City of Westminster Pension Fund

2016 Valuation

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November 2016

Agenda

- Purpose of valuations?
- Where were we 2013?
- Where are we at 2016?
  - Challenges
  - Assumptions
  - Results
- Next steps

Purpose of valuations?

BACKGROUND

Purpose of valuations

Valuations	• Answer questions • Many questions!
Ongoing triennial funding valuation	• How much do employers need to pay in future to have enough assets to pay benefits?
Annual accounting valuations (IAS19/FRS102)	• Help accountants compare
GAD valuations	• Long term costs of LGPS / section 13

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Triennial Funding Valuation

Set out in LGPS Regulations	• to *certify* levels of employer contributions to secure the *solvency* of the Fund and the *long term cost efficiency* of the Scheme
Also have regard to the Funding Strategy Statement	• As determined by administering authority • With some actuarial help and guidance from CIPFA
Actuary to "have regard to desirability of maintaining as nearly constant a (primary) contribution rate as possible"	• Function of Funding Model / investment strategy • Spreading and stepping
Different approaches possible for different employer types	• Statutory/non statutory bodies • Open or closed admission agreements • Look at employer financial strength ("covenant")

Funding Strategy Statement

Regulation 58 of the LGPS 2013 Regulations

- Responsibility of the administering authority
- Keep under review
- Consult other parties (mainly employers)
- Have regard to CIPFA guidance

CIPFA Guidance

- Transparency
- Prudent long term view
- Stability of contributions

Revised CIPFA guidance just issued

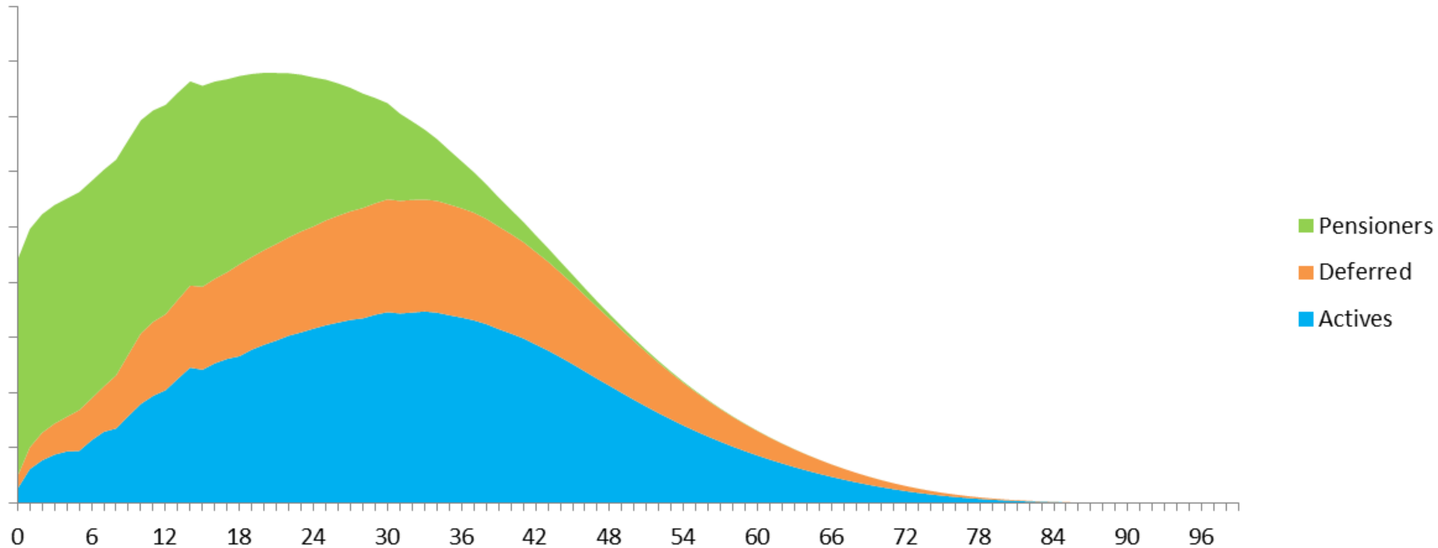
"Administering authorities are reminded that securing solvency and long term cost efficiency is a regulatory requirement whereas a constant as possible (primary) contribution rate remains only a desirable outcome".

