

Warwickshire Pension Fund

2019 valuation

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21 November 2019

This presentation has been prepared for discussion at the Warwickshire Pension Fund Employers AGM on 21 November 2019 only. It should not be used or relied upon for any other purpose.

What are we going to cover?

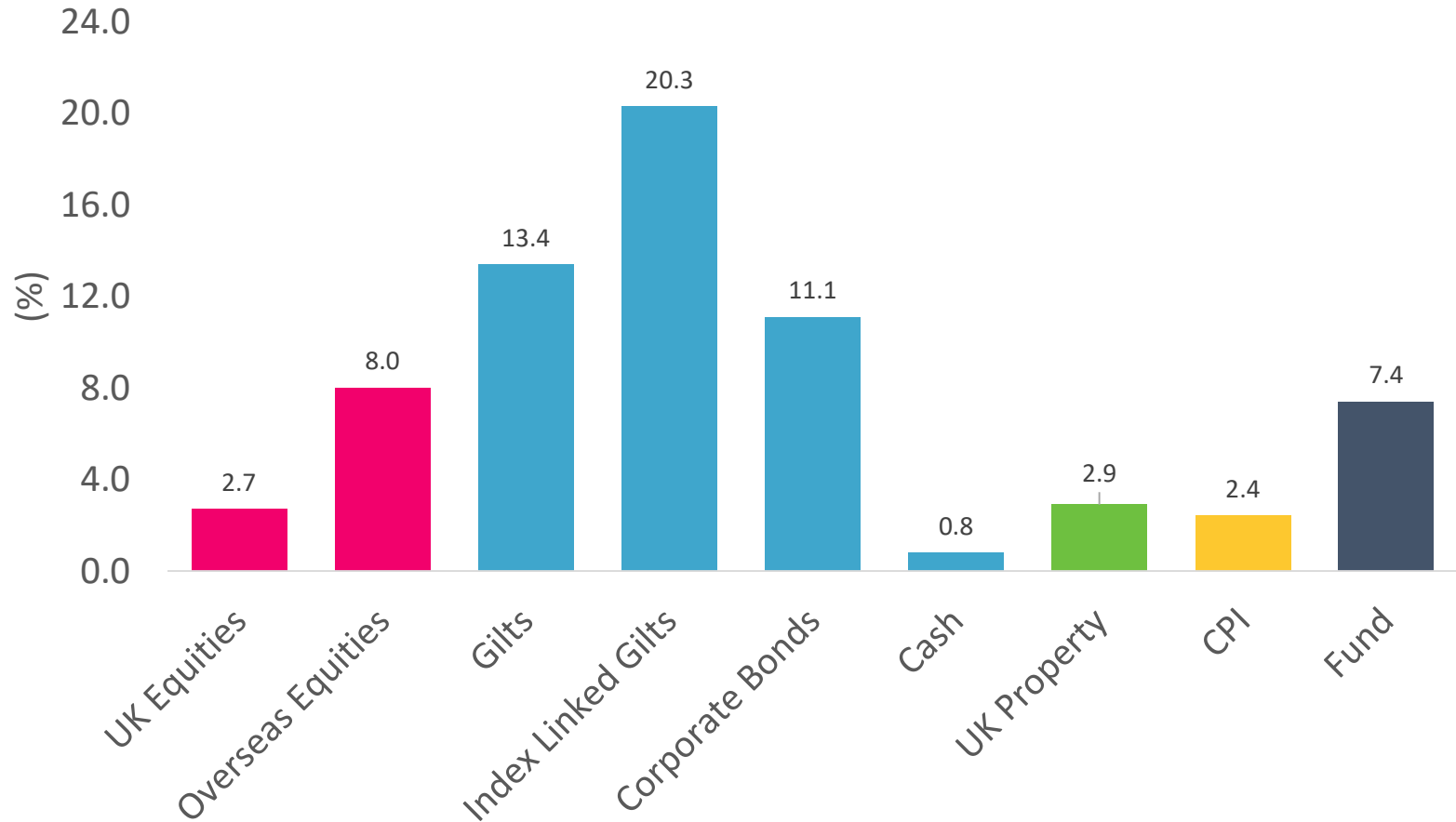
1. Investment overview
2. Valuation introduction
3. Valuation assumptions – what's changed?
4. Setting employer rates – what's changed?
5. Results – whole fund
6. Results – employer level
7. Next steps

Please ask questions as we go along

Investment overview

Market Background

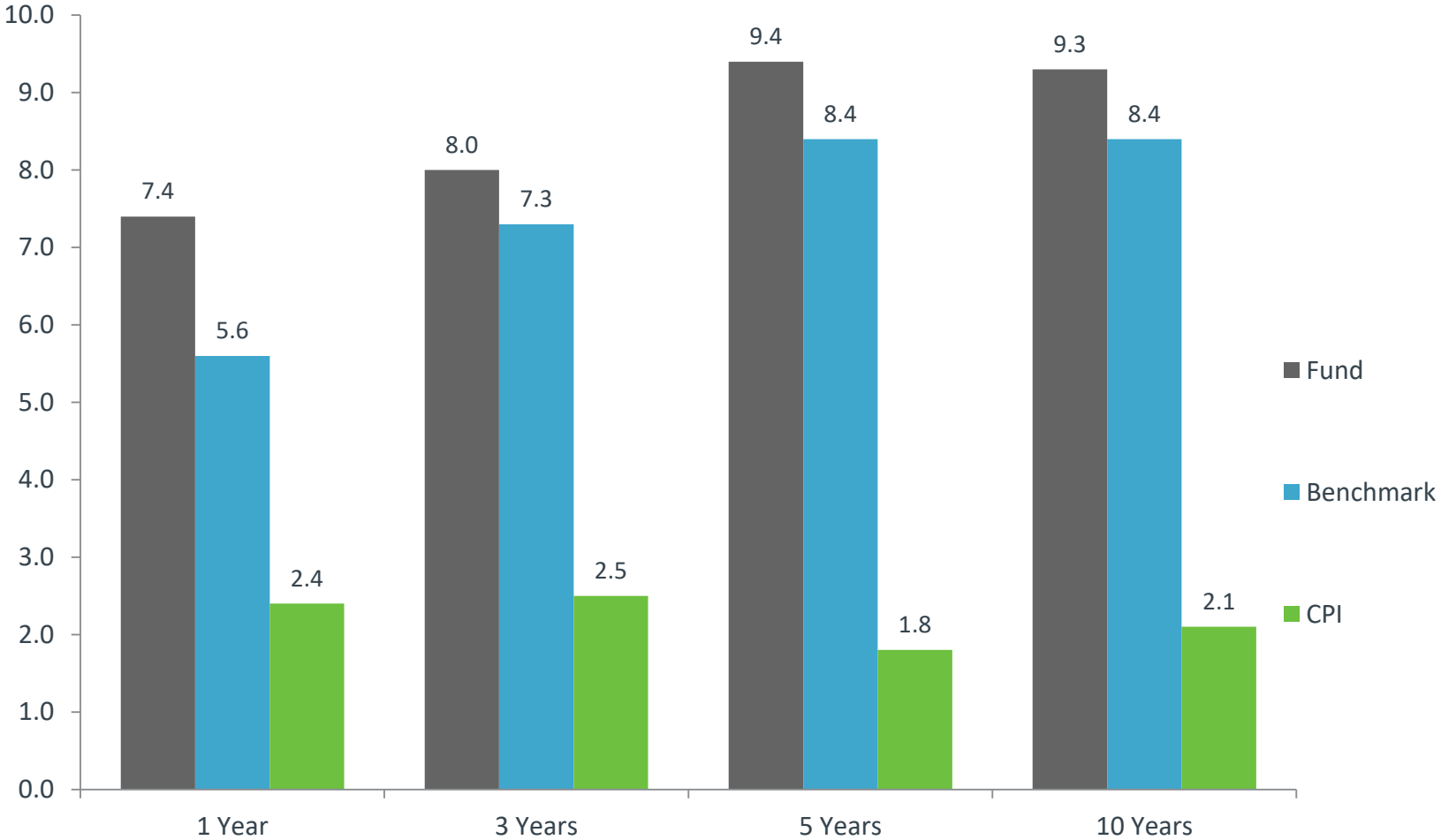
12 month returns to 30 September 2019



Source: Datastream and BNYM

Long term Fund performance (% p.a.)

