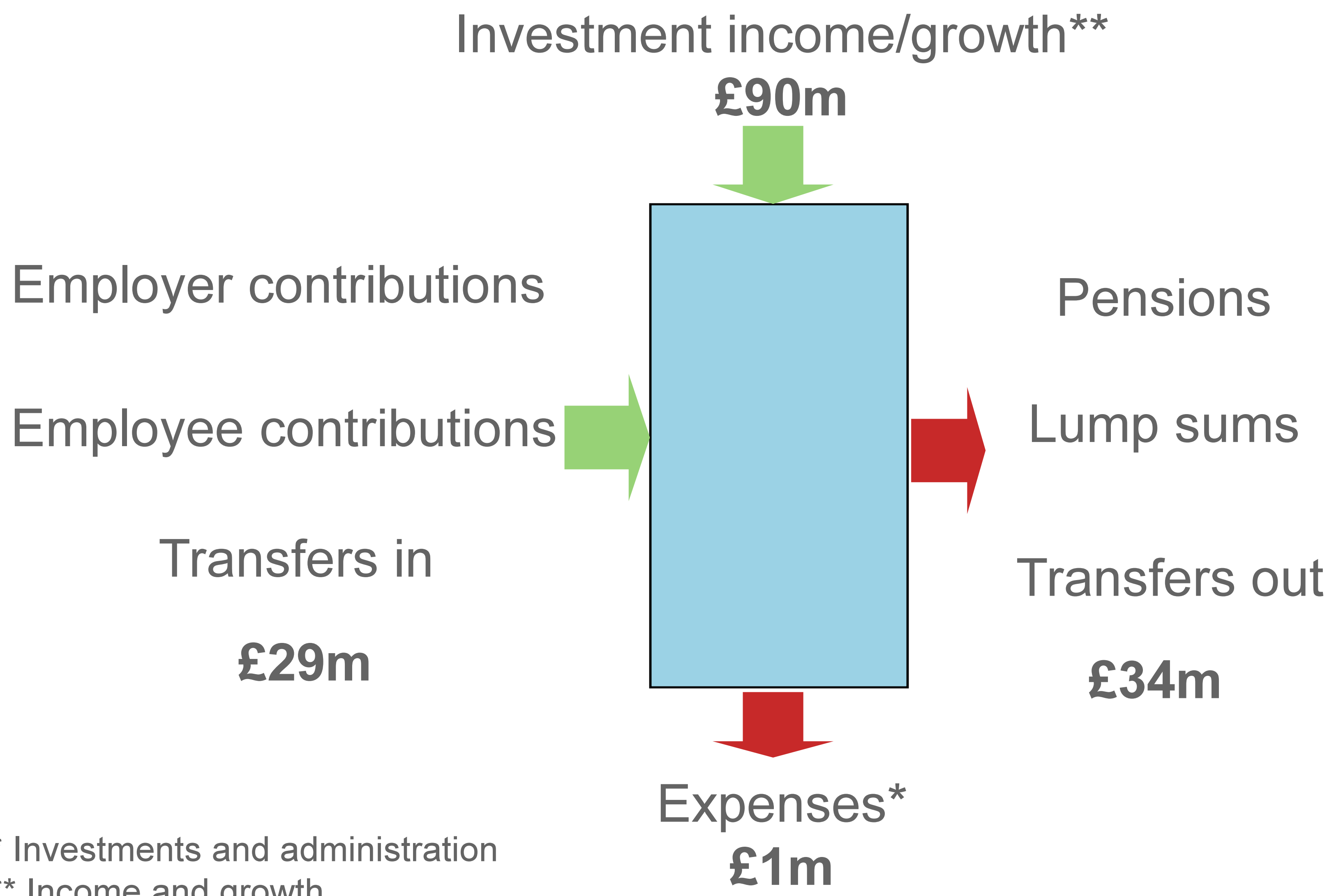
HYMANS ROBERTSON



Pay members' benefits

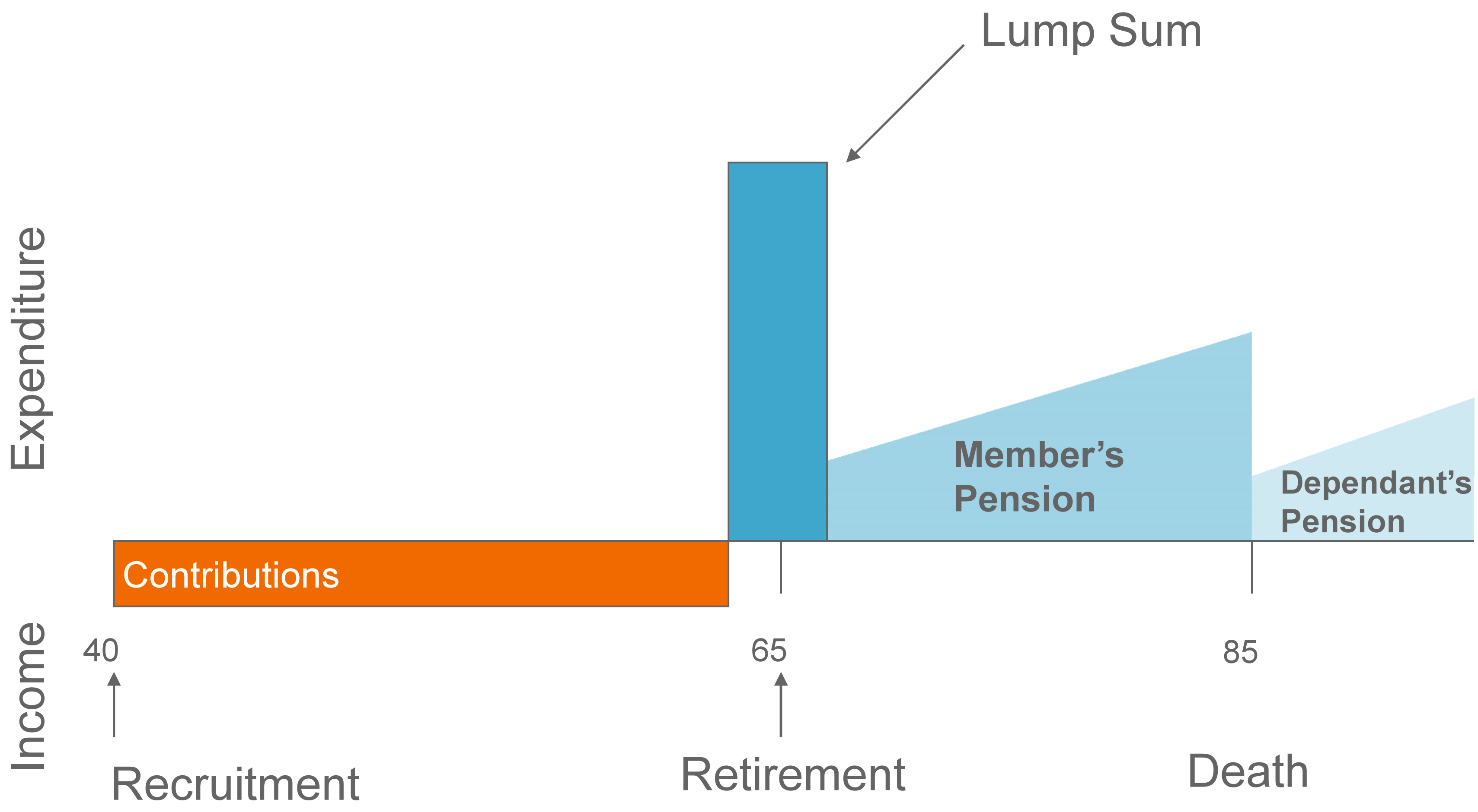
Source: London Borough of Harrow Pension Fund 2013 formal valuation cashflows

