

London Borough of Hounslow Pension Fund

Employers Forum
2019 valuation update

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4 February 2020

Executive summary – key questions



- What is a **valuation**?



- How do the **assumptions** fit together?



- What are the whole Fund **results** and **contribution rates**?



- What are the **employer results**?



- How do we manage all the **risks** including regulatory risks (McCloud)

Purpose of the valuation

- Required by Regulations
- Set appropriate contribution rates for each employer from 1 April 2020 to 31 March 2023
- Help Fund manage risk
- Section 13 valuations are separate
 - independent review to help funds compare

The desirability of maintaining as nearly **constant a primary rate** as possible

Apply current version of the administering authority's **funding strategy statement**

The requirement to secure the **solvency** of the pension fund

The **long-term cost efficiency** of the Scheme so far as relating to the pension fund

Purpose of the valuation – funding the benefits



Data requirements

Member data

Actives
Deferreds
Pensioners



Cashflow data

Benefits paid
Contributions
Transfers out

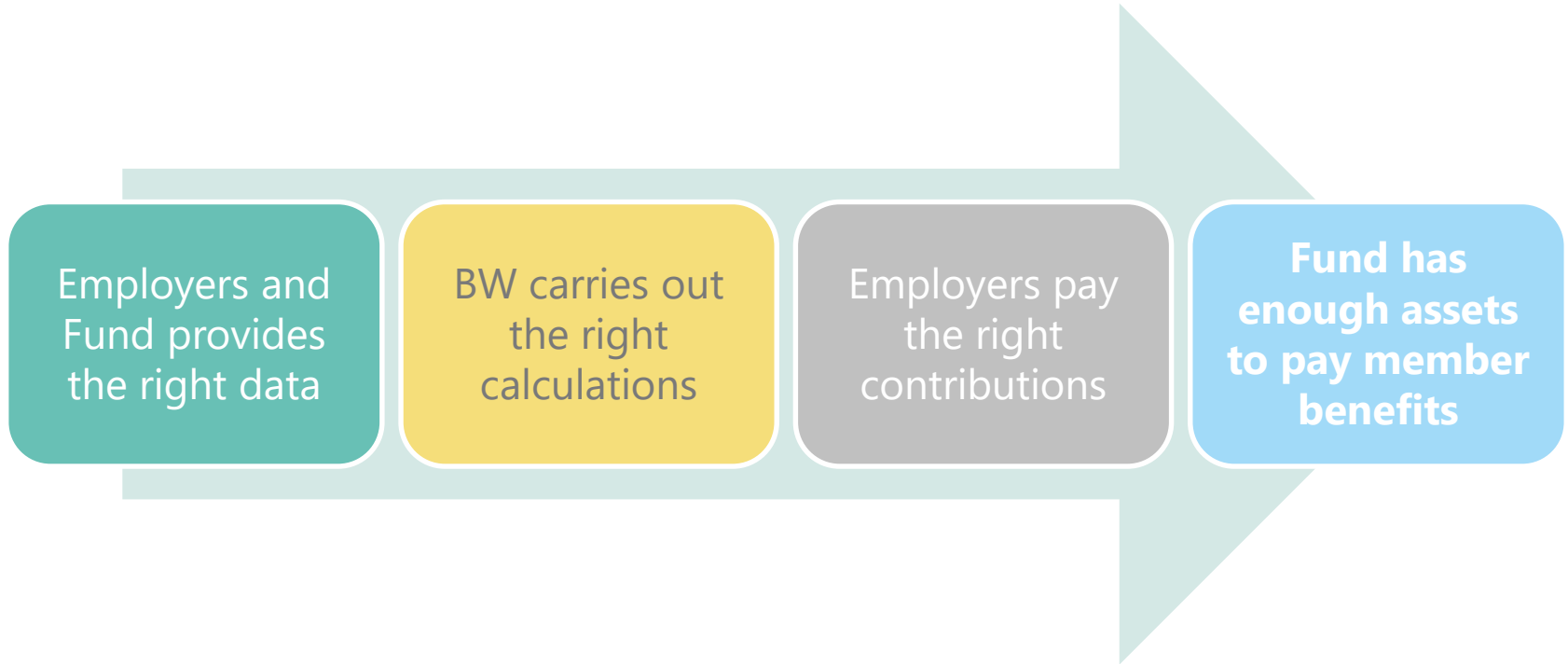
Employer data

Specific arrangements
Covenant strength
Cashflows

Investment data

Strategy
Assets
Performance

The importance of data



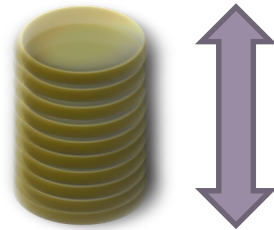
What do we do – Assets?