How do we do it?

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 obtain "value"



2013 valuation results

WHERE WERE WE IN 2013?

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March 2013 valuation results

- **Liabilities** of £1,164m less **assets** of £867m = **deficit** of £297m
- **Funding Level** of 74%
- Deficit contributions **of 16.5% of Pensionable Pay** to eliminate the deficit over a period of **25 years**
- **13.3% of Pensionable Pay** to meet the cost of new benefits as they are earned from year to year
- Total rate of **29.8% of Pensionable Pay**
- Contributions for Westminster stepped up to total rate via increases in deficit contributions on £1.5m a year
  - Deficit contribution of £9m for 2016/17
  - Further steps anticipated

Where are we in 2016?

2016 VALUATION CHALLENGES

2016 valuation

- KPIs
- New CIPFA guidance on Funding Strategy Statement
- Standardised results published
- Section 13
- Increased transparency and governance
- Employer Cost Cap
- Consistency

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Section 13 valuation

"Section 13 to provide for an independent review (by GAD) of the valuation and employer contribution rates to check that they are appropriate and requires remedial action to be taken where that review identifies a problem."

Compliance	• Have valuations been completed in accordance with the Regulations?
Consistency	• Has a Fund's valuation been completed on a basis "not inconsistent" with other Funds ?
Solvency	• Will certified contributions accumulate enough assets to meet liabilities over an "appropriate" period?
Long term cost efficiency	• Are certified rates "enough"? • Are employers kicking the contribution can down the road?

Summary

Funds can still have their own bespoke funding plan

- Funding model / assumptions / recovery period etc.

But need to key an eye on KPI measures and s13 valuation

- And avoid being summoned to the headmaster's office.....
- Will be an issue for some Funds/employers re affordability / stability of contribution

Some additional complexity expected...

Longer term

- Gravitating to the middle...
- Everyone will be average
- No need to compare!
- The public sector equivalent of the Minimum Funding Requirement?

Where are we in 2016?

FINANCIAL ASSUMPTIONS

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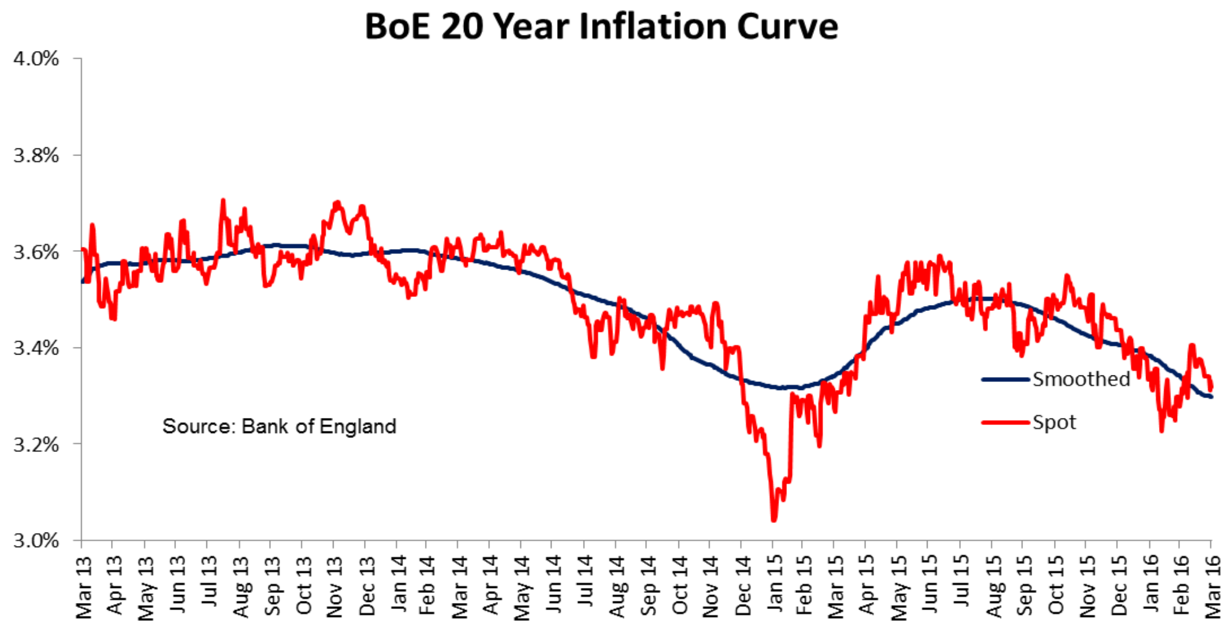
Setting assumptions

