2022 Actuarial Valuation and FSS consultation

Shropshire County Pension Fund

December 2022

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welcome to brighter

Valuation training recap

2019 review & what's happened since

Funding strategy statement

2022 valuation results

Employer risk

Next Steps

Questions

Valuation training recap

Valuation training recap

WHY

- Legislative requirement
- Good practice and governance
- Review performance
- Adjust strategy

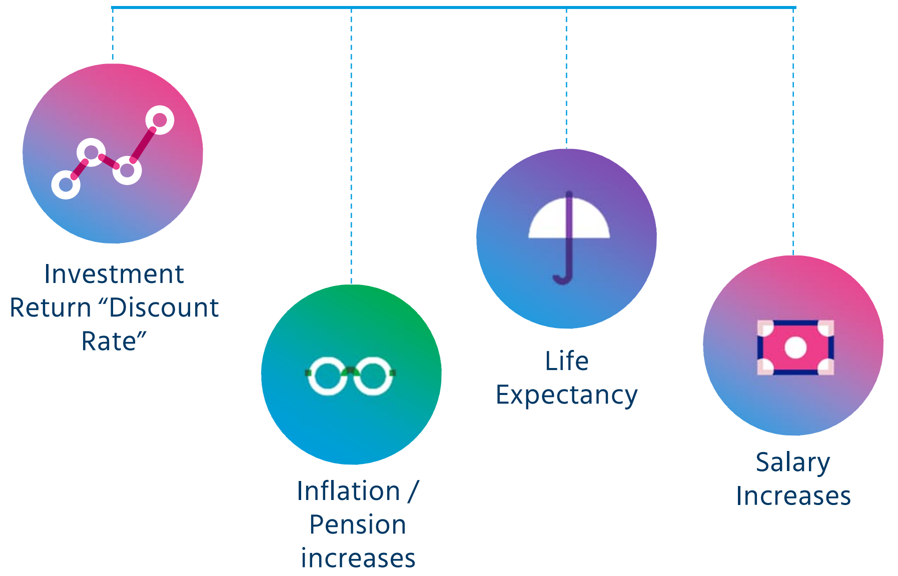
INPUTS

- Member data
- Asset / financial information
- Funding strategy
- Assumptions

OUTCOMES

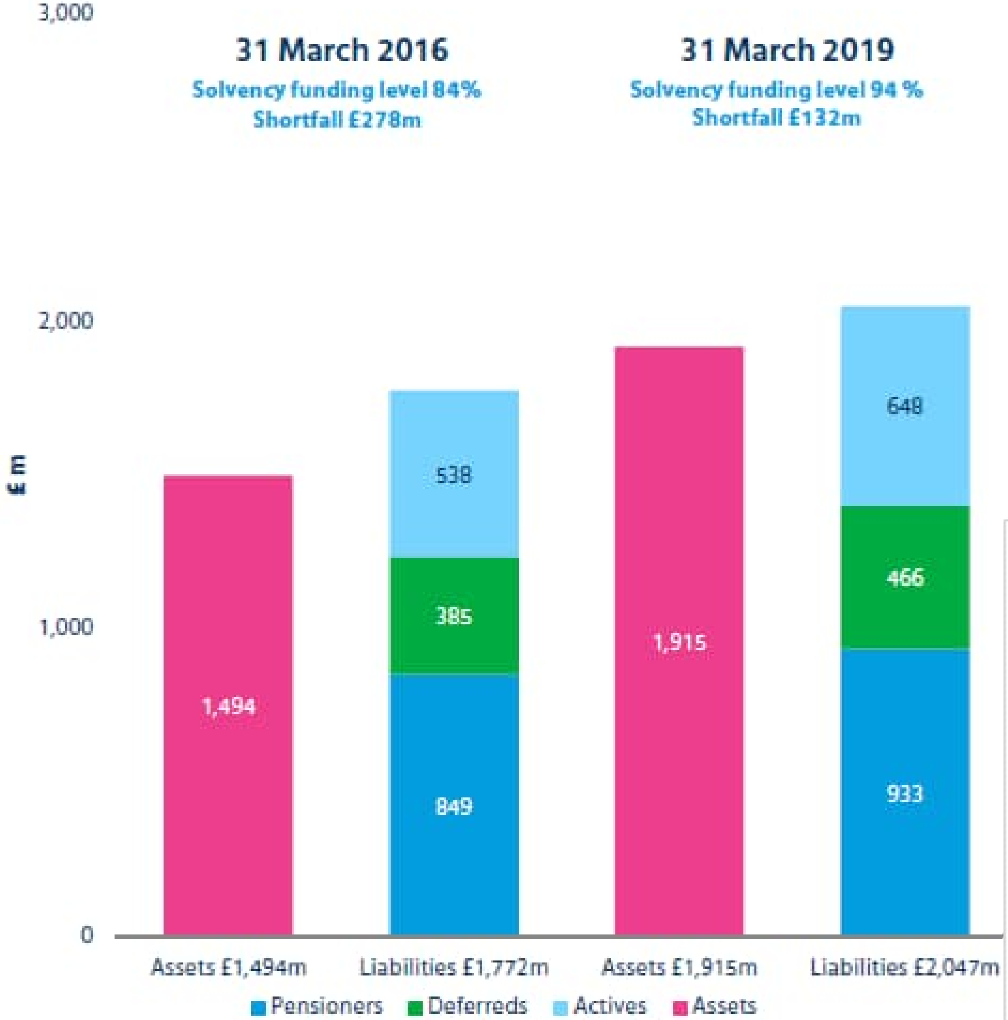
- Funding positions
- Future service contributions
- Deficit contributions / surplus offsets…
- …for every employer