Begin with assets at start of period

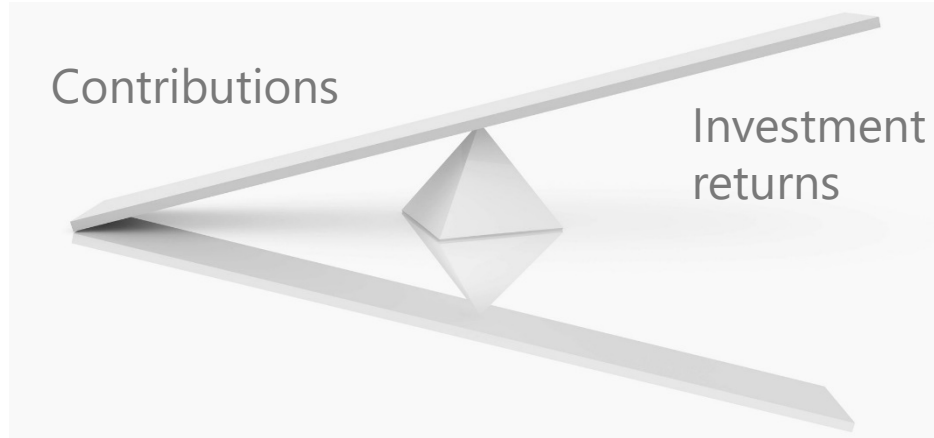
Increased by contributions paid in

Reduced by benefits paid out

With an additional gain or loss from Fund investment returns



What do we do – paying the benefits



Striking a balance between cash and returns

First project the cashflows...

Step 1

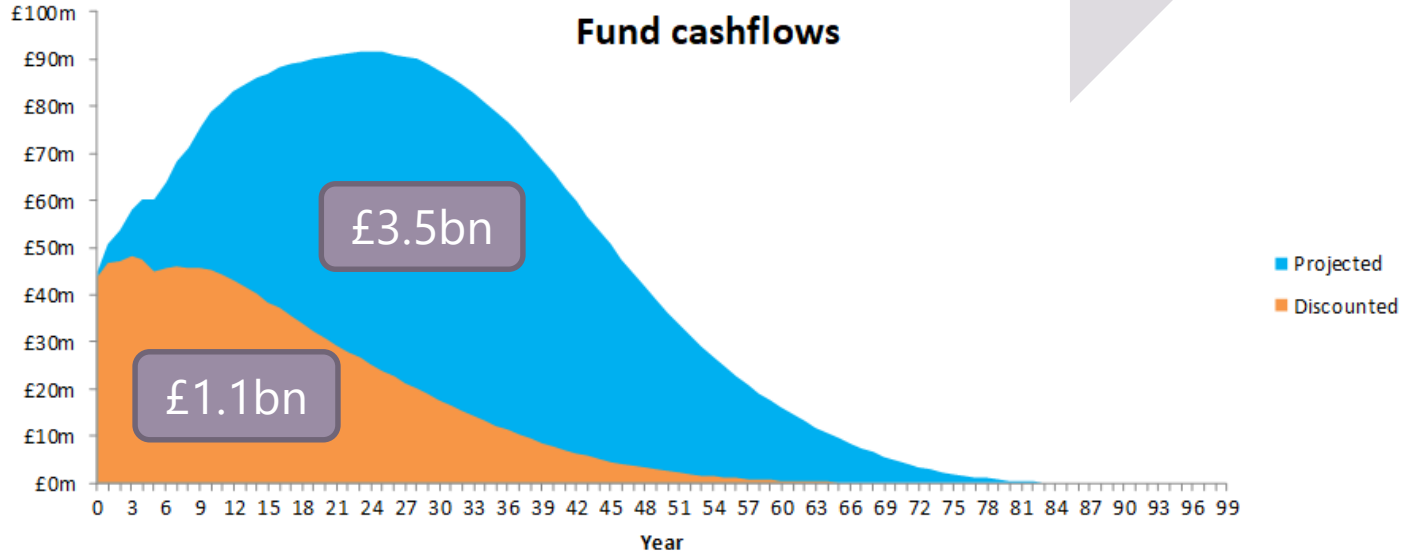
- Projection of all possible benefit payments for each member

