BARNETT WADDINGHAM
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City of Westminster Pension Fund

Funding update report as at 31 March 2020

Barnett Waddingham LLP

29 May 2020

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Introduction

We have carried out a funding monitoring assessment of the City of Westminster Pension Fund (the Fund) as well as Westminster City Council as at 31 March 2020. The purpose of this assessment is to provide an update on the funding position.

The Fund participates in the Local Government Pension Scheme (LGPS). The LGPS is a defined benefit statutory scheme administered in accordance with Local Government Pension Scheme Regulations 2013 (the Regulations).

The information in this report is addressed to and is provided for use by Westminster City Council as the administering authority to the Fund. This report may be shared with other interested parties but it does not constitute advice to them.

This report complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 300: Pensions (TAS 300) as issued by the Financial Reporting Council (FRC).

We assess the funding position on a smoothed basis which is an estimate of the average position over a six month period spanning the reporting date. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures are projected numbers and likely to change up until three months after the reporting date. The smoothed results are indicative of the underlying trend.

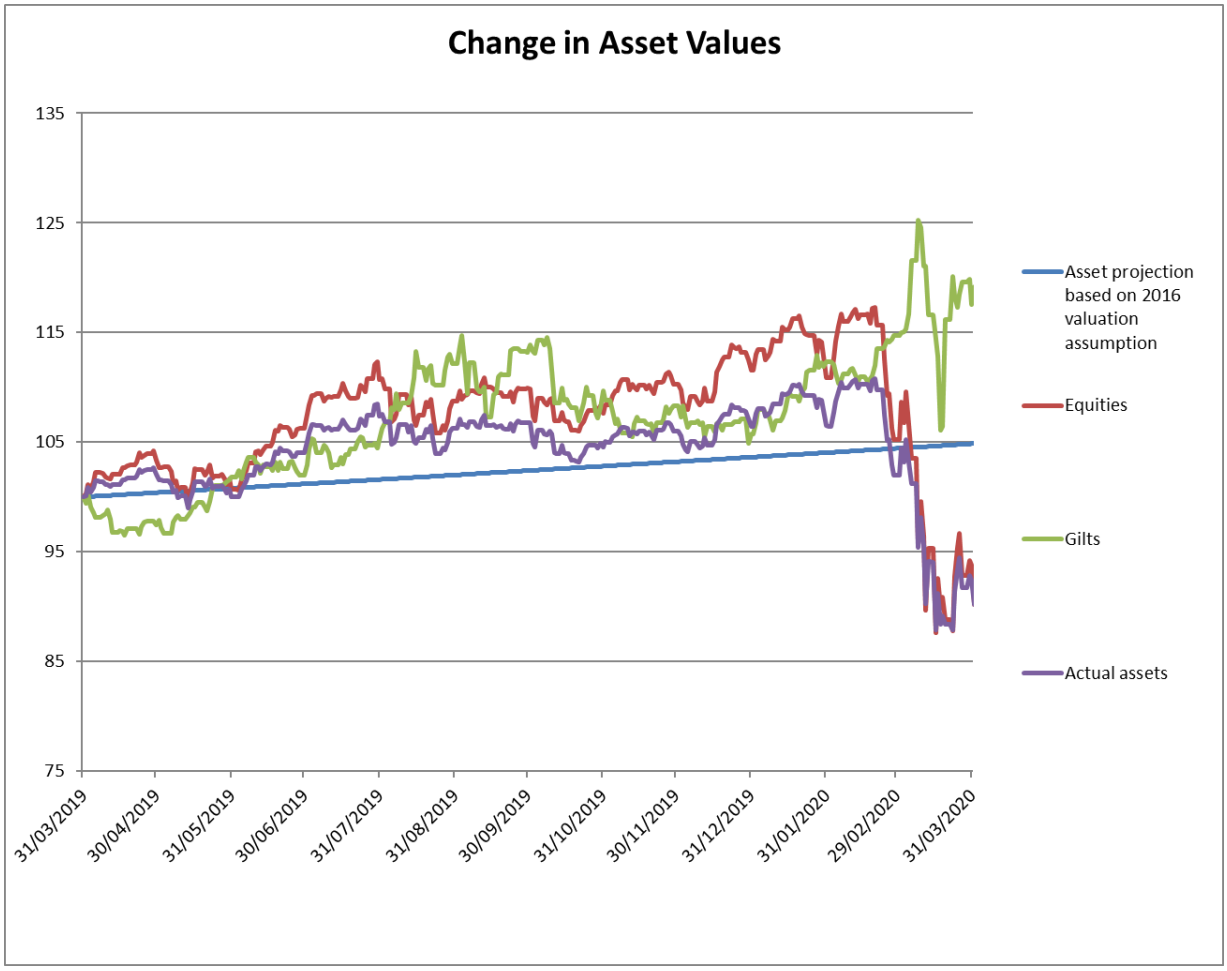
Assets

The estimated (unsmoothed) asset allocation of the City of Westminster Pension Fund as at 31 March 2020, based on data received from Westminster City Council, is as follows:

Assets (market value)	31 Mar 2020		31 Mar 2019	
	£000s	%	£000s	%
Equities	933,739	70.8%	1,064,368	75.0%
Bonds	216,088	16.4%	198,690	14.0%
Property	150,708	11.4%	144,358	10.2%
Cash and accruals	19,205	1.5%	10,916	0.8%
Total assets	1,319,740	100%	1,418,332	100%

The return achieved since the previous valuation is estimated to be -7.6%.

The following chart shows the changes in equity and bond markets since the previous actuarial valuation and compares them with the estimated actual fund returns and the expected fund returns assumed at the previous valuation:



Returns were strong for the first three quarters following the valuation date, however, recent market movements have seen significant falls in equity values. As we can see the asset value as at 31 March 2020, in market value terms, is less than where it was projected to be based on the previous valuation.

For funding purposes, we use a smoothed value of the assets rather than the market value. The financial assumptions that we use in valuing the liabilities are smoothed around the valuation date so that the market conditions used are the average of the daily observations over the six month period around 31 March 2020. Therefore, we value the assets in a consistent way and apply the same smoothing adjustment to the market value of the assets.