- Use **market indices / yield curves**
  - Use 20 year point on curves (duration of Fund liabilities)
- Our model uses assumptions assessed over six month period spanning valuation date **(smoothed)** to give stability
  - Assets smoothed in a consistent way
- Start with **neutral assumptions** (not deliberately optimistic or pessimistic)
  - Introduce **prudence** where there is uncertainty
  - The greater the uncertainty, the greater the **prudence**

Inflation

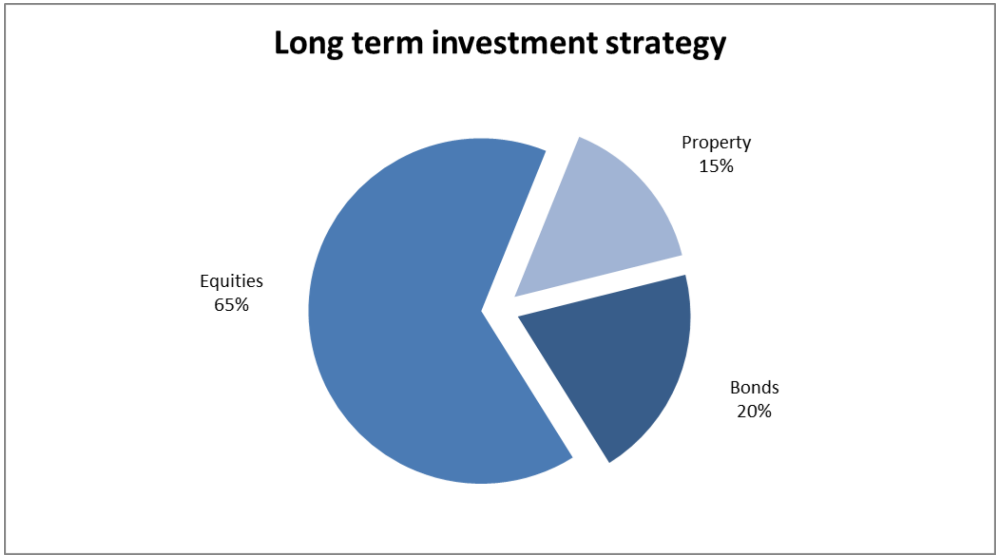


As at 31 March 2016

- 3.3% p.a. is the smoothed 20 year point on the BoE curve
- 0.9% deduction for CPI to get **2.4% p.a.**
- **Long term** salary increases of **1.5% more than CPI** (1.8% at 2013)
- **Short term** salary increases of **CPI** (until 2020)