How the fund works



* Investments and administration
** Income and growth

Promise now, pay later: Long term pension promise in ever-changing environment



HYMANS ROBERTSON

Scheme benefits – the building blocks

- **Period of Scheme Membership**
  - Time in the LGPS
  - Transferred in
  - Bought by the member
  - Awarded by the employer
- **Accrual rates**
  - Pre-2008 1/80th
  - Post-2008 1/60th
  - Post-2014 1/49th
- **Final pay in last year**
  - Basic pay/salary
  - Extras – bonus, overtime, benefits in kind
- **Pay during each year**
  - Basic pay/salary
  - Extras – bonus, Overtime, benefits in kind

Overview of a valuation

- Actual cost of a Scheme will depend on the pensions actually paid
- A valuation is an estimate of how much money will be needed to pay the pensions
- Estimate is based on assumptions about
  - amounts of benefit payments
  - probability of benefits being paid

The actuarial valuation: interested parties

Pension Committee
formally decides on appropriate balance between prudent funding of Members' benefits and affordable contributions which are consistent across all Employers

Councils/Taxpayers
want employees' benefits suitably funded, with minimal impact on Council services, and minimal inter-generation cross-subsidies

Employers
wish affordable, stable contributions which pay for their employees' benefits and are consistent with other employers

Actuary carries out valuation

Local Pension Board
oversees process, assists Pension Committee where necessary

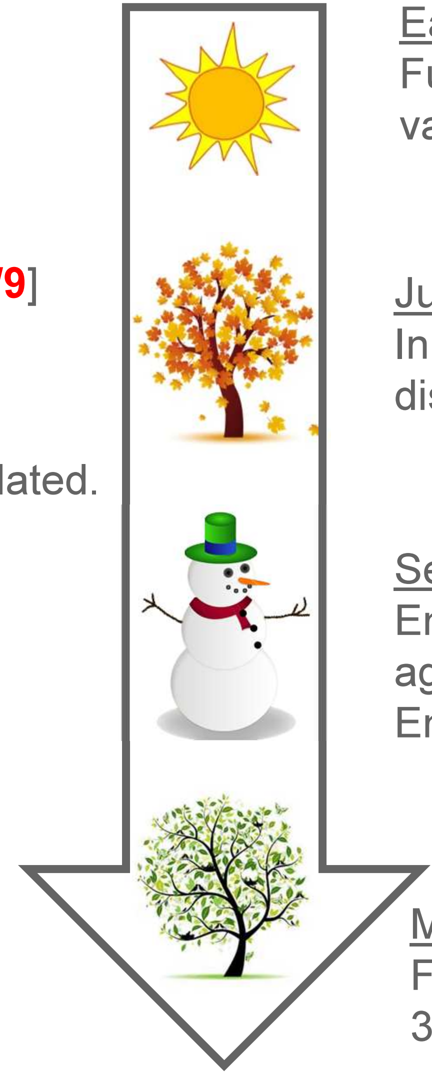
Officers
liaise closely with Actuary and other advisers, Pensions Committee, and Employers

Investment adviser
considers valuation projections relative to Fund's investment strategy

Fund members
must have their benefits paid in full. Want to see their Fund run well: look to Officers, Committee and Local Pension Board

HYMANS ROBERTSON

Valuation timeline



Early 2016
Funding strategy discussions and valuation planning.

May – July 2016
Data submitted and whole fund calculations processed.
[**Send draft results to National Scheme Advisory Board by 30/9**]

July 2016
Initial results and assumptions discussed and agreed with Fund.

August 2016
Individual employer results calculated.

September - December 2016
Employer results and funding strategies agreed in principle.
Employer forum and surgeries held.

February 2017
End of employer consultation.
Final employer results and FSS agreed.

March 2017
Final valuation report signed off by 31 March 2017.

Valuing the Fund

Liability valuation - assumptions

Amounts paid and probability of payment

Financial assumptions:

- Investment return
- Inflation
- Pay increases
- Pension increases

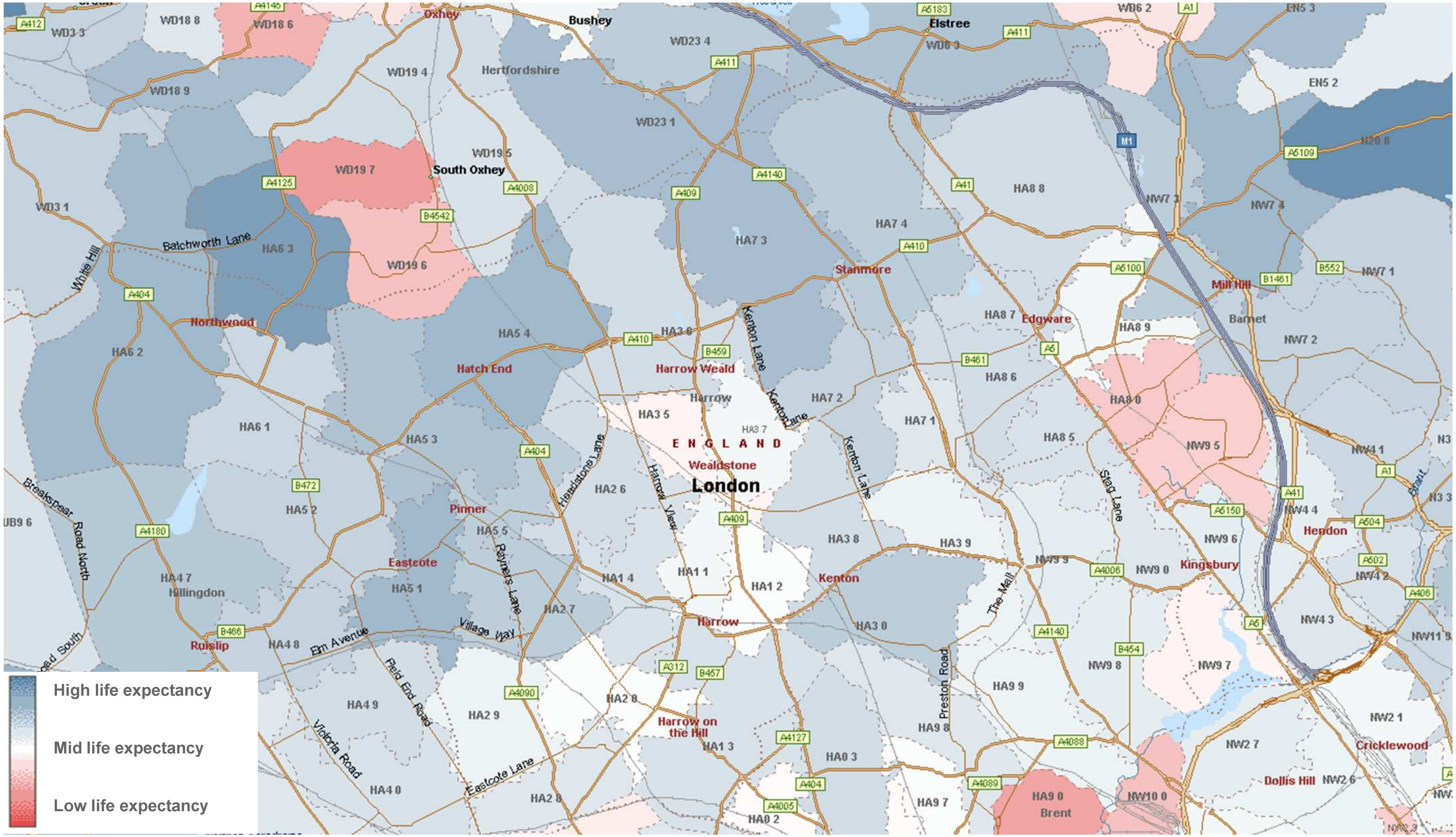
Consider:
Economic outlook
Actual scheme assets
Historical pay growth

Demographic assumptions:

- Life expectancy
- Retirement age and cause
- Withdrawals
- Marriage statistics

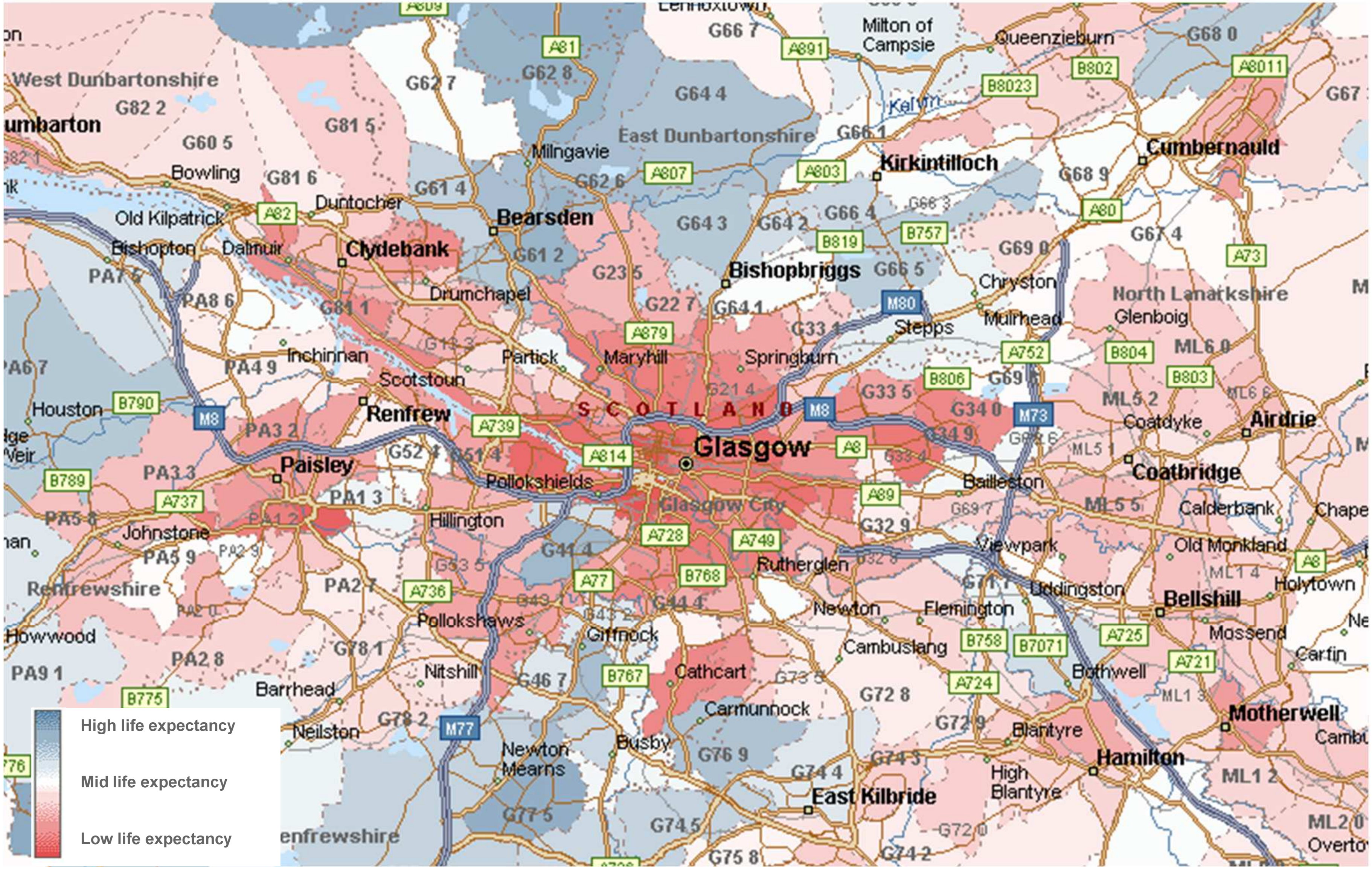
Consider:
Population trends
Members' social status
Past scheme experience