Step 2

- Attach probabilities to each possible payment to get "expected" payments

Step 3

- Discount "expected" payments to present day value



What is the key outcome? - *Contributions*

Future service contribution rate / Primary rate

- Annual cost of next year's pension earned
- Employer's share of cost

Past service contribution rate / Secondary rate

- Contribution to fund any deficit (cash sum or % of pay)

Primary rate + secondary rate

Total contribution rate

Key assumptions

Key assumptions: inflation (CPI)

- Used for pension increases, revaluation in deferment, CARE revaluation
- 2016 assumption was 0.9% p.a. below RPI
- 2019 assumption **increase to 1.0% p.a. below RPI** based on analysis
- Already moved to 1.0% p.a. for accounting purposes
- Also used as basis for salary increase assumption

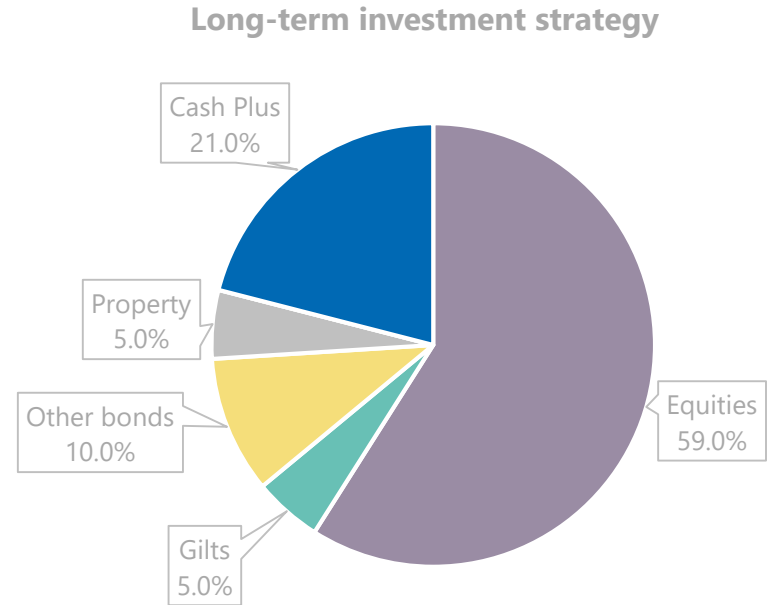
CPI
intervaluation