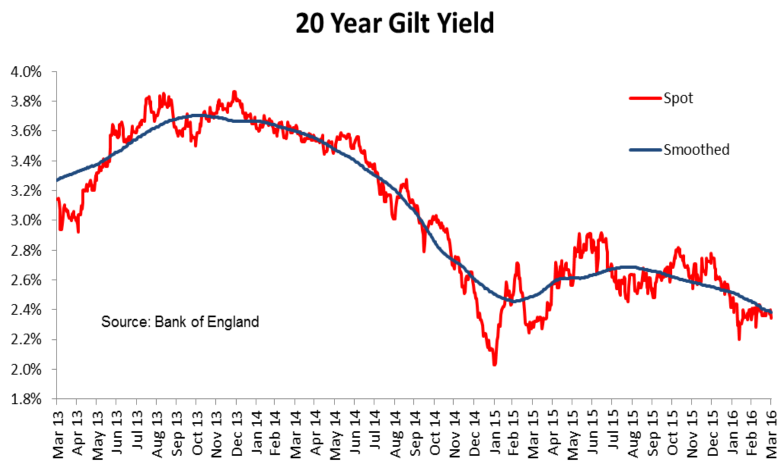
Discount rate – derivation

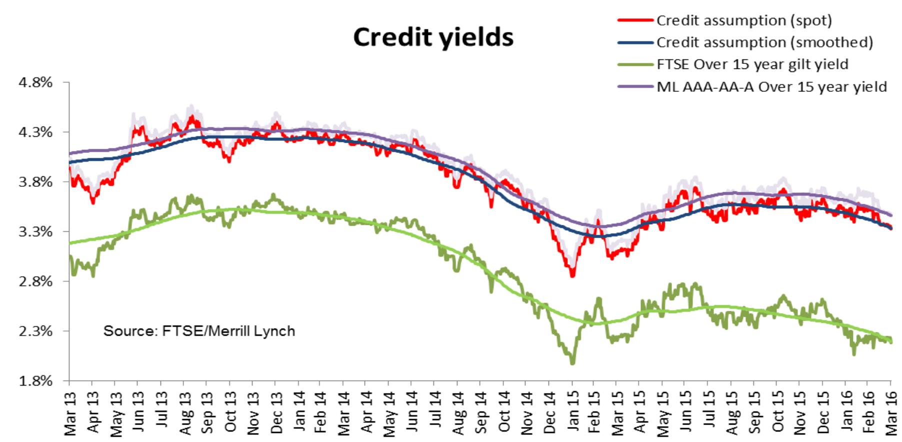
- Ongoing funding valuation so discount rate is…
  - Weighted expected future **investment return** from long-term investment strategy
- Assumptions assessed over six month period spanning valuation date **(smoothed)**



Discount rate – gilts & bonds

- Straightforward, based on current yields and credit spreads



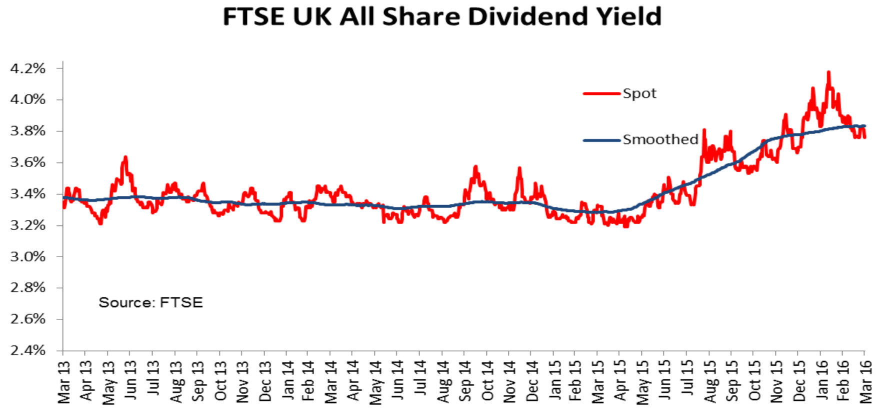


As at 31 March 2016

- **2.4% p.a.** from gilts
- **3.3% p.a.** from bonds

Discount rate – equities – BW model

equity return = dividend yield + inflation (CPI) + real capital growth



As at 31 March 2016

- Smoothed dividend yield of 3.8% p.a.
- plus CPI of 2.4% p.a.
- plus real capital growth of 1.2% p.a.
- equals **7.4% p.a.**