Key Assumptions



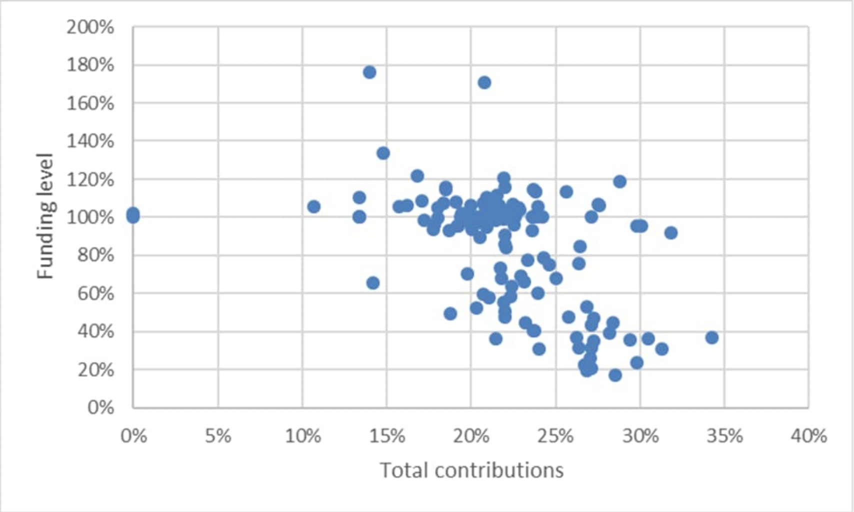
2019 review
& what's happened since

2019 valuation review
Whole Fund results as at 31 March 2019



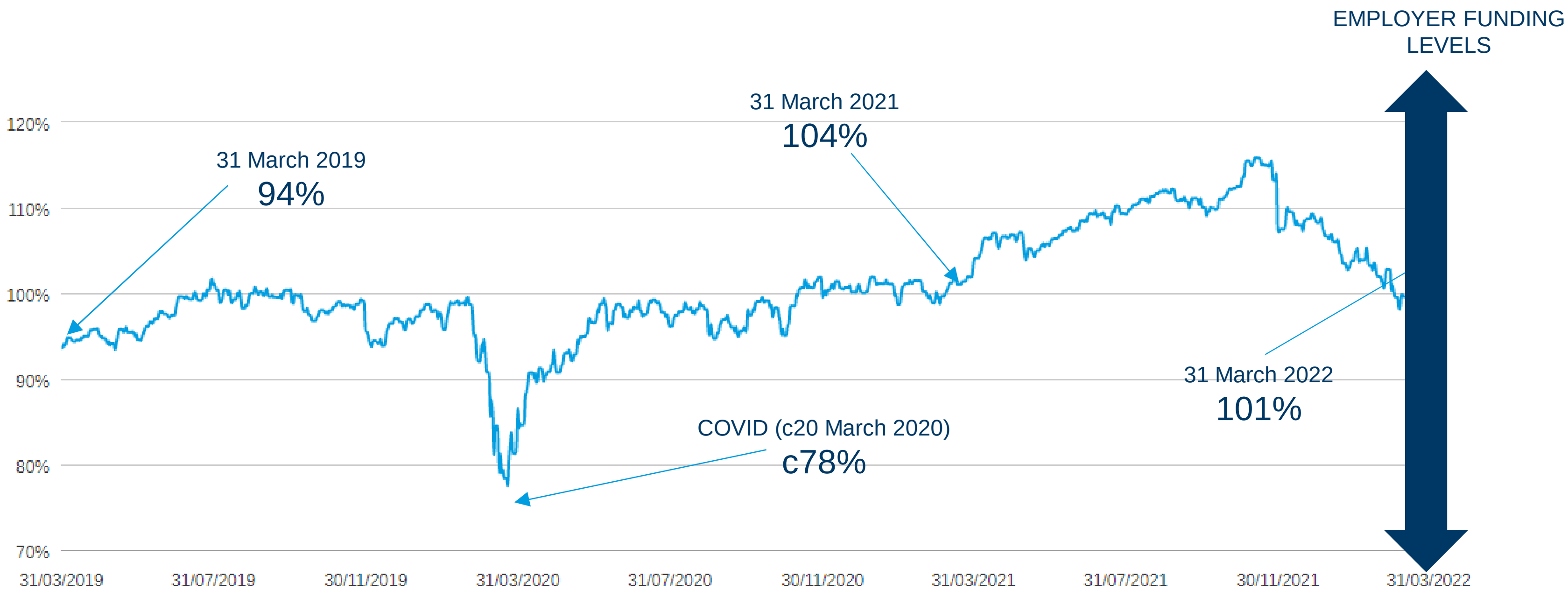
Average Future Service / Primary Rate for the Fund was **16.6%** of pay

Deficit / Secondary contributions of **c£9m p.a.**



Funding progression

“Like for like” assumptions and membership data



The Fund has seen strong investment performance since 2019. This has caused the like for like (i.e. ignoring potential assumption changes and McCloud) funding level to improve significantly.

At employer level the impact of this will vary significantly – better funded employers have more assets and so get more investment return

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Demographic analysis impact

	Liabilities	Future service rate
Mortality post ret – base	-c2.0%	-c0.6%
Mortality post ret – improvements	+c0.0%	+c0.0%
Commutation	+0.3%	+c0.3%
Proportions married	+0.1%	+0.0%
Mortality pre retirement	-0.2%	+0.1%
Ill-health	0.0%	+0.0%
Total	-1.8%	-0.2%