To 30 September 2019

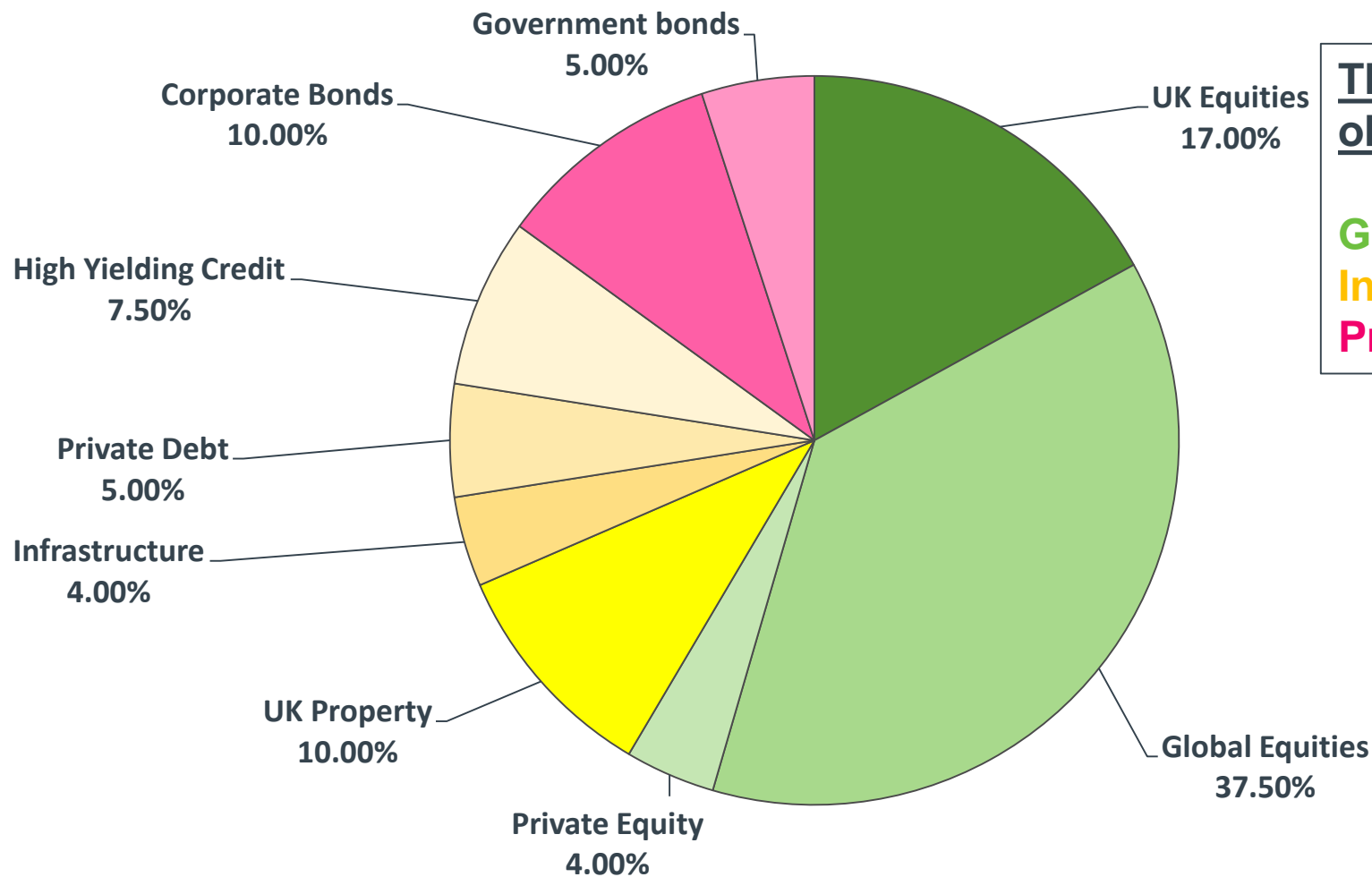


Source: Datastream, BNYM

Investment strategy

- Focus continues to be on investments expected to earn attractive real returns over the long term
- Diversification helps reduce the impact of shocks
 - Global nature of portfolio reduces exposure to the domestic UK economy
- Strategy is currently being reviewed in light of actuarial valuation
- Increasing focus on Responsible Investment and climate risks
















Current investment strategy target



Three key objectives

Growth
Income
Protection

The Fund's Investment Managers

| Asset class | Manager(s) |
|------------------------------|--|
| Passive Index Tracker |  |
| UK Equities |  |
| Global Equities |   |
| UK Property |   |
| Private Equity |   |
| Absolute Return Fixed Income |  |
| Infrastructure |    |
| Private Debt |    |

Asset pooling – a reminder

- Requirement for all England and Wales LGPS funds
- Pensions Committees will retain responsibility for setting contributions, high level investment strategy and detailed asset allocation
- The Fund is a member of the Border to Coast Pensions Partnership (BCPP) – total assets of £45-50bn
- A range of sub-funds are being established for partner funds

Asset transfers – progress to date



| Investments / commitments made | Planned investments in 2020 (subject to due diligence) | Areas still under discussion |
|---|--|------------------------------|
| Active UK Equity Fund Active Global Equity Fund Private Equity Fund Infrastructure Fund Private Credit Fund | Corporate Bond Fund Multi Asset Credit Fund | Property |

Passive index-tracking mandates remain with Legal and General

Conclusions

- Outperformance over all periods against the Fund Benchmark
- Level of absolute and real returns has been holding up well
- Investment strategy is currently under review
 - More emphasis on less volatile, income-producing investments
- Implementation of asset pooling well advanced

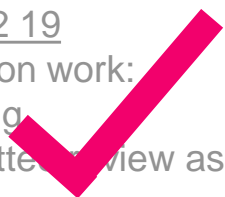
Valuation introduction

2019 valuation timeline

Q4 18 – Q2 19

Pre-valuation work:

- Planning
- Committee review assumptions



July/August 2019

Data cleansed and submitted to actuary
Actuarial calculations processed



September 2019

Committee review whole fund results



November 2019

AGM

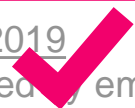
Individual employer results issued to employers alongside draft FSS

March 2020

Final report signed off by 31 March
Final FSS signed off by Committee

April - June 2019

Data submitted by employers



September 2019

Whole Fund results calculated



October 2019

Initial individual employer results calculated



December 2019

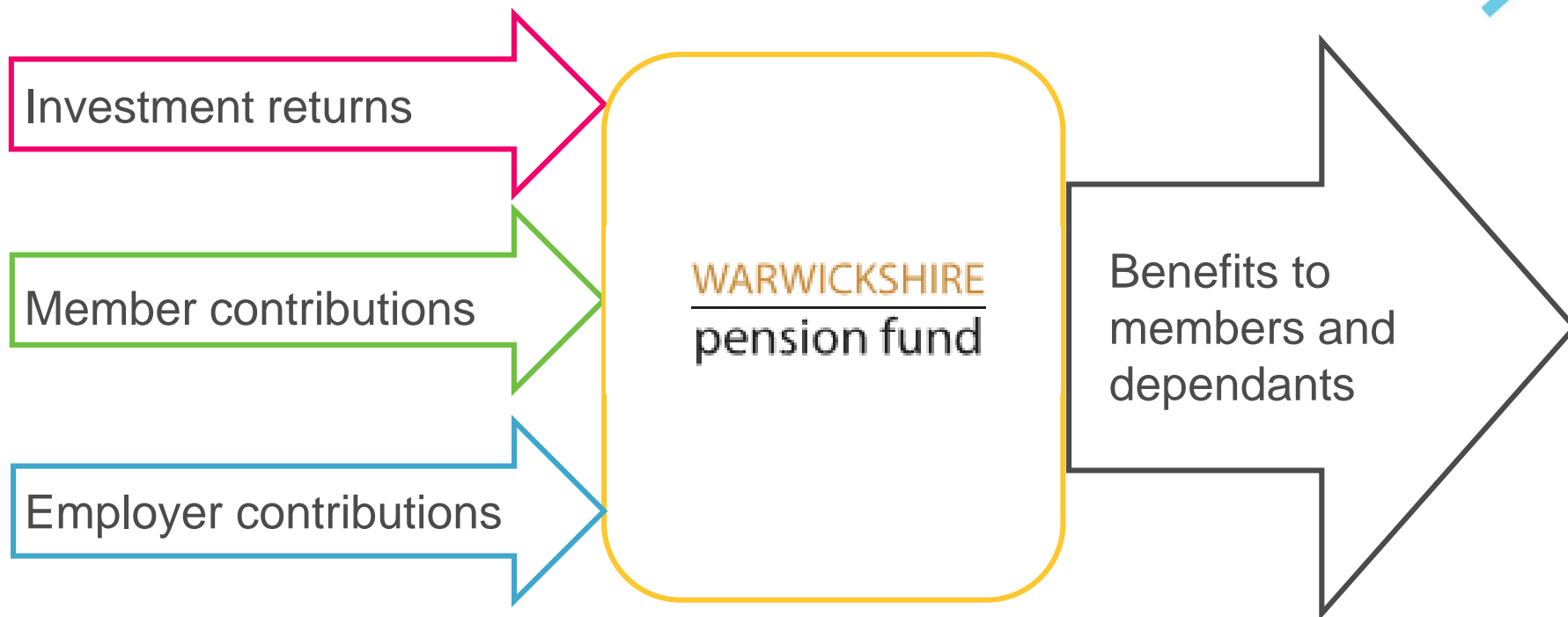
Pension committee review draft FSS and employer results