experience

2017 = 1.0%
2018 = 3.0%
2019 = 2.4%

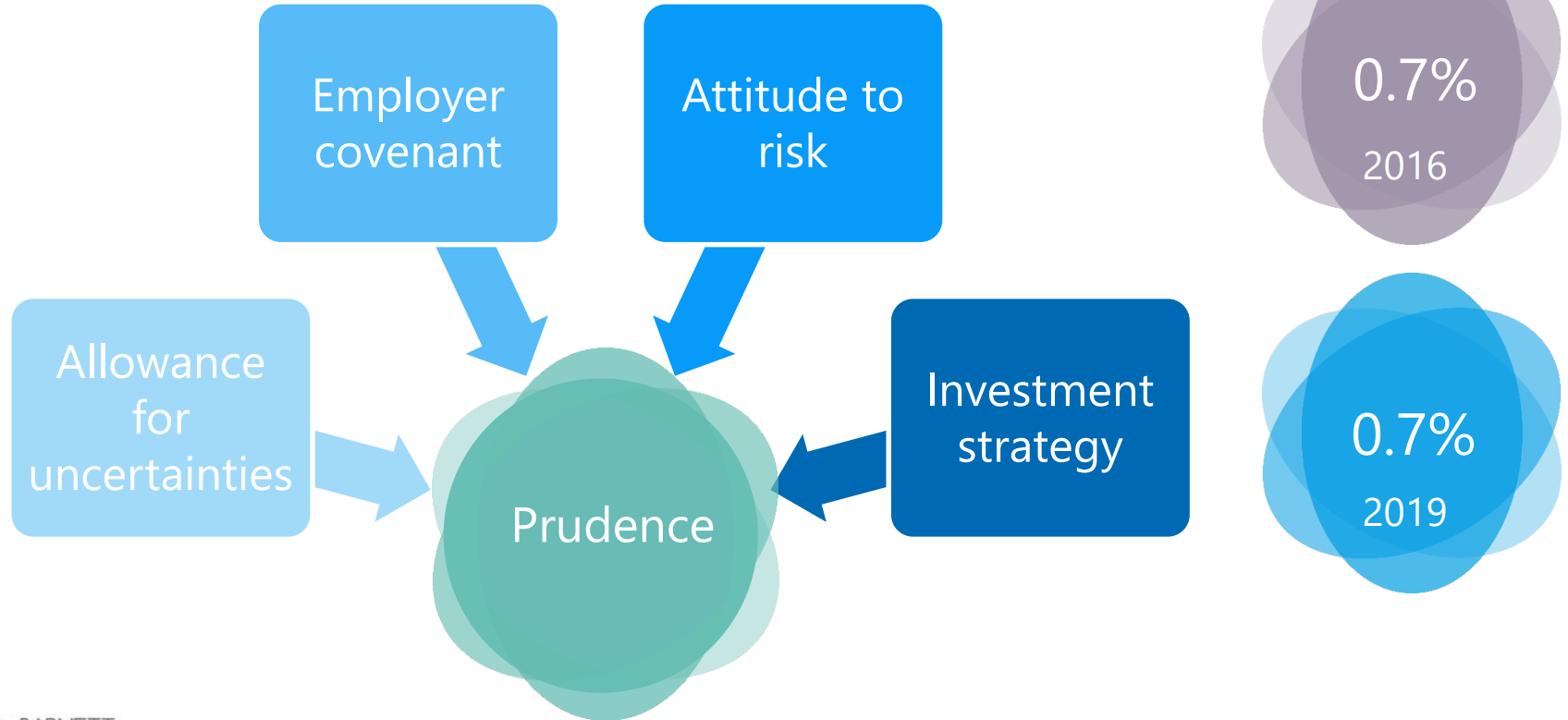
*Source: Pensions
Increase Order*

Discount rate – *BW economic model*

- Weighted expected future investment returns from long-term investment strategy (top down approach)
- Assumptions assessed over six month period spanning valuation date (smoothed)
- Specifically designed for LGPS
- Smoothed returns help stability
- Expenses allowance included here rather than primary rate



Discount rate – prudence allowance



Discount rate – combining returns

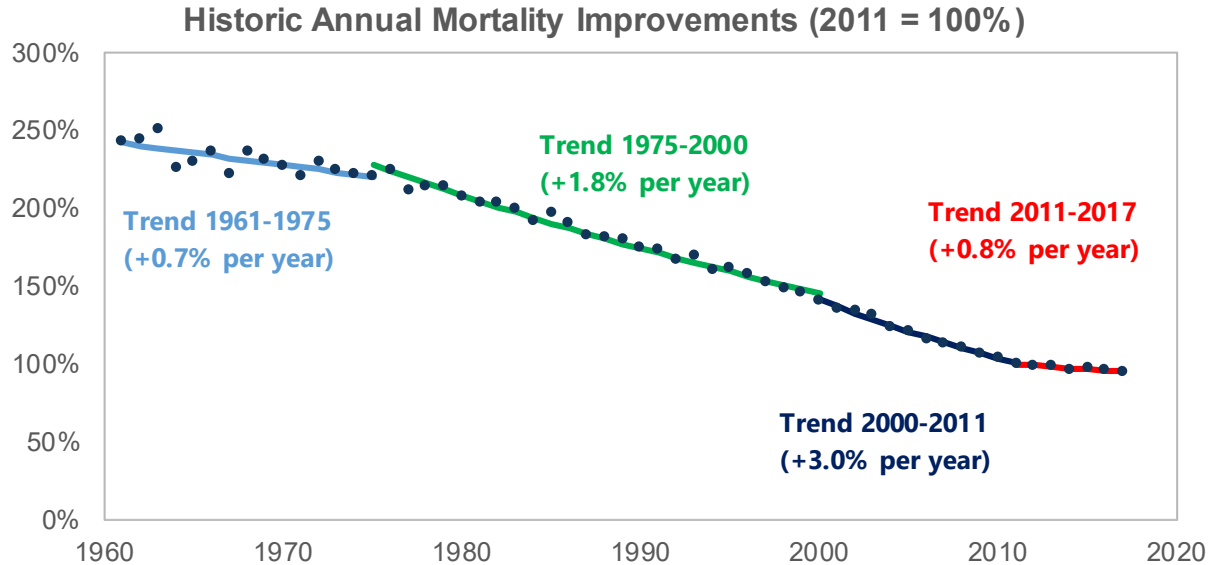
Asset class	2019 allocation	Neutral assumption (p.a.)
Equities	59.0%	6.7%
Gilts	5.0%	1.7%
Other bonds	10.0%	2.6%
Property	5.0%	6.1%
Cash	0.0%	0.8%
Cash Plus	21.0%	5.0%
Less expenses		0.2%
Neutral return		5.4%
Less prudence adj.		0.7%
Prudent discount rate assumption		4.7%
Relative to CPI		2.1%