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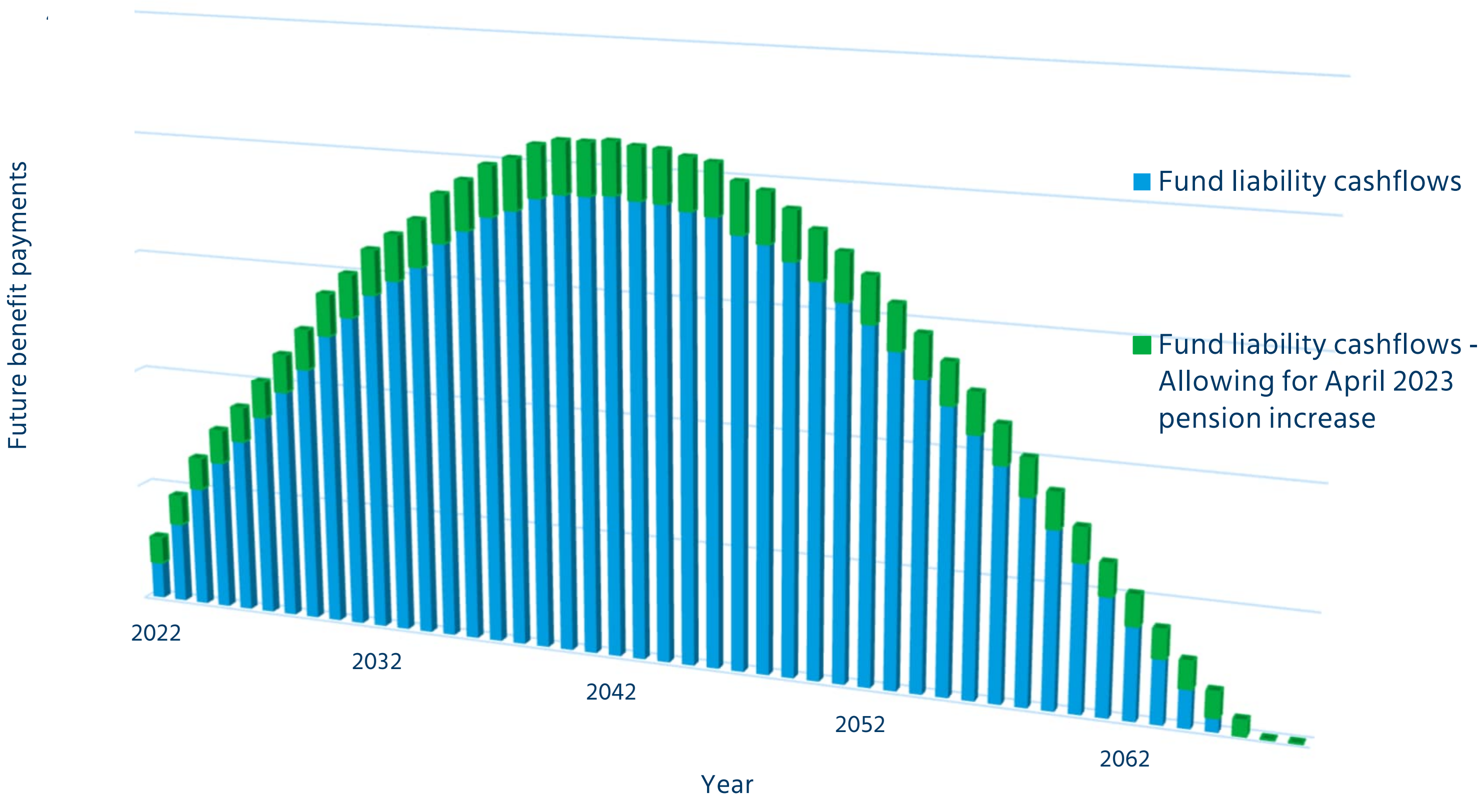
Inflation risk – 2023 pension increase



The 2023 pension increase is expected to be 10.1%, almost the same as the total of the last 5 years' increases.
This means higher pension payments in every future year for all Scheme members

Funding Strategy Statement (FSS)

Funding Strategy Statement (FSS)