1 April 2020

New employer contributions start to be paid

How the Fund works

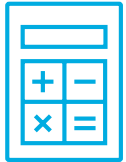


Determined by investment strategy & manager performance

Determined by LGPS Regulations

Must meet balance of cost over longer term

Why we do a valuation



- Calculate employer contribution rates



- Compliance with legislation



- Analyse actual experience vs assumptions



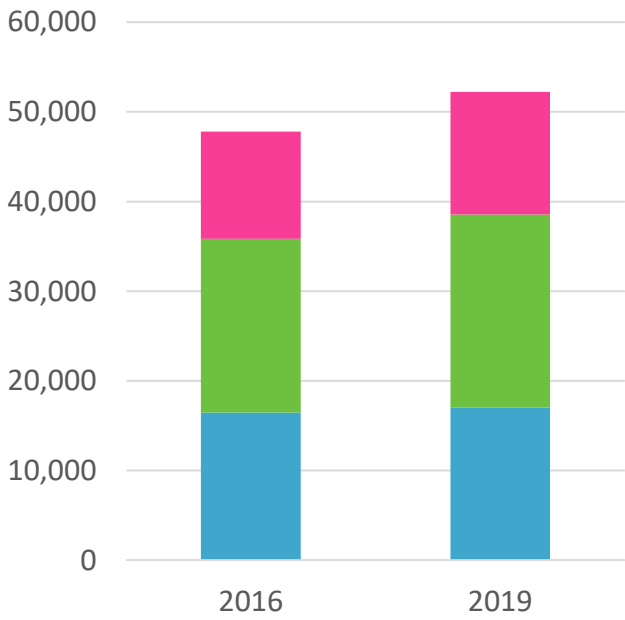
- Review Funding Strategy Statement



- Part of continual 'health check' on fund solvency

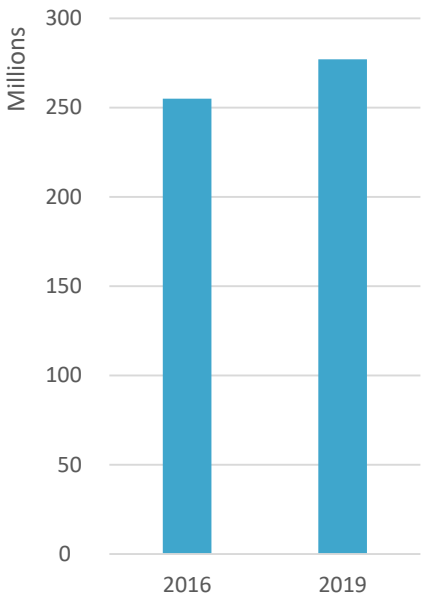
Membership data received and validated

Membership of the Warwickshire Pension Fund

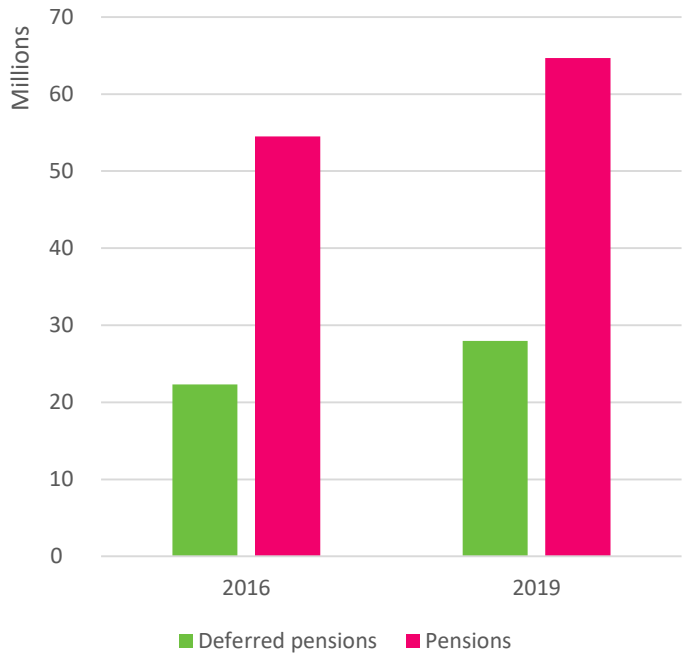


- Pensioners
- Deferred Pensioners
- Actives

Payroll of actives




Pension amounts



- Deferred pensions
- Pensions

The fund has continued to grow in size, increased burden on the admin team



Valuation assumptions – what's changed?

How to fund benefits

Liabilities

Benefits earned in future

Benefits earned to date

Assets

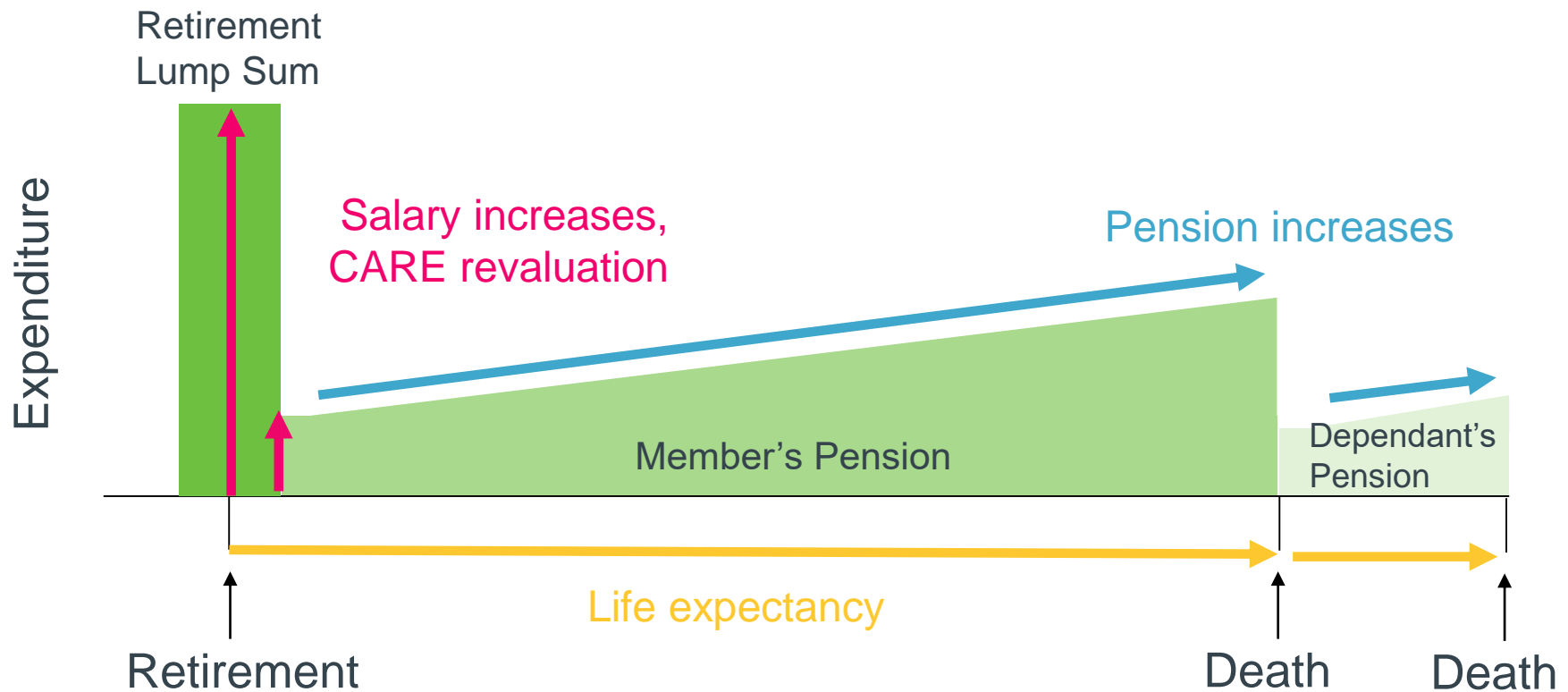
Future investment performance

Future contributions

Assets today

The purpose of a valuation is to review each of these sections and set a prudent plan to pay each member's benefits

Why do we need assumptions?