5.4%
2016

4.7%
2019

2.1% real
discount
rate

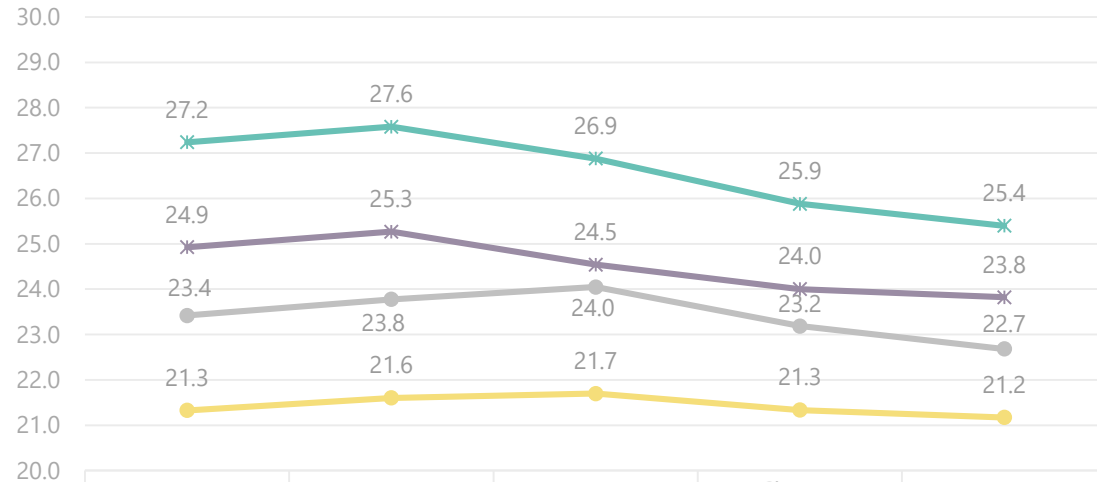
Longevity experience



Source: Barnett Waddingham calculations using Office for National Statistics data






Longevity experience

Life expectancies from age 65



	2016 basis at 31 March 2016	2016 basis at 31 March 2019	Change base table (and multipliers)	Change projection from CMI 2015 to CMI 2018	Change LTR from 1.5% to 1.25%
✱ Female retiring today	24.9	25.3	24.5	24.0	23.8
✱ Female retiring in 20 years	27.2	27.6	26.9	25.9	25.4
● Male retiring today	21.3	21.6	21.7	21.3	21.2
● Male retiring in 20 years	23.4	23.8	24.0	23.2	22.7