Key assumption changes since 2019

Assumption	2019	2022	Comments
Ongoing Discount Rate	4.25% p.a. (past) 4.65% p.a. (future)	4.80% p.a. (past) 5.20% p.a. (future)	Higher than in 2019 by 0.55% (0.15% p.a. reduction in real return above inflation)
Lower Risk Discount Rate	n/a	4.55% p.a. (past) 4.70% p.a. (future)	0.25%/0.5% reduction in discount rate compared with ongoing rate above, for employers without a bond or taxpayer guarantee (see later)
Future Inflation	2.40% p.a.	3.10% p.a.	The 2022 assumption increased by 0.7% p.a. takes account of both market expectations and Bank of England targets.
Observed CPI Inflation	No allowance	Allowance for the 6 month period to 31 March 2022	Experience after March will be incorporated into the 2025 valuation or earlier update
Life Expectancy	CMI 2018 with 1.5% long term improvements – base table as per 2019 actuarial valuation report	CMI 2021 with 1.5% long term improvements –base table as per draft FSS	The overall liability impact is a small reduction in liabilities and future service rates, but with some variation by employer
McCloud	No allowance (unless employers elected to pre-fund	Individual member calculations for actives	Regulations aren't finalised yet but this is on the basis that they will be finalised by 31 March 2023 and Fund guidance issued. This reduces funding level (all other things equal).
Other demographics	As per 2019 actuarial valuation report	Updated as per draft FSS	Full demographic analysis showed some adjustments required – small increase in liabilities / contributions.

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Funding Strategy Statement (FSS)

2022 Key points and changes

1. The existing recovery period target is reduced by 3 years (or change in average future working lifetime if closed). Where in surplus, off-sets applied if there is no shortfall on the termination basis.

2. Non guaranteed / non tax raising employers will have a choice of paying a risk premium (funding on the lower risk basis) or supply a bond based on the termination shortfall to support their covenant

3. The FSS is structured to provide flexibility so employers can manage the balance between affordability and sustainability of contributions and determines the ***minimum*** contributions payable

4. With Fund agreement, employers may be given the option to prepay deficit contributions. In limited circumstances employers can prepay employer future service contributions (net of surplus offsets if applicable) but the Fund ***will not*** allow employers to prepay employee contributions

5. Ill health captive arrangement for smaller employers introduced to provide protection against potentially material ill health early retirement costs

6. Where contributions are increasing, employers will have the option of paying the existing rate over 23/24 before stepping up to the higher contributions. Further phasing options also available.

The Funding Strategy Statement has been revamped in 2022 to make it easier to read and communicate to employers

2022 valuation results

Whole Fund results

	31/03/2019 (exc McCloud)	31/03/2022 results	Illustration - stagflation "cost" of 0.25% pa
Discount rate (past service) (CPI +)	1.85%	1.70%	1.45%
Discount rate (future service) (CPI +)	2.25%	2.10%	1.85%
Mortality	CMI 2018 1.5%	CMI 2021 1.5%	CMI 2021 1.5%
Real salary / deficit contribution increases	1.25% / 1.5%	1.25%	1.25%
Recovery period	19	16	16
Expenses (% of pay)	0.6%	0.8%	0.8%
Surplus / (deficit)	-£132m	-£10m	-£111m
Funding level	94%	100%	95%
Primary contributions	16.6%	18.0%	19.5%
Secondary contributions (p.a.)	£10m	£1m	£7m
Secondary contributions as % of pay*	3.5%	0.2%	2.6%
Pay	£288m	£288m	£288m
Total employer contributions (%)	**20.1%**	**18.2%**	**22.1%**

1. Assets from draft accounts as at 31 March 2022

2. The final declared whole Fund results will be based on the sum of each individual employers results after all parameters are finalised.

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Post valuation experience

Since the valuation date we have seen:

- **Assets down** – the Fund's assets fell by c6% to £2.2bn over the seven months to end of October
- **High inflation** – inflation between March and October was 7.8% (so equivalent to c14% pa). This directly increases the liabilities

In isolation, these two factors would reduce the like for like funding level from 100% **to below 90% at the end of October.**

In practice, there has been a corresponding reduction in assumed future inflation (of around 0.5%) over the same period, as the seven months of very high inflation is now removed from the future assumption. If we were to rerun the discount rate analysis at 31 October, the **expected real returns may well be higher** than as at 31 March on account of this, in isolation of other impacts, absorbing the increase in liabilities due to the seven months high inflation. The position would still be very uncertain though, with any improvement in expected returns being **accompanied by significant uncertainty**.