Recap: 2016 funding plan

2016

Benefits
earned in
future

Liabilities
(Benefits
earned to
date)

Future
investment
performance

Future
contributions

Assets today

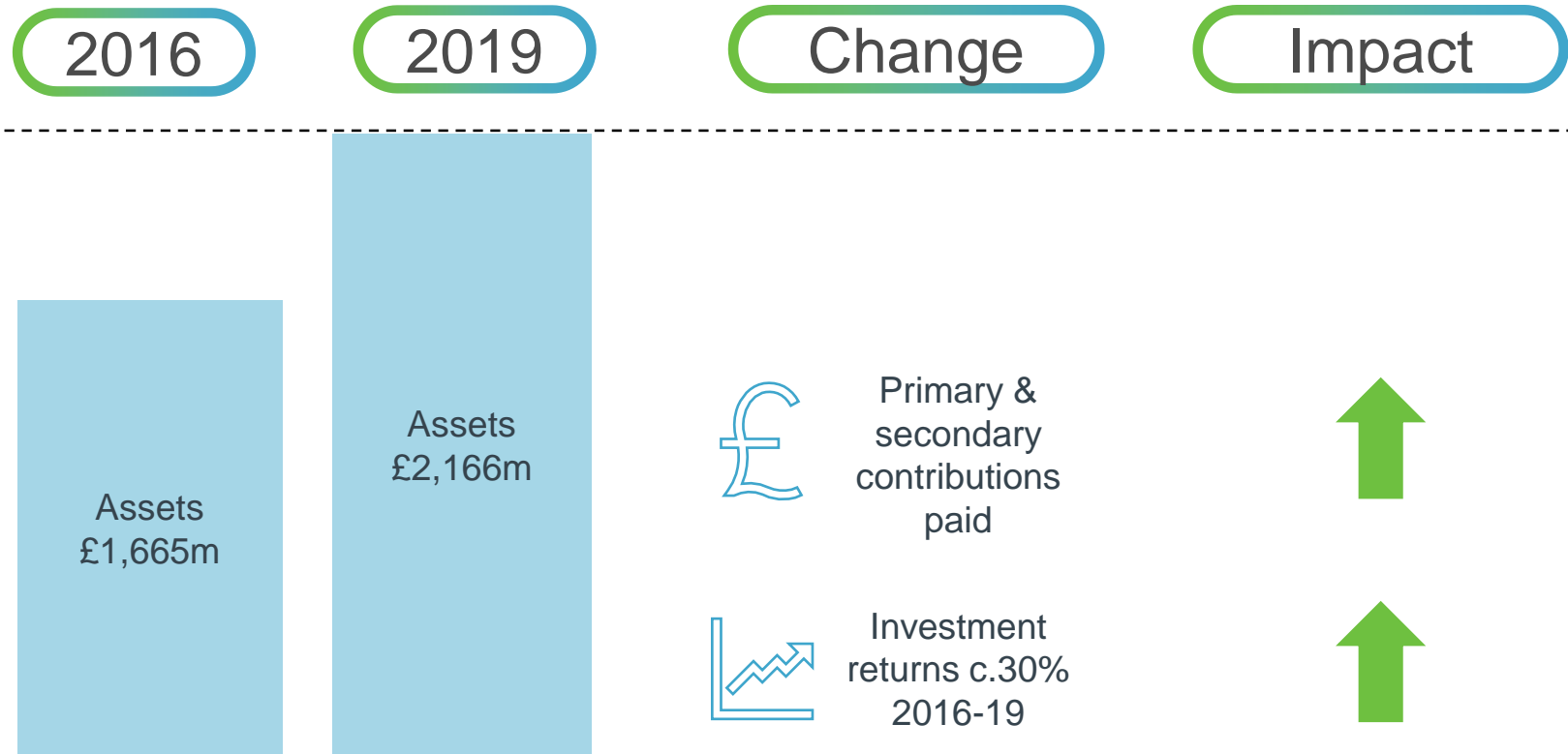
3.8% p.a.

Primary: 20.0% of pay
Secondary: £8,440,000

Funding level 82%

The key valuation decision is the balance of contributions and investment performance

What has happened to the Fund's assets between 2016-2019?



What is the outlook for the return on the assets the Fund holds?

2016

2019

Change

Impact

3.8% p.a.

3.7% p.a.

Assets have increased in price

Price increases mean assets now cost more

When assets cost more, outlook for returns is lower

What has happened to the benefits you need to fund?

2019

Change

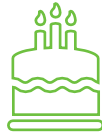
Impact

Benefits earned in future

Liabilities (Benefits earned to date)



Future pay increases



Life expectancy



GMP indexation



McCloud judgement





Future pay increases

Then

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Budget 2013: Public sector pay rise cap extended

© 20 March 2013



A 1% pay rise cap for public sector workers will be extended for an extra year to 2015-16, Chancellor George Osborne has announced.

The move comes as some civil servants stage a one-day strike over pay and pensions.

Mr Osborne said that public sector pay would be limited to an average of 1% including in 2015-16.



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Politics Parliaments Brexit

Public sector workers 'to get above-inflation pay rise'

© 19 July 2019



Hundreds of thousands of public sector workers are reportedly in line to get a pay rise.

Long-term pay increase assumption up from 0.6% to 0.8% above CPI inflation



Falling life expectancy makes headlines

The Actuary

The magazine of the Institute & Faculty of Actuaries

Falling life expectancy to slash pension scheme liabilities

sky news

A lot of people in the City are getting very excited about death

“...£2bn windfall to the life sector.”

MailOnline

British life expectancy falls by SIX MONTHS for men and women with experts blaming NHS cuts and a rise in dementia, diabetes and obesity

“...pension firms have already began to cash in on falling life expectancies.”

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MARKETS | HEARD ON THE STREET