Discount rate - others

- **Property**
  - Expect to return between equities and gilts
  - CPI + 3.5% p.a. gives 5.9% p.a.
- **Cash**
  - Smoothed 20 year LIBOR swap curve point gives a rate of 1.8% p.a.
- **Absolute return**
  - Based on mandate – inflation / cash plus

Discount rate – prudence allowance

- What is prudence?
  - Opposite of rashness…
- Based on a number of factors:
  - the actual **proportion of the liabilities that are the responsibility of tax raising bodies** (or where a tax raising body is providing a guarantee)
  - views on the **ability of employers to pay more** later if required
  - **attitude to risk** and risk appetite of the Administering Authority
  - levels of **uncertainty** in the assumed asset returns
  - overall **asset allocation**

Starting point for 31 March 2016

- 1.1% reduction from neutral / best estimate for Scheduled Bodies
- A bit more for admission bodies

Discount rate – combining returns

Asset class	Percentage of Fund	Initial proposed assumption (% p.a.)	Real (relative to CPI)
Other bonds	20%	3.3%	0.9%
Equities	65%	7.4%	5.0%
Property	15%	5.9%	3.5%
Expenses (deduction)		-0.2%	
Neutral estimate of discount rate based on long-term investment strategy		**6.2%**	**3.8%**
Prudence allowance (Scheduled Bodies)		1.1%	
Prudence allowance (Admitted Bodies, in service)		2.3%	
Prudence allowance (Admitted Bodies, having left service)		4.0%	
Proposed discount rate assumption (Scheduled Bodies)		**5.1%**	**2.7%**
Proposed discount rate assumption (Admitted Bodies, in service)		**3.9%**	**1.5%**
Proposed discount rate assumption (Admitted Bodies, having left service)		**2.2%**	**-0.2%**

Where are we in 2016?

DEMOGRAPHIC ASSUMPTIONS

Pensioner mortality assumptions

- Review of Fund mortality over period 2011 – 2015
- Now using revised tables
- Impact best demonstrated using **life expectancies**

Life expectancy from age 65 (years)		31 March 2016	31 March 2013
Retiring today			
	Male	24.3	23.0
	Female	25.8	25.4
Retiring in 20 years			
	Male	26.5	24.8
	Female	28.1	27.3

Small increase in the value of liabilities

Where are we in 2016?

WHOLE FUND RESULTS

Initial results

Past service funding position		
		Proposed basis 31 March 2016 £000
Smoothed asset value		1,056,747
Past service liabilities		
	Actives	325,561
	Deferred pensioners	383,821
	Pensioners	659,773
	Total	1,369,155
Surplus (Deficit)		(312,408)
Funding level		77%

Primary rate	% of payroll
Total future service rate	25.3%
less employee contribution rate	(7.4%)
Total primary rate	**17.9%**

Total rate	% of payroll
Primary rate	17.9%
plus deficit recovery over 25 years	12.2%
Total rate	**30.1%**

Total rate	% of payroll
Primary rate	17.9%
plus deficit recovery over 22 years	13.7%
Total rate	**31.6%**