Key assumptions - summary

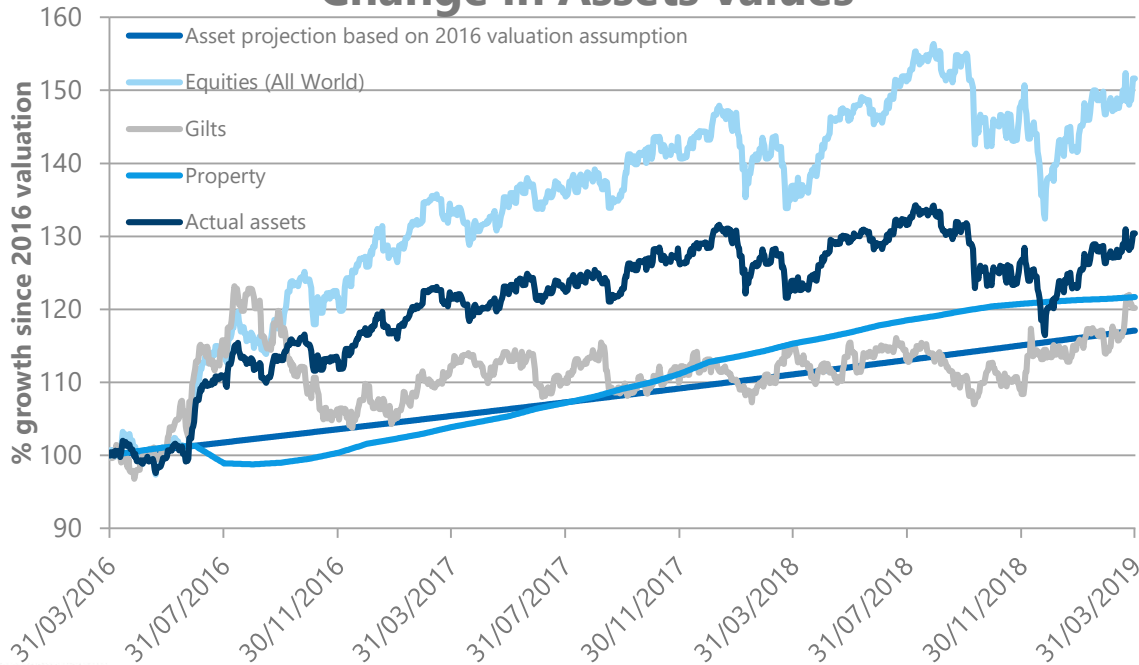
Assumption	2019	2016	Effect
CPI inflation	2.6% p.a.	2.4% p.a.	
Salary increases	3.6% p.a.	2.4%/3.9% p.a.	Minimal
Discount rate	4.7% p.a.	5.4% p.a.	
Mortality base tables	CMI S3PA_H	CMI S2PA	
Improvement model	CMI 2018	CMI 2015	
Long-term rate of imp	1.25%	1.5%	

Results

Assets

Market value at 31 March 2019 = £1,039m

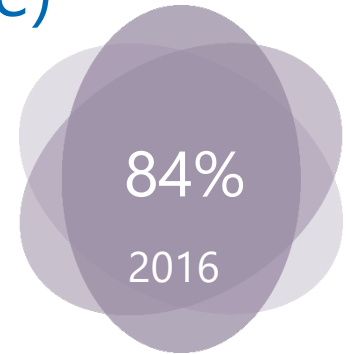
Change in Assets values



Year	Annual return
2016/17	21.9%
2017/18	2.0%
2018/19	9.4%
Average	10.8%

Summary - whole Fund results (past service)