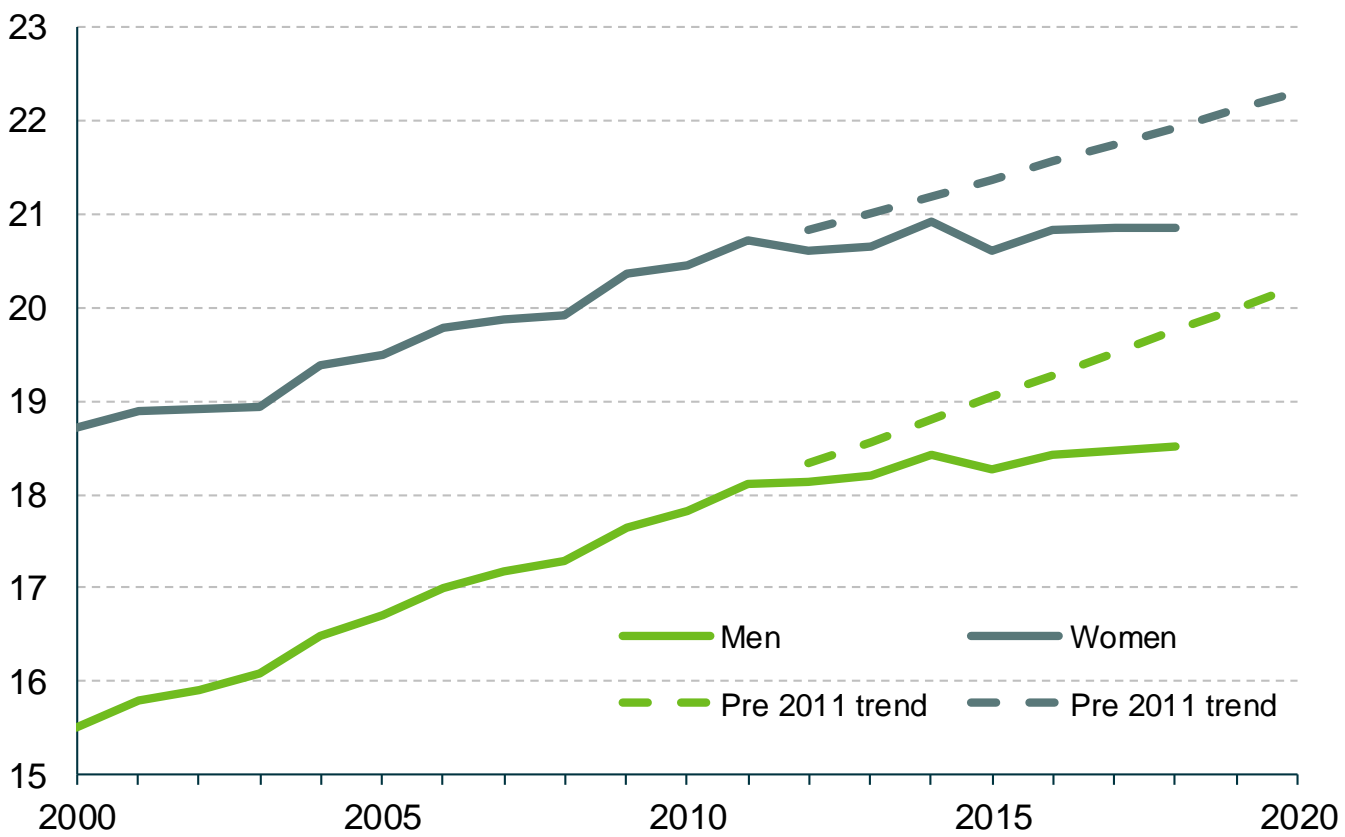
Life Was Short for Longevity Gains

Life expectancy at 65 is falling and that means cash windfalls for insurers



Is it fake news?

Period life expectancy from age 65



True for the general population...



Not the same for everyone



| Group | Annualised mortality improvement (age-standardised) | | |
|--------------------|---|----------------------|----------------------|
| | 2001-2006 | 2006-2011 | 2011-2016 |
| General Population | 3.0% ($\pm 0.1\%$) | 2.6% ($\pm 0.1\%$) | 0.9% ($\pm 0.1\%$) |
| Comfortable | 2.0% ($\pm 0.6\%$) | 2.6% ($\pm 0.4\%$) | 1.5% ($\pm 0.4\%$) |
| Making-Do | 2.9% ($\pm 0.4\%$) | 2.9% ($\pm 0.3\%$) | 1.1% ($\pm 0.3\%$) |
| Hard-Pressed | 2.6% ($\pm 0.4\%$) | 3.1% ($\pm 0.3\%$) | 0.7% ($\pm 0.3\%$) |

Still improving

Slowing down

Typical LGPS Fund Profile

Lives - male



10-15% of members...

Liabilities - male



...50% of liabilities

- Hard Pressed
- Making Do
- Comfortable
- Unknown

Less impact than the headlines suggest



GMP: Generating More Problems



State pension age before 2016

Baseline GMP funded by LGPS employers

Annual increases funded by combination of LGPS employers and central government

Overall GMP + state pension equal between men and women

State pension age after 2016

Baseline GMP funded by LGPS employers

Annual increases **entirely** funded by LGPS employers

Overall GMP + state pension equal between men and women

Potential increase to liabilities depending on your membership

Many employers will see no impact at all



McClouds on the horizon

Apr
2014/5

Reforms to public service pensions following Hutton review – benefits generally made less generous but older members are spared

➔ Members launch legal challenge claiming age discrimination

Jan
2017

➔ Government loses and appeals to Court of Appeal

Dec
2018

Court of Appeal rules against the Government

➔ Government appeals to Supreme Court

June
2019

Supreme Court declines to hear the Government's appeal

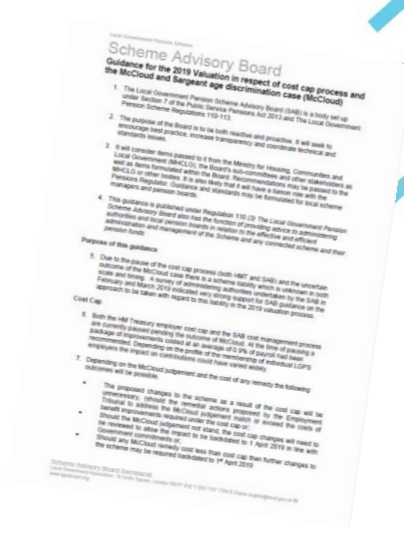
???

Significant uncertainty over public sector pension benefits (and costs)



Impact on 2019 valuation

- What benefit structure to value?
 - Actuaries should value the current benefits*
- How will the fund manage the risk over benefit structure uncertainty?
 - Increase prudence when setting rates via higher likelihood of meeting the funding target
- Can funds revisit rates after the valuation once the case is resolved?
 - Yes
- What about employers leaving the fund?
 - If you leave the fund before the case is resolved, you may be asked to pay more to cover the potential cost of improved benefits



2019 funding plan

2019

Benefits
earned in
future

Liabilities
(Benefits
earned to
date)

Future
investment
performance

Future
contributions

Assets today

3.7% p.a.

Broadly similar to current levels

Funding level 92%

No significant change to assumptions since the last valuation


“No news is good news!”

Setting employer rates – what's changed?

Recap: how we calculate contributions

2013 and before


What is the funding target? 


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

What single set of assumptions are we going to use?

2016 onwards

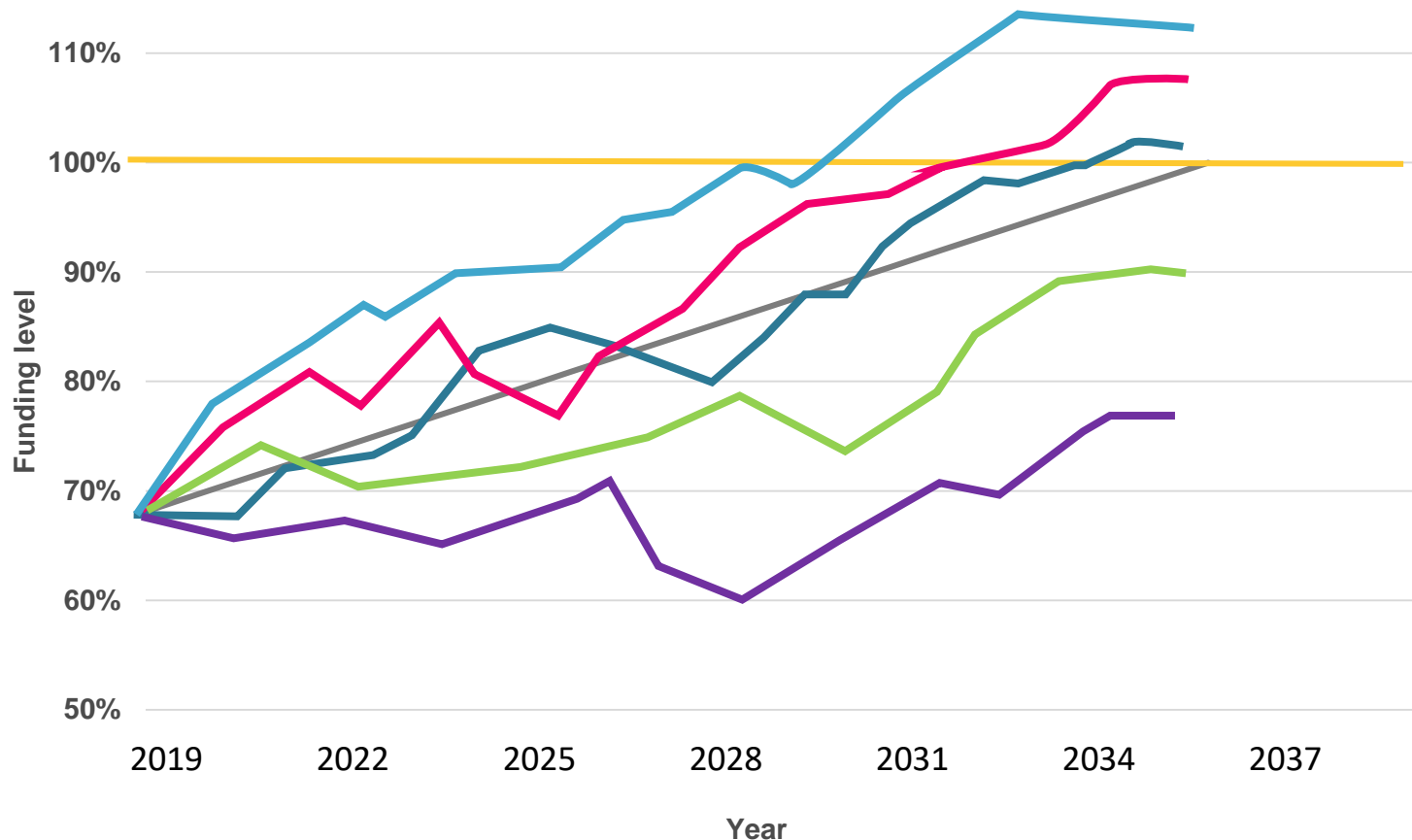
What is the funding target? 