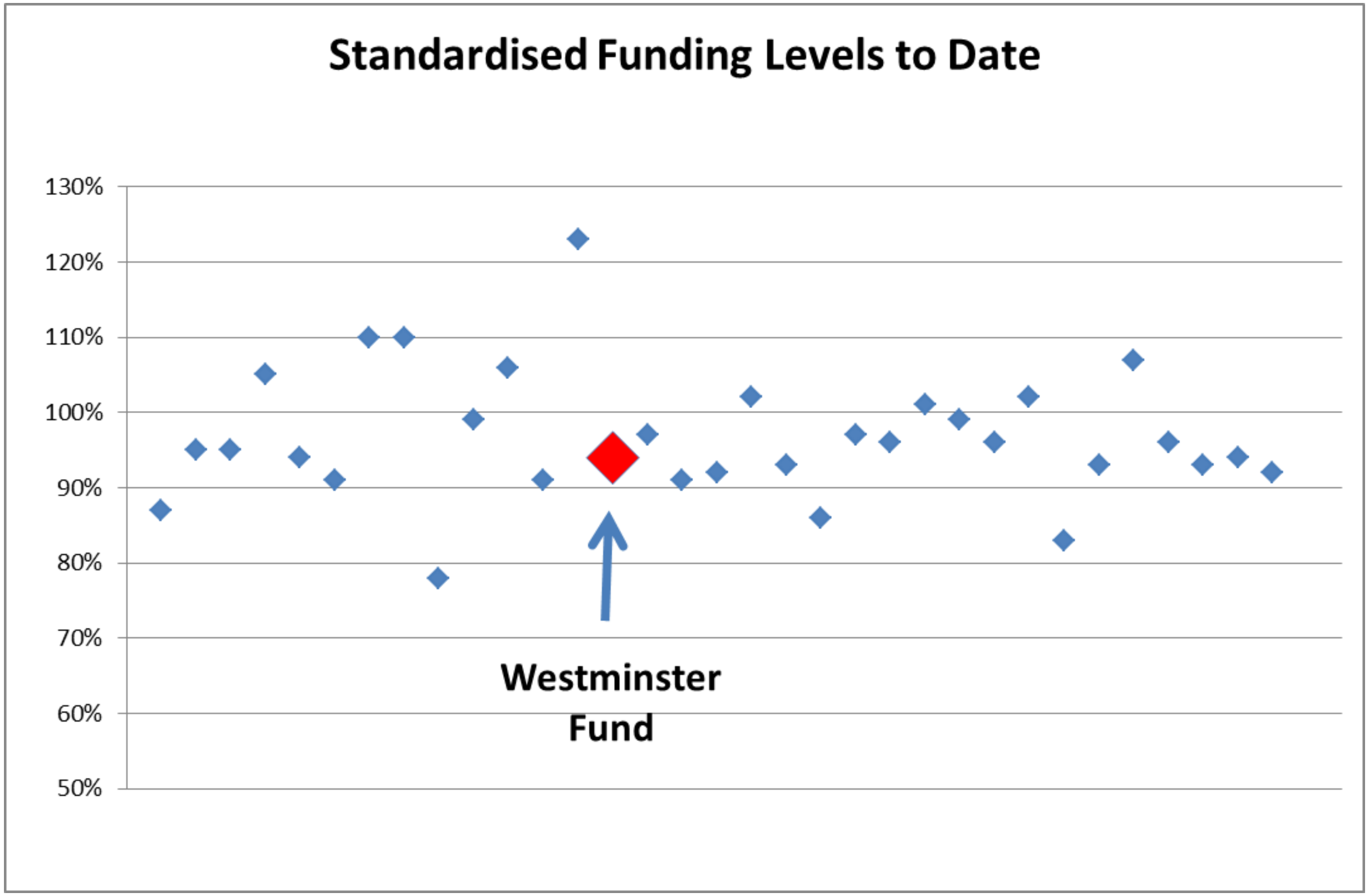
Total rate	% of payroll
Primary rate	17.9%
plus deficit recovery over 20 years	14.9%
Total rate	**32.8%**

Westminster City Council

Westminster City Council	2013	2016	Change
Assets (£000s)	589,461	671,415	81,954
Liabilities (£000s)	853,561	956,788	103,227
Deficit (£000s)	264,100	285,373	21,273
Funding Level	69%	70%	1.1%
Payroll (£000s)	76,021	81,762	5,741
Future service rate (% of pay)	12.5%	15.7%	3.2%
2016/17 future service contributions	10,220	12,803	2,583

Recovery period (years)	Monetary deficit contributions (£000s)			
	2016/17	2017/18	2018/19	2019/20
25	9,008	13,143	13,654	14,186
22		14,690	15,262	15,856
20		15,981	16,603	17,249

Standardised Funding Levels



Next steps……

Managing contribution increases

Special contributions?

Asset backed contributions?