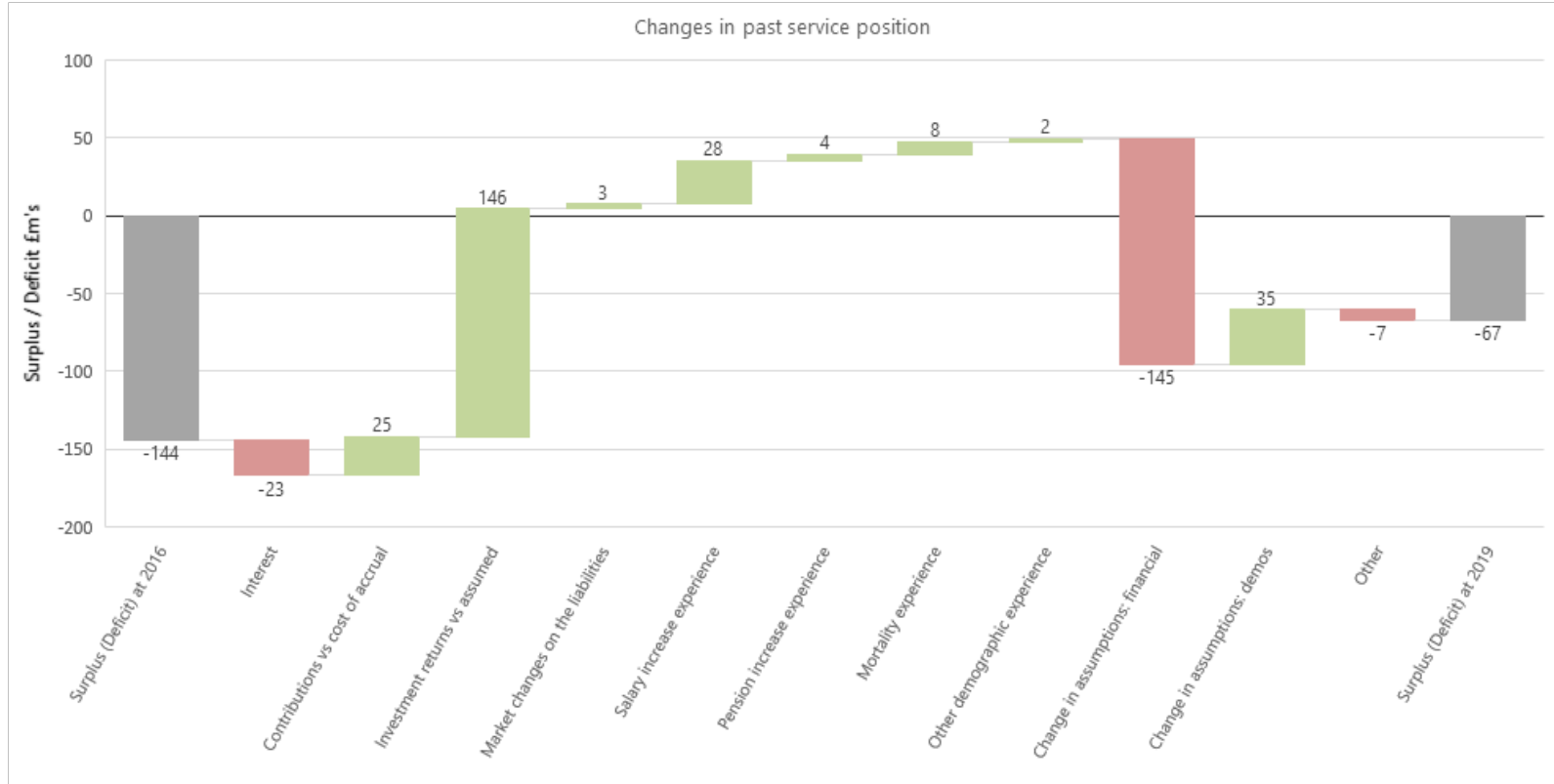
Past service funding position	Proposed basis	Previous valuation
	31 March 2019	31 March 2016
	£m	£m
Smoothed asset value	1,034	772
Past service liabilities		
Actives	304	344
Deferred pensioners	303	179
Pensioners	494	393
Total Liabilities	1,101	916
Surplus (Deficit)	-67	-144
Funding level	94%	84%



Key takeaway

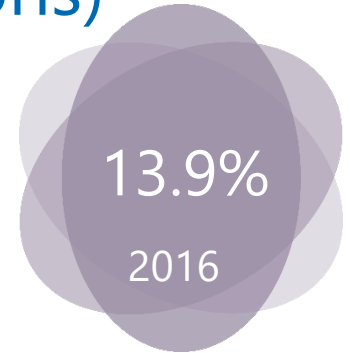
- Improvement in position since 2016
- Will vary by employer
- Lots of legislative uncertainty (McCloud)

Reconciliation - whole Fund results



Summary - whole Fund results (contributions)