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

How sure do we want to be that the employer hits the target? 

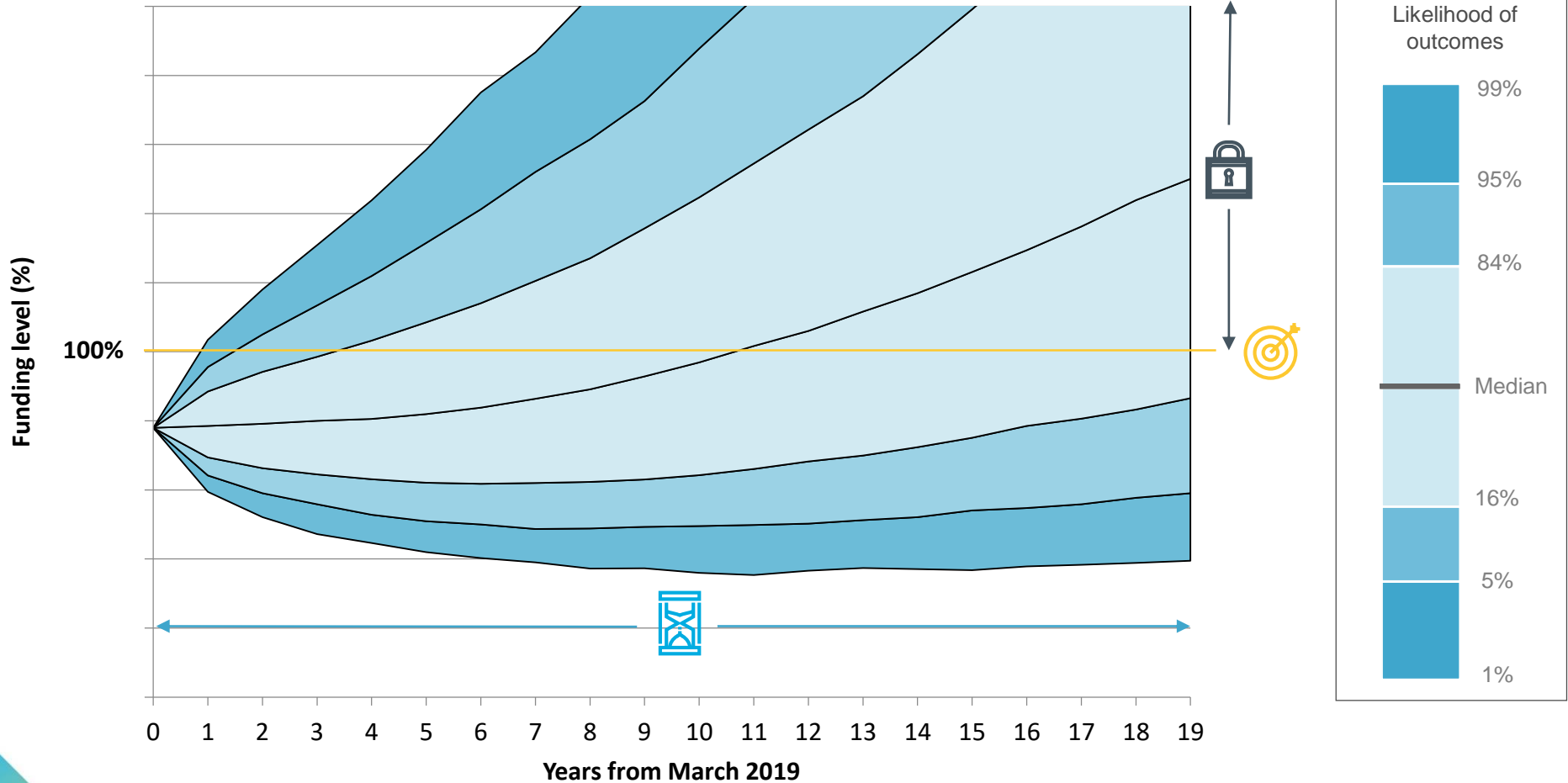
The method for setting contribution rates allows for future uncertainty and helps all stakeholders understand the risk inherent in funding plans

Test contributions under thousands of economic scenarios



Each scenario has different inflation, investment returns, interest rates etc

Combining it all together



Set a contribution rate so that enough outcomes are 'successful'

2016 valuation: funding strategy



| Employer type | Funding target | Time horizon | Likelihood of success | Stabilised contributions |
|-----------------------------|----------------|--------------|-----------------------|--------------------------|
| Councils and Police | Ongoing | Long | 66% | Yes |
| Academies | Ongoing | Long | 66% | No |
| Colleges | Ongoing | Long | 75% | No |
| Transferee Admission Bodies | Ongoing | Short | 66% | No |
| Community Admission Bodies | Cessation | Medium/Short | 75% | No |

Ensuring funding strategy is appropriate for each employer group

2019 valuation: funding strategy



| Employer type | Funding target | Time horizon | Likelihood of success | Stabilised contributions |
|-----------------------------|----------------|--------------|-----------------------|--------------------------|
| Councils and Police | Ongoing | Long | 70% | Yes |
| Academies | Ongoing | Long | 70% | No |
| Colleges | Ongoing | Long | 80% | No |
| Transferee Admission Bodies | Ongoing | Short | 70% | No |
| Community Admission Bodies | Cessation | Medium/Short | 80% | No |

Higher likelihoods applied to cover emerging risks at this valuation

Where to find further information



Funding Strategy Statement details the Fund's approach to funding benefits for all employers and managing risks

Results— whole fund

Whole Fund funding position - change

| | 2016 valuation (£m) | 2019 valuation (£m) |
|--------------------------------|---------------------|---------------------|
| Active liabilities | 736 | 809 |
| Deferred pensioner liabilities | 409 | 503 |
| Pensioner liabilities | 878 | 1,033 |
| Total liabilities | 2,023 | 2,346 |
| Assets | 1,665 | 2,166 |
| Surplus/(Deficit) | (358) | (180) |
| Funding level | 82% | 92% |

Funding level shows a snapshot on one particular day,
but funding pension benefits is a long term game

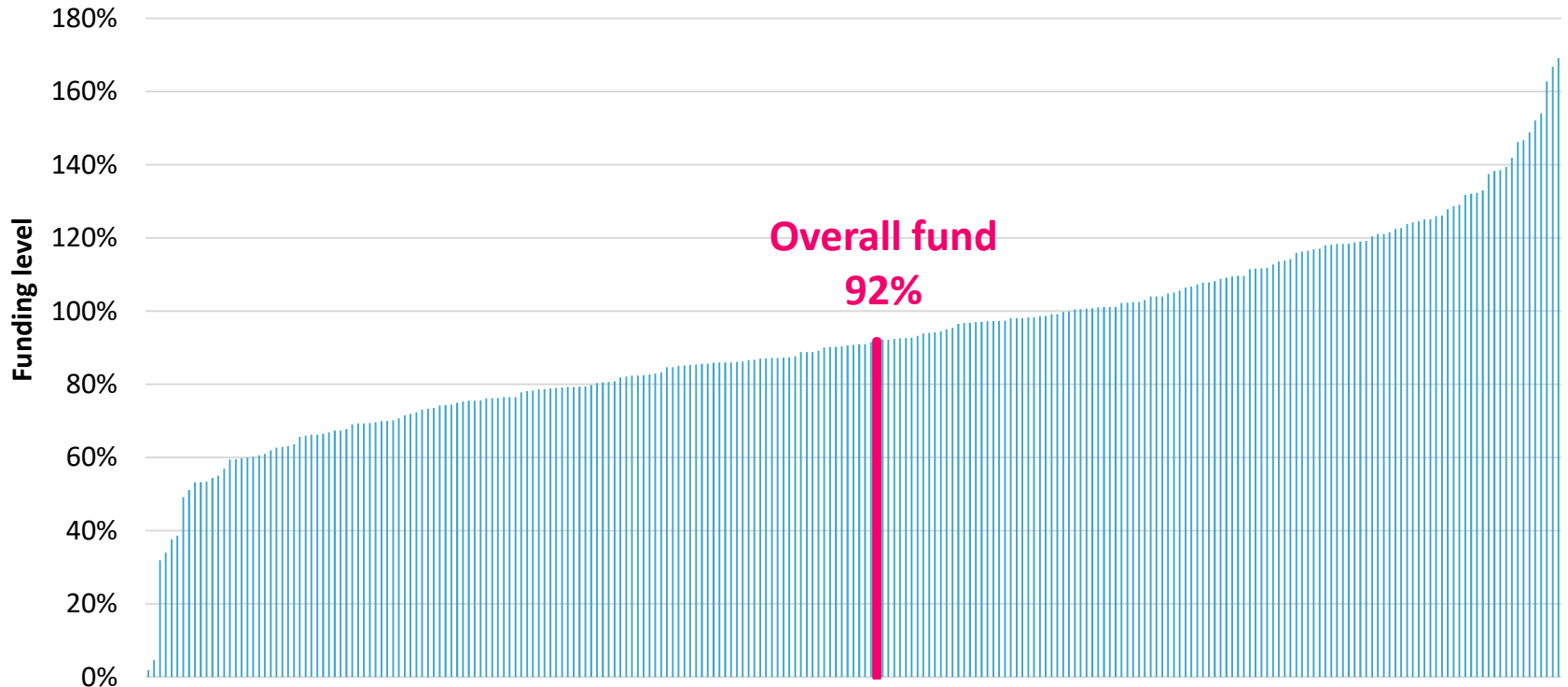
What's changed since 2016?