Granularity of Fund membership



Each Fund is different

HYMANS ROBERTSON



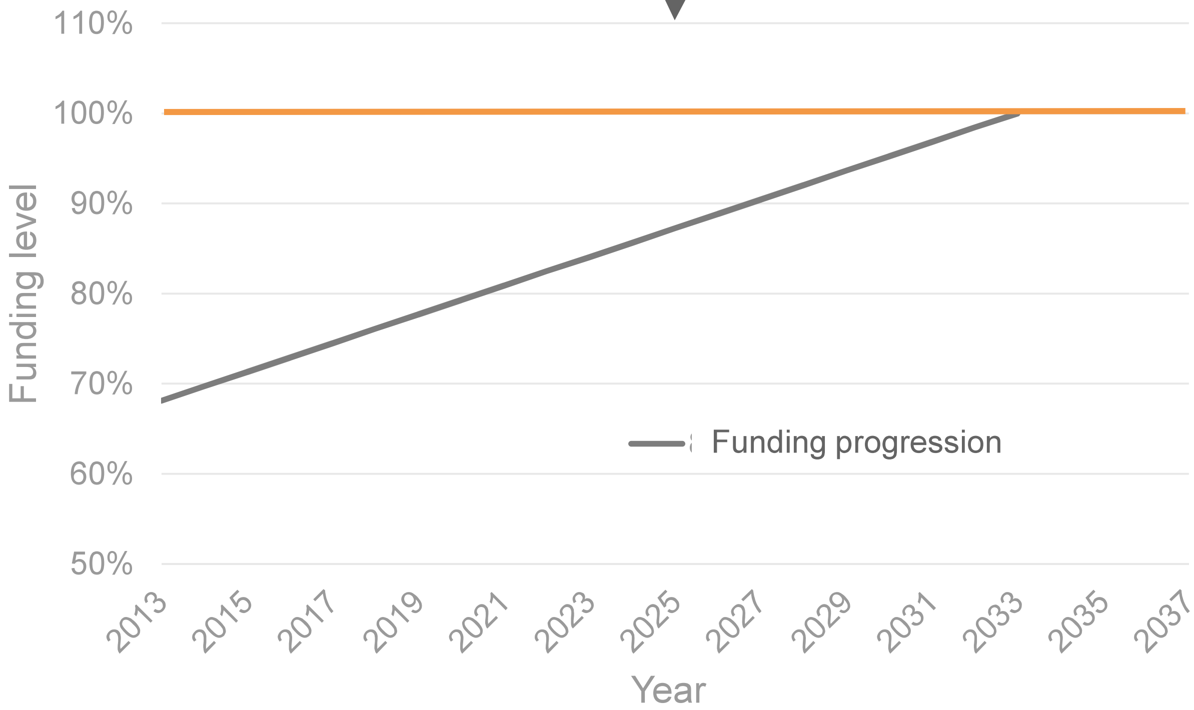
Source: Club Vita research based on VitaBank as at January 2012

HYMANS ROBERTSON

Traditionally: funding plans based on single expectation of the future

Actuary & Fund agree one set of assumptions

Actuary calculates contribution rates



Recap of 2013 approach

LB Harrow Pension Fund approach

Measurement and management of funding position

Measure:

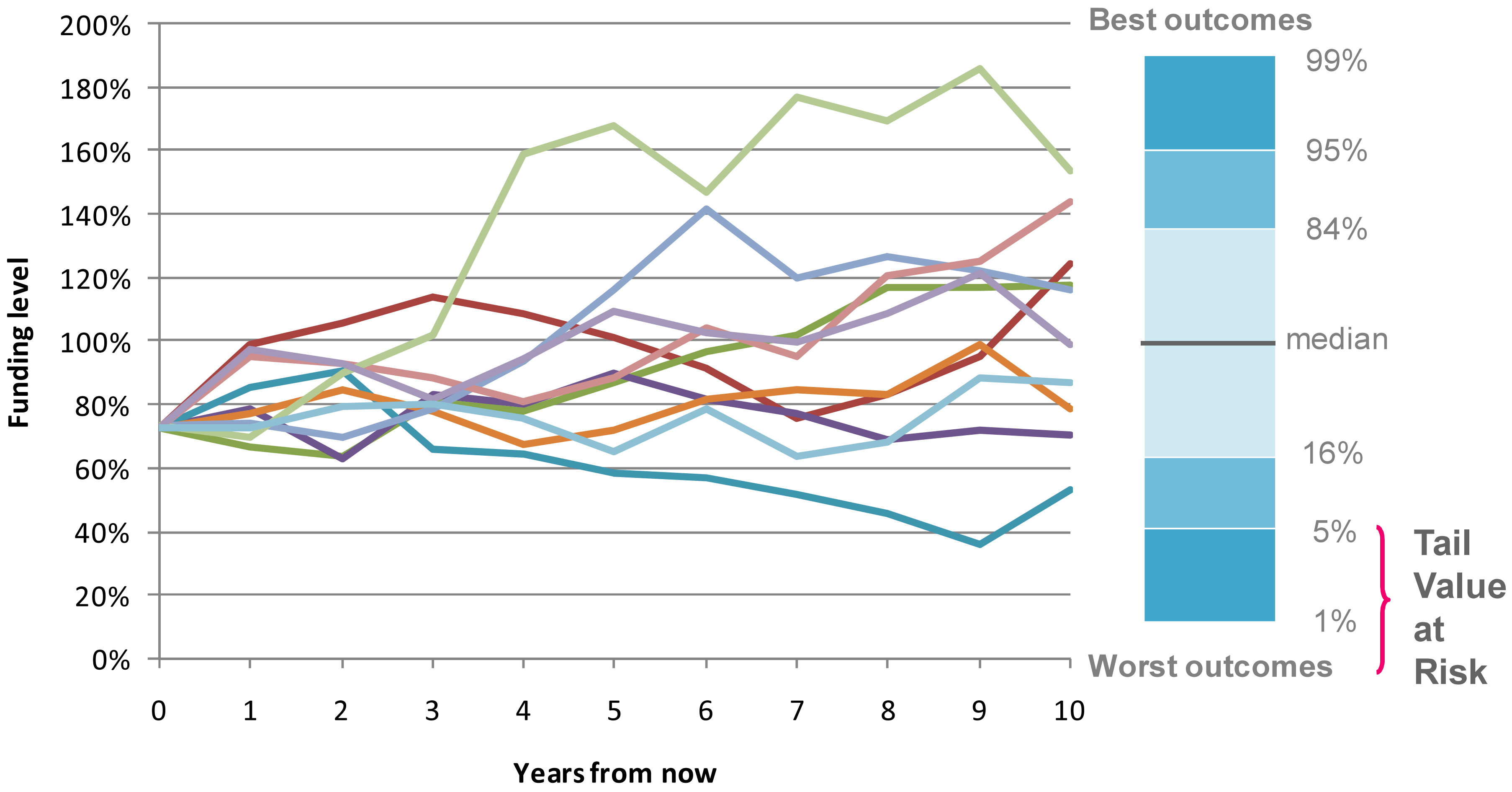
- Assets and liabilities valued using market conditions
- Ensure transparency and consistency
- Understand deficit
- Appreciation of risk