This volatility highlights the risks that need to be managed and the challenges in striving for stable but affordable contribution rates.

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Employer risk

Employer risk

The risk

- Wide variety of employers in the Fund. Only some have **taxpayer guarantee**.
- **c10%** of Fund liabilities are not guaranteed. Here the Fund relies on the strength of the employer.
- To protect the other employers, **a higher exit debt is paid** (to leave a buffer of assets as protection).
- **The risk** is that those with no taxpayer guarantee can't meet their obligations – i.e. **can't pay their exit debt –** and so it falls to other employers.

What to do?

- **Do nothing?** Leaves the remaining **employers exposed to the risk of unfunded exit debts**, and the Fund has a responsibility to consider this.
- **Focus on the highest risk employers only**? Some targeting is built in. But **no private employer covenant matches a Government guarantee**. So there is a strong argument that this should be reflected in Fund policy.
- **Why do this now?** Many Funds implemented a similar policy in 2019 valuation (or before). GAD has since raised issues related to the increased size of covenant risk (relative to overall payroll funding). And the current economic climate increases the chance of employers falling into difficulty.
- **What form should any policy take?**
    - **bonds / security** – direct protection in full against the unfunded exit debts, or
    - **increased contributions** – gradually reduce the potential unfunded debt

Proposed funding approach

- The funding strategy will be updated for the non-taxpayer backed employers to request either:
  - a bond provided by the employer. This will be based on the value of the unfunded exit debt, or
  - “stronger” funding assumptions, meaning potentially higher contributions, to gradually build up assets and so reduce the unfunded exit debt
- The employer will be able to select their preferred approach with the default approach being stronger funding assumptions
- The Fund will have discretion for high risk employers or those close to exit to seek higher contributions/a bond beyond the above if required
- Any increases in contributions can be phased in over three years

	Taxpayer backed	Non-taxpayer backed Full bond provided	Non-taxpayer backed Lower or nil bond
Bond / security provided	N/A	Yes	No
Funding target (i.e. liability value and so deficit contributions)	Standard	Standard	Higher (reduced discount rate)
Future service rate	Standard	Standard	Higher (reduced discount rate)
Deficit recovery period	Standard	Standard	Potentially shorter
Surplus offset allowed?	Yes	No	No
Alter funding approach if close to exit	No	Optional	Optional

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Comparison With Other Funds

Funding Strategy Statements can be fairly opaque. But a review of a sample of other (non-Mercer) Funds who addressed this issues showed that for non-taxpayer backed employers:

- no Funds gave exactly the same treatment as Councils – all allowed for some level of "stronger" treatment (e.g. no surplus offsets, shorter recovery period)
- Many (below) have an approach that will produce significantly higher contributions than a corresponding Council – lower discount rates / higher funding target
- Note that if we factor in exit terms as well, the current SCPF approach is more generous than the majority of LGPS Funds. We aren't aware of any LGPS Funds that currently have a more generous combined approach to non tax payer backed employers than SCPF

Examples:

Staffordshire
No surplus offsets
Higher funding target
Shorter recovery period
More volatile contributions

West Mids
Loading to liabilities
(even higher if weak covenant)
Shorter recovery period

Warks
No surplus offsets
Higher funding target
More volatile contributions

Hertfordshire
No surplus offsets
Higher funding target
(CAB only)

Cardiff
Lower discount rate

Durham
Lower discount rate

Funds will review their approach at this valuation. We are expecting that many of those who did not have a materially stronger funding approach for non-guaranteed employers in 2019 will increase their measures in 2022.