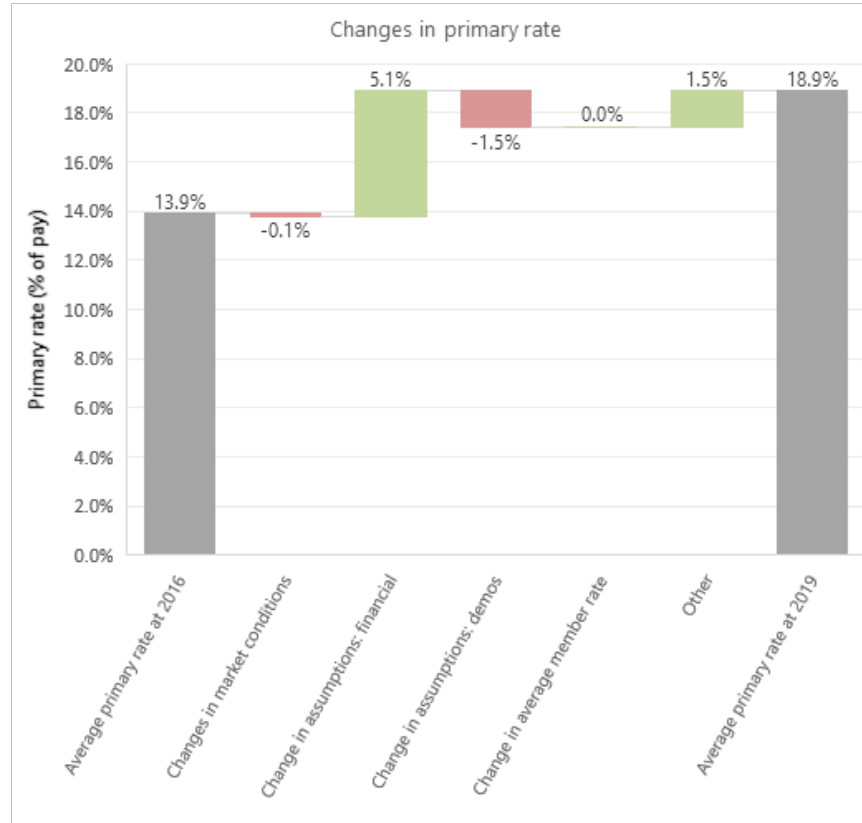
Primary rate	Proposed basis 31 March 2019 % of payroll p.a.	Previous valuation 31 March 2016 % of payroll p.a.
Average total future service rate	25.4%	20.4%
Less average member rate	-6.5%	-6.5%
Fund primary rate	18.9%	13.9%



Key takeaway

- Will vary by employer
- Increase in primary rate
- Secondary rate not included
- Overall aiming for stability of total level of contributions

Reconciliation – primary contribution rate



Key factors

Good news

- Good asset performance
- Improved funding position
- Slow down in mortality improvements

Bad news

- Reduction in real discount rate
- Increase in primary rate

Other Considerations

Employer contributions and cash flow

- Employer contributions kept as stable as possible though all employers are different
- Fund benefit payments now exceed contributions received
- But Fund's investment strategy positioned to provide investment income
- Contributions plus investment income will meet benefit payments for long term

Section 13

An independent review by the Government Actuary's Department of local LGPS funding valuations and employer contribution rates

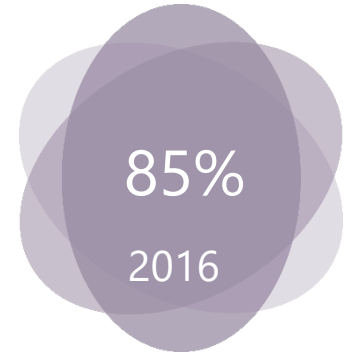
- Funds can still have their own bespoke funding plan
 - Funding model / assumptions / recovery period etc.
- But need to keep an eye on s13 valuation
 - Avoid being flagged
 - Will be an issue for some Funds/employers re affordability / stability of contribution

Good results for London Borough of Hounslow Fund at 2016

- Green flags achieved for all measures

Standardised basis - results

Past service funding position	Standardised basis	
	31 March 2019	
	£m	
Unsmoothed asset value	1,039	
Past service liabilities		
	Actives	279
	Deferred pensioners	258
	Pensioners	470
Total Liabilities	1,007	
Surplus (Deficit)	32	
Funding level	103%	



Changes to the scheme?

20 December 2018 McCloud judgement

- Judges (McCloud) and firefighters (Sargeant) schemes
- Transitional protections
- Unlawful on grounds of age discrimination

30 January 2019 – pause to the cost control mechanism announced

- All public service schemes
- Government applied to Supreme Court for permission to appeal
- 27 June 2019 appeal denied

What are we going to do?

- 14 February 2019 SAB published McCloud Q&A
- Majority voted for SAB to provide guidance with regards to the 2019 valuations
- Decide approach with your actuary based on materiality
- 3.2% of active liabilities (based on GAD analysis – worst case scenario)

Key takeaways

Funding position

Funding position improved from 84% to 94%

Contributions

18.9% primary rate.
Secondary rates to follow.

Financial assumptions

4.7% discount rate compared to 5.4% at 2016

Demographic assumptions

Members living not as long as previously thought

Regulatory uncertainty

McCloud, valuation cycles, Section 13

Regulatory information

- The information in this presentation is based on our understanding of current taxation law, proposed legislation and HM Revenue & Customs practice, which may be subject to future variation.
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