Manage:

- Balance affordability and risk
- Recognise risk posed by different employers
- Consider term of participation
- Consider different future outcomes for market conditions

HYMANS ROBERTSON

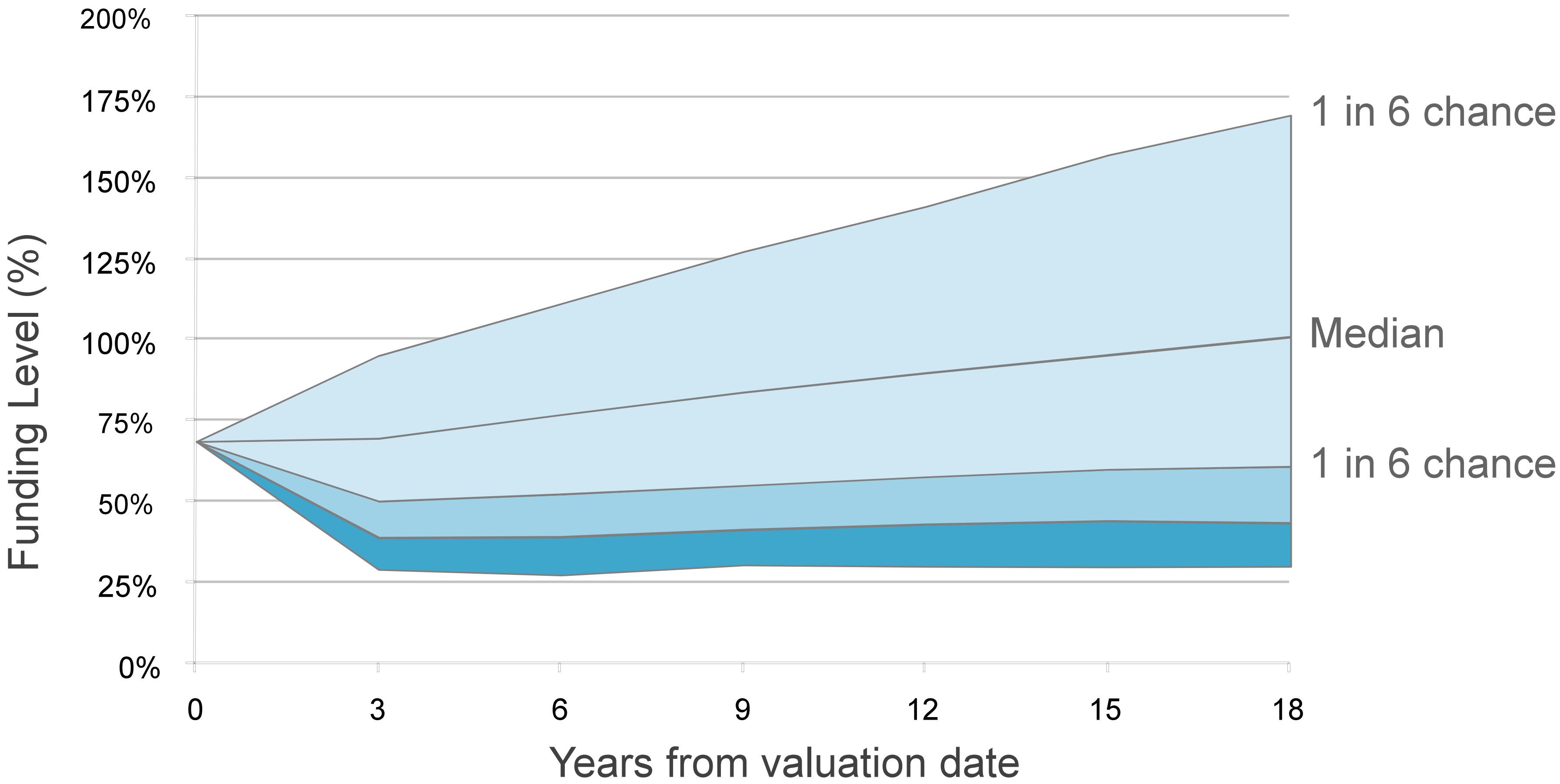
LB Harrow Pension Fund: risk based approach to setting council contribution strategy