| Change in value (£m) | Assets | Liabilities | Surplus / (Deficit) |
|--|--------------|--------------|---------------------|
| Last valuation – 31 March 2016 | 1,665 | 2,023 | (358) |
| Cashflows | | | |
| Employer contributions paid in | 167 | | 167 |
| Employee contributions paid in | 51 | | 52 |
| Benefits paid out | (223) | (223) | 0 |
| Net transfers into / out of the Fund | 7 | | 7 |
| Other cashflows (e.g. expenses) | (6) | | (6) |
| Expected changes in membership | | | |
| Interest on benefits already accrued | | 242 | (242) |
| Accrual of new benefits | | 251 | (251) |
| Membership experience vs expectations | | | |
| Salary increases less than expected | | (1) | (1) |
| Benefit increases less than expected | | (0) | 0 |
| Early retirement strain & contributions | 0 | 17 | (17) |
| Ill health retirement strain | | (9) | 9 |
| Early leavers less than expected | | (2) | 2 |
| Pensions ceasing greater than expected | | 4 | (4) |
| Commutation less than expected | | 0 | (0) |
| Impact of GMP equalisation | | 3 | (3) |
| Other membership experience | | (8) | 8 |
| Change in market conditions | | | |
| Investment returns on the Fund's assets | 505 | | 505 |
| Changes in future inflation expectations | | 67 | (67) |
| Changes in actuarial assumptions | | | |
| Change in demographic assumptions | | (5) | 5 |
| Change in longevity assumptions | | (67) | 67 |
| Change in salary increase assumption | | 7 | (7) |
| Change in discount rate | | 47 | (47) |
| This valuation – 31 March 2019 | 2,166 | 2,346 | (180) |

Results— employer level

Range of employer funding levels

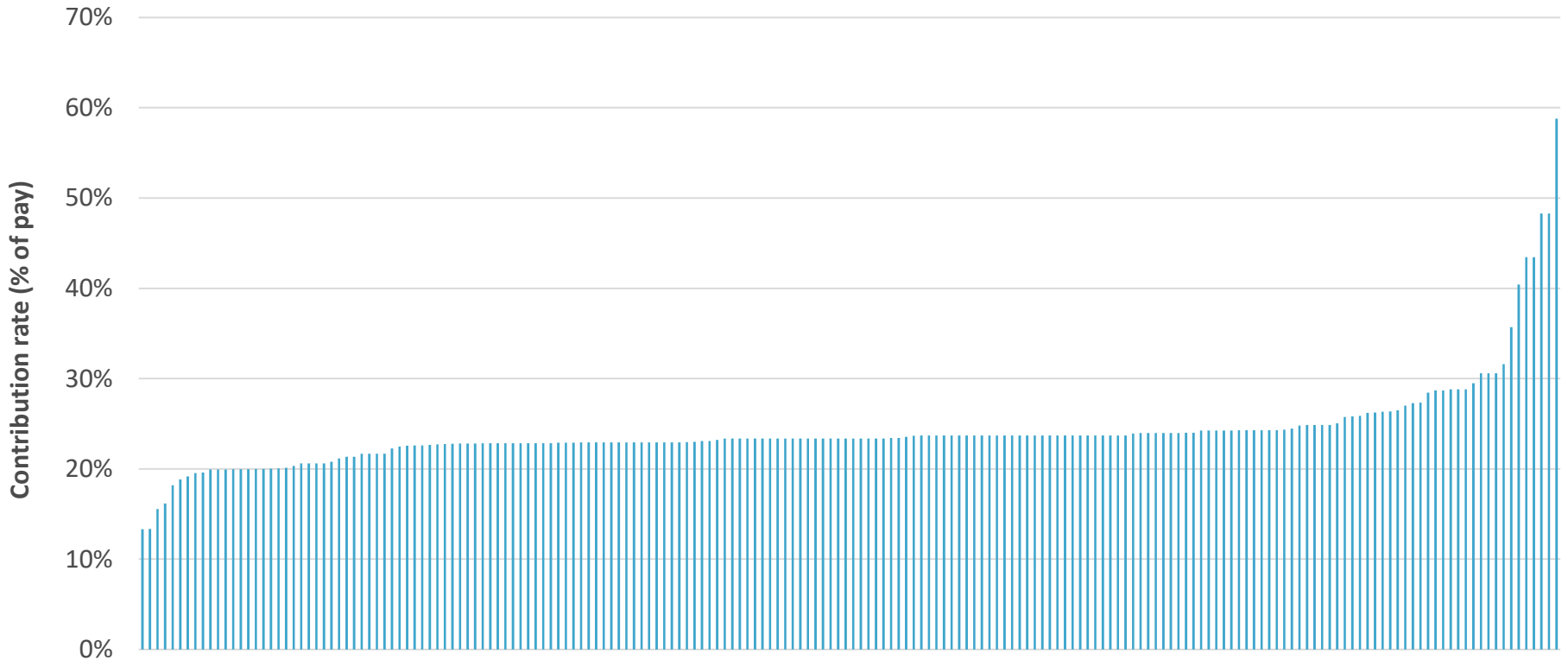
2019 valuation - distribution of employer funding levels



Most employers will see an improved funding level versus 2016, but there is a wide range

Range of employer contribution rates

Distribution of employer contribution rates



Overall, not much change is expected but will vary between employers

Themes emerging from employer results

Funding positions

Strong investment returns since 2016
Improved funding positions
Lower deficits

Contribution rates

Slight rise in Primary Rate
(cost of new benefits)
Secondary rates generally stable

Generally positive news for employers

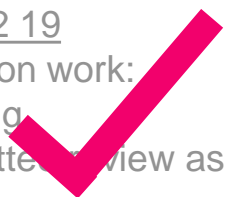
Next steps

2019 valuation timeline

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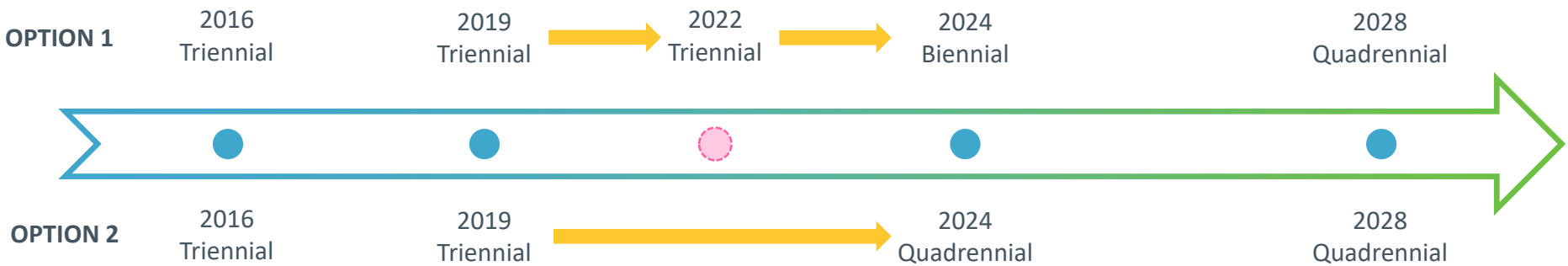