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Changes in market conditions – market yields and discount rates

The actual investment returns earned by the Fund will affect the value of the Fund's assets. The value of the Fund's liabilities, however, is dependent on the assumptions used to value the future benefits payable.

For the purpose of this exercise it is appropriate to use the method and assumptions consistent with those set by the Fund actuary for the purpose of the 31 March 2019 actuarial valuation, updated where necessary to reflect market conditions. Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report.

The following table shows how the main financial assumptions have changed since the last triennial valuation:

Assumptions (smoothed)	31 Mar 2020		31 Mar 2019	
	Nominal	Real	Nominal	Real
	% p.a.		% p.a.	
Pension increases (CPI)	2.19%	-	2.65%	-
Salary increases	3.19%	1.00%	3.65%	1.00%
Discount rate	4.39%	2.19%	4.84%	2.19%

The discount rate assumption is set with reference to the Fund's long term investment strategy and therefore reflects the long term expected return on assets for the Fund. Consistent with the method adopted for the 31 March 2019 valuation, we have included in the main discount rate assumption an explicit prudence allowance of 0.7%.

The key assumption which has the greatest impact on the valuation of liabilities is the real discount rate (the discount rate relative to CPI inflation) – the higher the real discount rate the lower the value of liabilities. As we see, the real discount rate is broadly similar as at the 31 March 2019 valuation, maintaining the value of liabilities used for funding purposes.

Results

The funding position for each month has been rolled forward from the formal valuation and is shown in Appendix 1. It should be borne in mind that the nature of the calculations is approximate and so the results are only indicative of the underlying position.

The results of our assessment indicate that:

- The current projection of the smoothed funding level as at 31 March 2020 is 97.2% and the average required employer contribution would be 19.6% of payroll assuming the deficit is to be paid by 31 March 2039.
- This compares with the reported (smoothed) funding level of 98.6% and average required employer contribution of 18.8% of payroll at the 31 March 2019 funding valuation.

The main discount rate underlying the smoothed funding level as at 31 March 2020 is 4.4% p.a. The investment return required to restore the funding level to 100% by 31 March 2039, without the employers paying deficit contributions, would be 4.5% p.a.

As the smoothing period is the six months spanning 31 March 2020 the results on the smoothed basis will not be known accurately until after 30 June 2020. Given current market volatility we will update the results once we are past 30 June as part of future funding updates.