Assess the likelihood of different outcomes

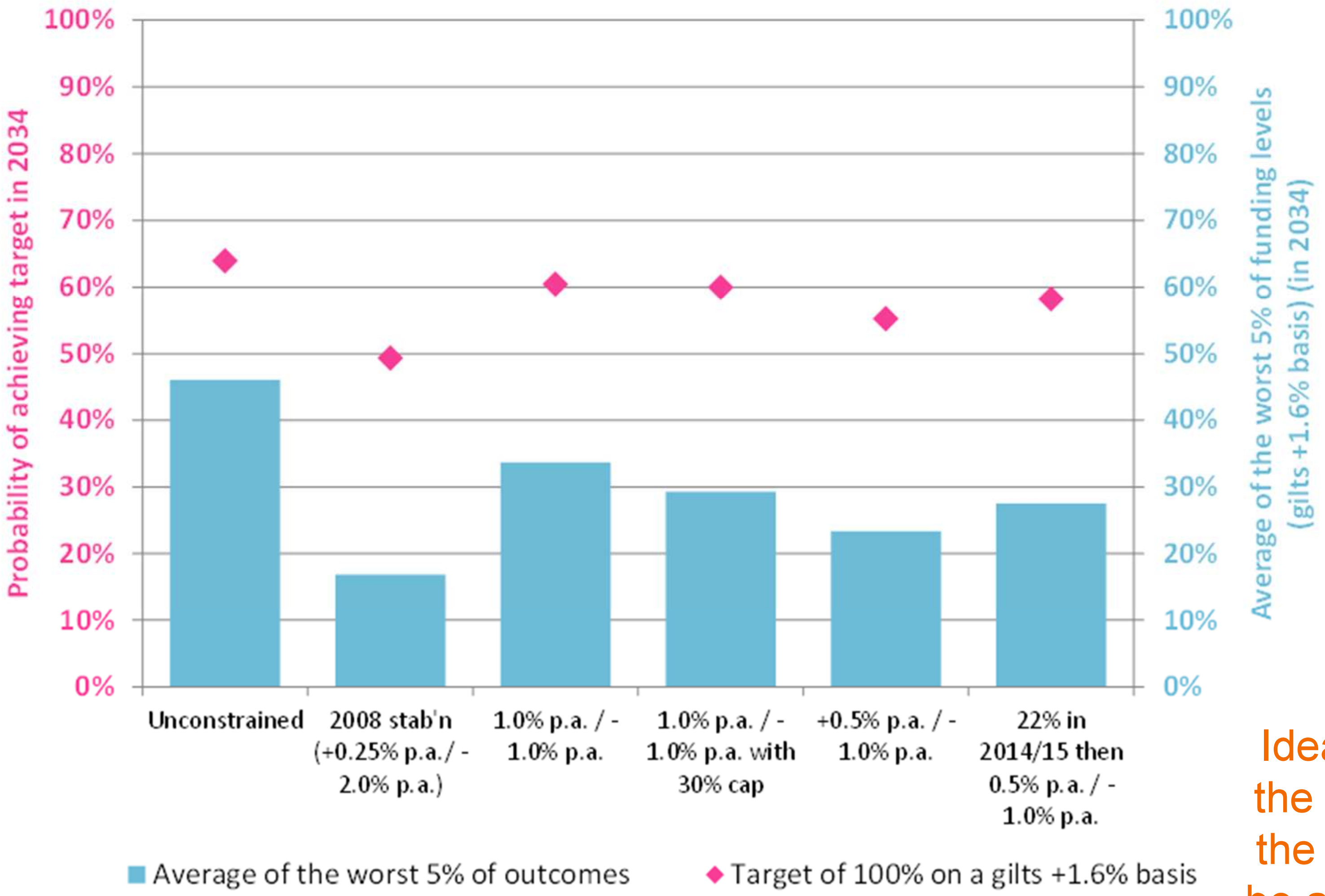
HYMANS ROBERTSON

5,000 scenarios gives a distribution of outcomes



More than 50% chance meet funding objective

LB Harrow Pension Fund: understanding future risks



Ideally want the bars and the points to be as high as possible

Source: Hymans Robertson LLP, comPASS, LB Harrow modelling (2013)

LB Harrow Pension Fund: understanding the trade offs

CONTRIBUTION STRATEGY	Prudence		Stewardship	Affordability
	LONG TERM LIKELIHOOD OF SUCCESS	AVERAGE OF THE WORST 5% OF FUNDING LEVELS IN 2035	MEDIAN FUNDING LEVEL IN 22 YEARS	HIGHEST MEDIAN CONTS DURING THE NEXT 22 YEARS
Strategy 1	78%	39%	170%	20.7%
Strategy 2	77%	55%	146%	27.0%
Strategy 3	63%	45%	120%	20.7%
Strategy 4	50%	47%	105%	21.7%
Strategy 5	70%	50%	163%	20.5%
Strategy 6	77%	52%	161%	22.7%

Source: Hymans Robertson LLP, comPASS, sample output

HYMANS # ROBERTSON

2013 contribution rate strategies

Type of employer	Scheduled Bodies		Community Admission Bodies and Designating Employers		Transferee Admission Bodies
Sub-type	**Council Pool**	**Academies**	**Open to new entrants**	**Closed to new entrants**	**(all)**
Basis used	Ongoing, assumes long-term Fund participation (see Appendix E)		Ongoing, but may move to "gilts basis" - see Note (a)	Ongoing, but may move to "gilts basis" - see Note (a)	Ongoing, assumes fixed contract term in the Fund (see Appendix E)
Future service rate	Projected Unit Credit approach (see Appendix D – D.2)		Projected Unit Credit approach if open (see Appendix D – D.2)	Attained Age approach (see Appendix D – D.2)	Projected Unit Credit approach if open, Attained Age otherwise (see Appendix D – D.2)
Stabilised rate?	Yes - see Note (b)	Yes - see Note (b)	No	No	No
Maximum deficit recovery period – Note (c)	20 years	20 years	15 years – subject to security / covenant check	15 years – subject to security / covenant check	Outstanding contract term
Deficit recovery payments – Note (d)	Monetary amount	Monetary amount	Monetary amount	Monetary amount	Monetary amount
Treatment of surplus	Covered by stabilisation arrangement	Covered by stabilisation arrangement	Preferred approach: contributions kept at future service rate. However, reductions may be permitted by the Administering Authority		Reduce contributions by spreading the surplus over the remaining contract term
Phasing of contribution changes	Covered by stabilisation arrangement	Covered by stabilisation arrangement	None	None	None
Review of rates – Note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations				Particularly reviewed in last 3 years of contract
New employer	n/a	Note (g)	Note (h)		Notes (h) & (i)
Cessation of participation: cessation debt payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt principles applied would be as per Note (j).		Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (j).		Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising.