Ill health “captive” arrangement
In-house insurance for smaller employers

- Ill-health (IH) retirements see benefit enhancements that result in one off increases in liability – these can be very large.
- Previously, the expected cost of ill-health retirements was included in the future service contributions. For larger employers this covers costs quite well.
- But for smaller employers, experience can be very volatile and costs relative to total liabilities can be very high when an ill health retirement occurs. Post Covid-19, there is even more uncertainty associated with ill health

	Large employer	Small employer (no IH)	Small employer (1 IH)
Deficit pre IH	£50m	£50k	£50k
Deficit contributions pa	£3.3m	£3k	£3k
IH contributions pa (0.6% of pay)	£0.5m	£1k	£1k
IH costs pa (c£50k* per case)	£0.5m	Nil	£50k
IH strain / deficit increase	Nil	Nil	£49k
Increase in contributions	Nil	Nil	£3k (100% increase)

*This was the average over 2016-2019

The intention is to introduce an **ill-health captive insurance arrangement from 1 April 2022**. This is akin to insurance, but is provided internally by the Fund, and so avoids transferring profits to insurers, so costs employers less for the protection.

Next steps

Looking Forward – 2022 Valuation

Timescales

Early Dec 2022
- Employer 1-2-1s and discussions
- Funding Strategy principles to committee
- Employer 1:1's

Jan 2022
- Consultation closes

Dec 2022
- Employer consultation on FSS

Q1 2023
- Finalise employer contributions

Jan / Mar 2023
- Rates certified
- Valuation report issued

Questions?

Supporting information

Funding Strategy Statement

LGPS Regulatory Requirements

LGPS Regulations

Reg. 62(6)(b)	Reg. 62(6)(d)	Reg. 64(2)
"The actuary must have regard .... to the desirability of maintaining as nearly **constant a primary rate** as possible".	"The actuary must have regard to the requirement to **secure the solvency of the pension fund** and the **long term cost efficiency** of the Scheme…"	"(2) When a person becomes an **exiting employer**, the appropriate administering authority must obtain- (a) **an actuarial valuation** as at the exit date…; and (b) **a revised… certificate** showing the exit payment due...

Public Service Pensions Act 2013

Section 13(4)(c)

"A person appointed… is to report on whether… the rate of employer contributions is set… at an appropriate level to ensure

(a) the **solvency of the pension fund**, and

(b) the **long-term cost efficiency** of the Scheme…"

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Data summary
Whole Fund

	31 March 2022
Active members	
Number	16,616
Total Pensionable Salaries	£275m p.a.
Average Pensionable Salary	£16,576 p.a.
Deferred pensioners	
Number	21,659
Total deferred pensions revalued to valuation date	£27.8m p.a.
Average deferred pension	£1,282 p.a.
Pensioners (including dependants)	
Number	13,749
Total pensions payable	£67.2m p.a.
Average pension	£4,890 p.a.

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Actuarial Advice

- We have prepared this document for the Administering Authority for the purpose of assisting employers with planning ahead of the 2022 valuation of the Fund
- "Technical Actuarial Standard 100: Principles for Technical Actuarial Work" issued by the Financial Reporting Council applies to this presentation and the associated work, and we confirm compliance with this standard. This presentation should be read in conjunction with our report on the actuarial valuation of the Fund as at 31 March 2019.
- Unless otherwise stated, we have relied on the information and 2022 member data plus other data supplied to us in preparing the information, without independent verification. We will not be responsible for any inaccuracy in the advice that is a result of any incorrect information provided to us.
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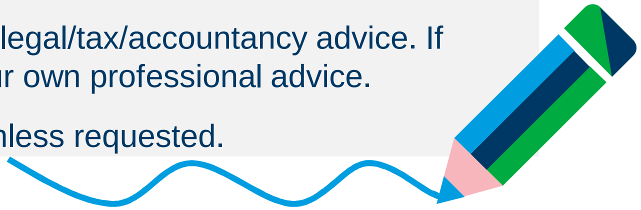
- This presentation is correct as at November 2022. It will not be updated unless requested.



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