1 April 2020

New employer contributions start to be paid

National hot topics

Valuation cycle and management of employer risk

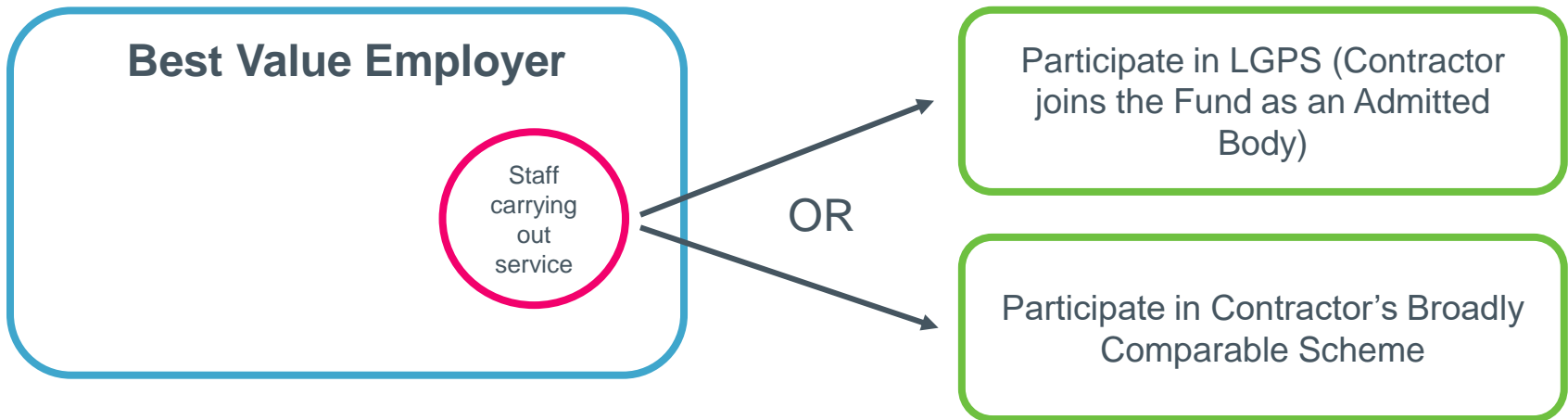


1. MHCLG proposal of flexibility on exit payments
2. Exit credits: consideration of the employer's exposure to risk for exit credits
3. Further Education Bodies: access to the LGPS limited for new employees?

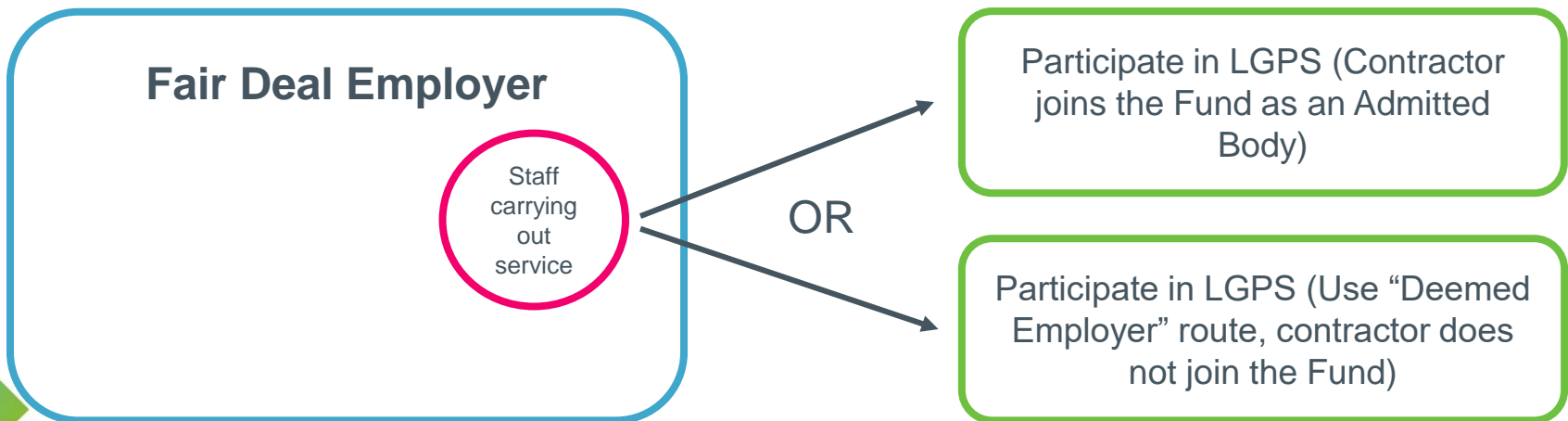
Consultation closed 31 July 2019

New Fair Deal consultation

Current approach – Best Value Directions 2007

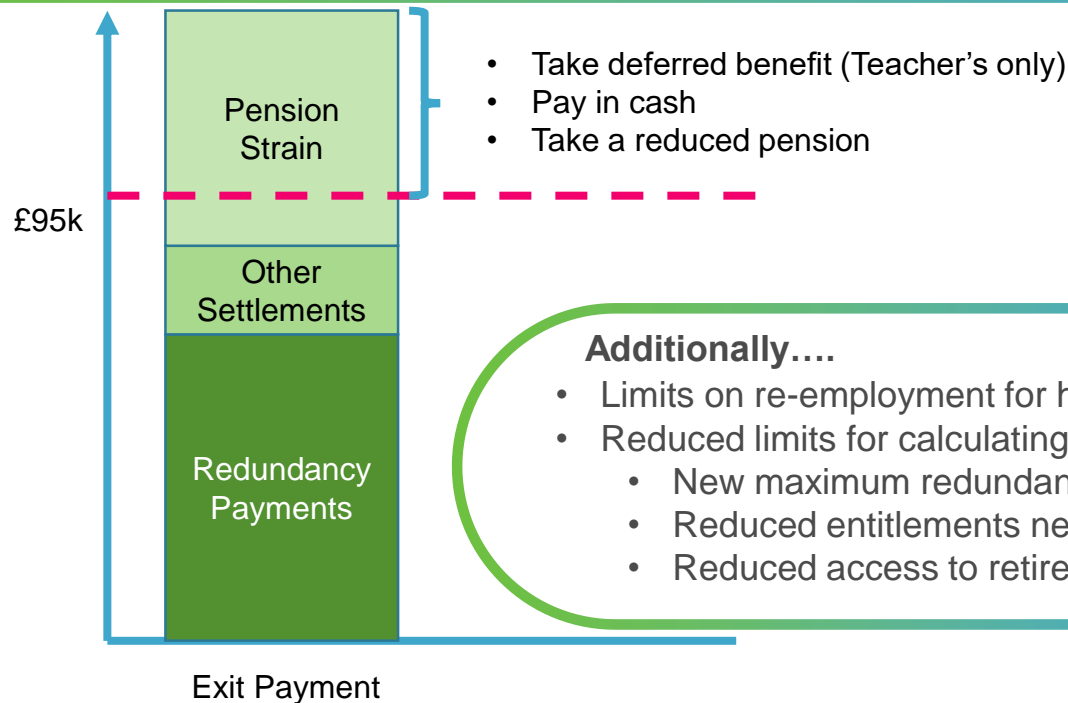


Proposed approach – Fair Deal in the LGPS



Public Sector Exit Payment Cap

- Total exit payments to an individual should not exceed £95k
- If they do the employer must **reduce** any of the elements that make up the exit payment so as not to exceed £95k
- The exit payment cannot be reduced below any statutory redundancy payment



Additionally....

- Limits on re-employment for high earners
- Reduced limits for calculating exit payments:
 - New maximum redundancy settlements
 - Reduced entitlements near retirement
 - Reduced access to retirement options

Potential impact on LGPS

Examples of roles & real voluntary redundancy schemes:

CAPPED
Trading Standard
Manager
£44k 20 years

CAPPED
Adult Social Care Worker
£35k 30 years

CAPPED
HR staff
£28k 40 years

CAPPED
Planning Manager
£51k 15 years

Consultation closed 2 July 2019, awaiting outcomes

Good Governance in the LGPS



Good governance in the LGPS

Phase II report from Working Groups to SAB

November 2019

Conclusions

- Outcomes based model instead of prescribed approach
 - Robust management of conflicts of interest
 - Policy on member and employer representation
 - Level of knowledge and understanding
 - KPIs to measure level of service to fund stakeholders
 - Sufficient resources to effectively manage and administer the fund
 - Independent review of a fund's governance
- Independent review of a fund's governance arrangements
- Improvement plans where needed

Next steps

- Drafting proposed changes to Guidance
- Establish KPIs to measure service standards
- Define contents of Governance Compliance Statement

Thank you



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