Development of 2016 strategy

3 step approach to setting funding plans

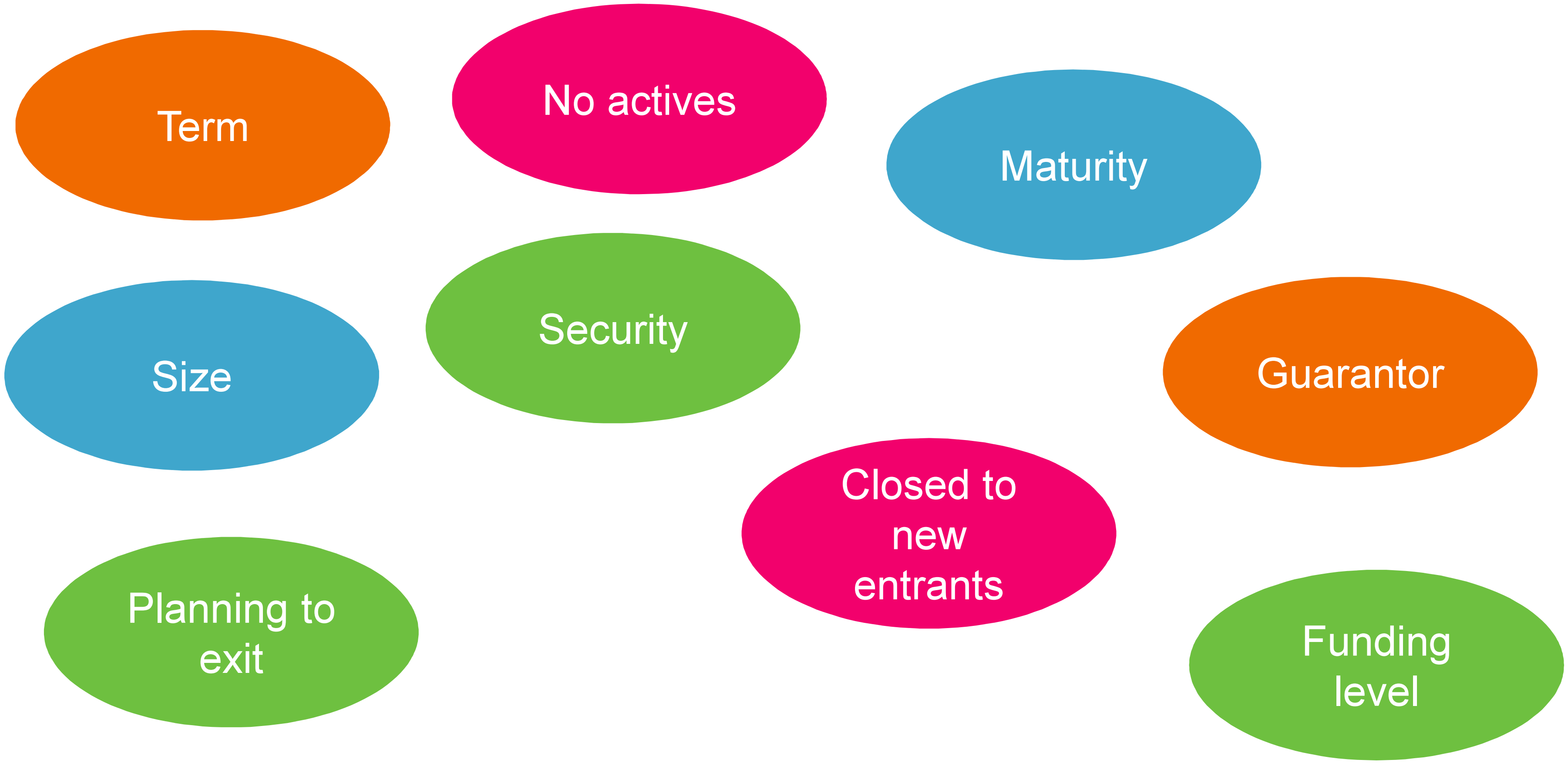
What is our funding target?

How long do we want to give ourselves to get to the target?

How sure do we want to be that we hit the target?

HYMANS ROBERTSON

Employers are different



Set a funding strategy which recognises this diversity to achieve better funding outcomes

What this looks like in practice

Employer	Funding target	Recovery period	Risk category	Likelihood of success
Employer A	Ongoing	17 years	Low	66%
Employer B	Ongoing	17 years	Medium	75%
Employer C	Ongoing	10 years	High	80%
Employer D	Gilts	5 years	High	70%[1]
Employer E	Ongoing	3 years	Low	66%

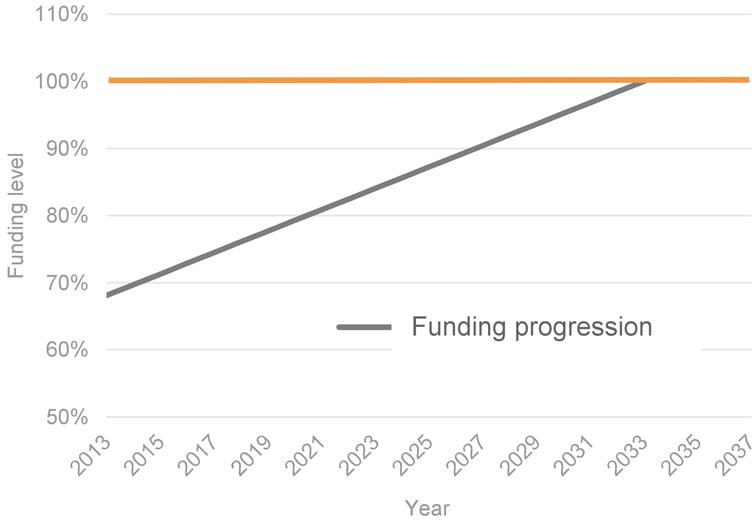
Notes:

1. Charge on assets, reduction in likelihood of success from 80% to 70% to reflect additional security

- Help all parties understand approach to setting contribution rates (including SAB and DCLG)

Transparent approach to funding plans

Development for 2016: risk based contribution rates



The 'old' world

The 'new' world

CONTRIBUTION STRATEGY	LONG TERM LIKELIHOOD OF SUCCESS	AVERAGE OF THE WORST 5% OF FUNDING LEVELS IN 2035
Strategy 1	58%	39%
Strategy 2	77%	55%
Strategy 3	67%	45%

Bespoke risk based contribution rate strategies set for selected high risk employers

2016 valuation

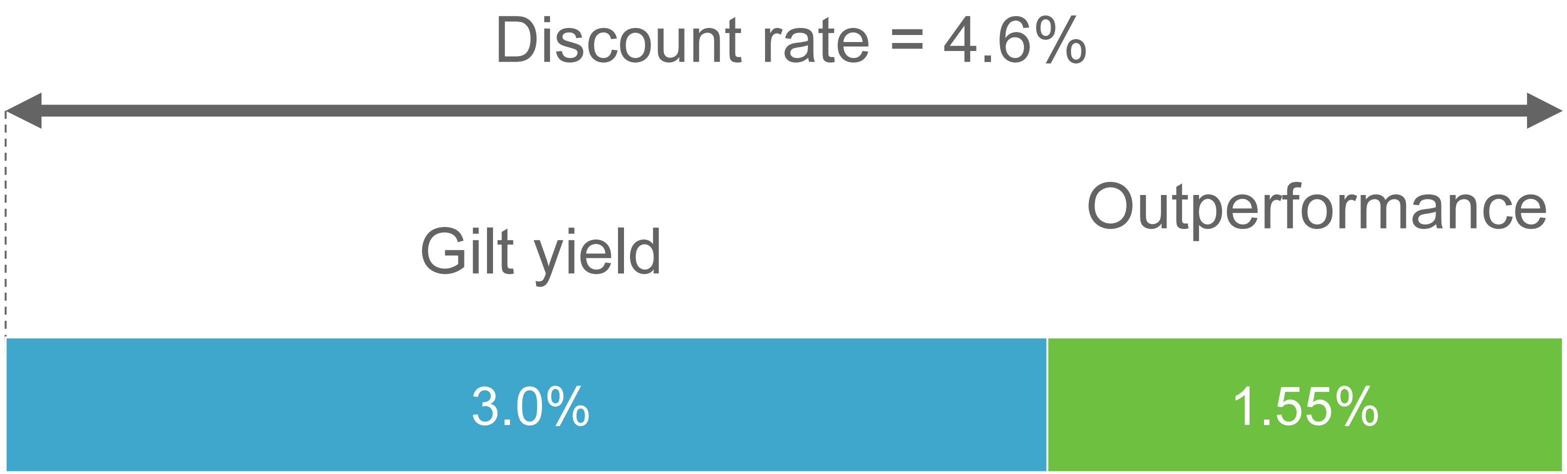
- More scrutiny than ever before
- Audit control and clear decision making processes
- Employer communications will be key
- Timescales are challenging
- Risk based contribution rates for all employers

Thank you

Any questions?

Appendix

Discount rate: assumed future investment return



- Set the target assets wisely
- Also the interest rate for any deficit

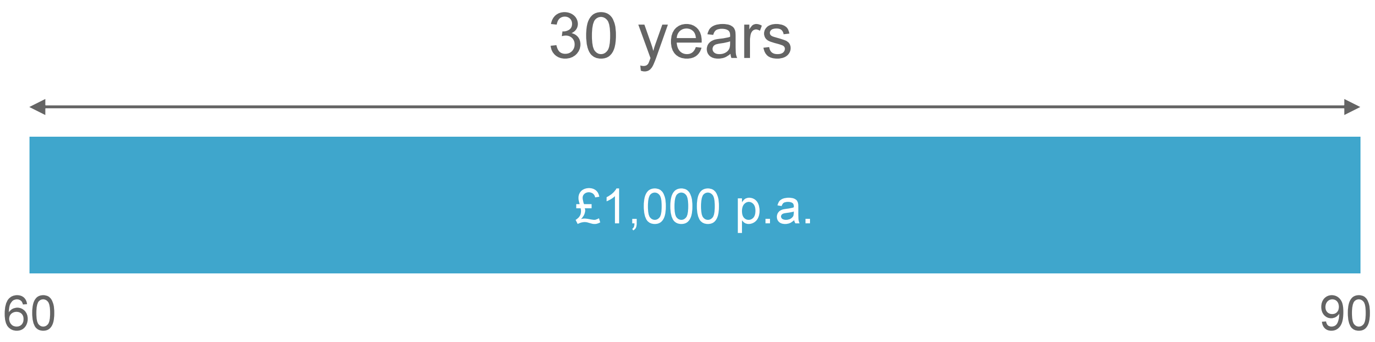
Discount rate = bond yield plus allowance for expected outperformance

Value today of £100 in 10 years time

Future Inflation	In 10 years £100 grows to	Assumed future investment return	How much cash do I need today
Zero	£100	7%	£48
3%	£134	7%	£65
3%	£134	5%	£80

Higher inflation, lower future investment return, need more cash today

Value of Pension Fund Liabilities: How much money do I need today?



Capitalised cost ignoring interest = £30,000

Capitalised cost allowing for interest[1] = £14,100

Capitalised cost allowing for interest and inflation[2] = £20,100

[1,2] Assume 6% investment return and 3% inflation

.. and allow for probability of survival

Reliances and Limitations

- This presentation is addressed to the London Borough of Harrow Council for its sole use as Administering Authority and not for the purposes of advice to any other party; Hymans Robertson LLP makes no representation or warranties to any third party as to the accuracy or completeness.
- This presentation discusses the current issues in the LGPS and was prepared purely for illustration to employers. Hymans Robertson LLP accepts no liability for any other purpose of this presentation.
- The following Technical Actuarial Standards* are applicable in relation to this presentation and have been complied with where material:
  - TAS R – Reporting;
  - TAS D – Data;
  - TAS M – Modelling; and
  - Pensions TAS.

* Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council and set standards for certain items of actuarial work, including the information and advice contained here.