Westminster City Council

We have also estimated the funding position of Westminster City Council. The development since 31 March 2019 can be found in the table below.

Smoothed Valuation date	Assets £000s	Liabilities £000s	Surplus / Deficit £000s	Funding level %	CARE ongoing cost (% of payroll)
31 Mar 2019	952,247	1,104,595	(152,348)	86%	16.8%
30 Apr 2019	967,125	1,117,039	(149,914)	87%	17.1%
31 May 2019	978,573	1,126,775	(148,202)	87%	17.3%
30 Jun 2019	990,090	1,134,713	(144,623)	87%	17.5%
31 Jul 2019	995,425	1,139,250	(143,825)	87%	17.5%
31 Aug 2019	1,002,471	1,144,578	(142,107)	88%	17.6%
30 Sep 2019	1,005,329	1,148,818	(143,489)	88%	17.6%
31 Oct 2019	1,007,432	1,154,176	(146,744)	87%	17.7%
30 Nov 2019	1,009,145	1,159,693	(150,548)	87%	17.8%
31 Dec 2019	991,682	1,146,605	(154,923)	86%	17.3%
31 Jan 2020	979,867	1,139,276	(159,409)	86%	17.0%
29 Feb 2020	973,416	1,136,805	(163,389)	86%	16.9%
31 Mar 2020	972,693	1,133,989	(161,296)	86%	16.7%

Update to funding assumptions

Future investment returns that will be achieved by the Fund in the short term are more uncertain than usual, in particular the return from equities due to actual and potential reductions and suspensions of dividends. The funding model assumes that current dividend levels will increase by 1.5% more than CPI in the longer term.

Dividend futures markets can provide an indication of future dividend expectations and although quite volatile are currently suggesting potentially a 20% reduction.

If global dividends were to reduce by 20% without any additional long term growth to compensate then the funding level of both the Fund and Westminster City Council would reduce by around 6%.

Once we understand the longer term effects of the current crisis on the investment markets, we suggest we review that the valuation assumptions remain appropriate for the purposes of these funding updates.

Final comments

There are many factors that affect the Fund's funding position and could lead to the Fund's funding objectives not being met within the timescales expected. Some of the key risks that could have a material impact on the Fund include longevity risk and financial risks (including inflation and investment risk). There is more detail on this contained within the Fund's Funding Strategy Statement and the 31 March 2019 actuarial valuation report.

Note that the funding position at a future date will be dependent on the investment performance of the Fund as well as future market conditions which determine the financial assumptions.

We would be pleased to answer any questions arising from this report.

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Appendix 1 Financial position since previous valuation

Below we show the financial position on a smoothed basis for each month since the previous full valuation. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures for the previous three months are projected numbers and likely to change up until three months after the reporting date.

Please note that the results shown below are sensitive to the underlying assumptions. For example, increasing the discount rate assumption by 0.5% will increase the funding level by about 9%, and increasing the CPI inflation assumption by 0.5% will reduce the funding level by about 9%.

Smoothed Valuation date	Assets £000s	Liabilities £000s	Surplus / Deficit £000s	Funding level %	CARE ongoing cost (% of payroll)	Past service ctbn	Total ctbn (% of payroll)	Discount rate	Return required to restore funding level (p.a.)
31 Mar 2019	1,410,581	1,430,547	(19,966)	99%	17.9%	0.9%	18.8%	4.8%	4.9%
30 Apr 2019	1,447,503	1,447,420	83	100%	18.2%	0.0%	18.2%	4.8%	4.8%
31 May 2019	1,454,375	1,460,533	(6,158)	100%	18.4%	0.3%	18.7%	4.7%	4.8%
30 Jun 2019	1,483,529	1,471,765	11,764	101%	18.6%	0.0%	18.6%	4.7%	4.7%
31 Jul 2019	1,494,312	1,478,072	16,240	101%	18.7%	0.0%	18.7%	4.6%	4.6%
31 Aug 2019	1,490,620	1,485,419	5,201	100%	18.7%	0.0%	18.7%	4.6%	4.6%
30 Sep 2019	1,497,782	1,491,329	6,453	100%	18.8%	0.0%	18.8%	4.5%	4.5%
31 Oct 2019	1,509,343	1,498,720	10,623	101%	18.9%	0.0%	18.9%	4.5%	4.4%
30 Nov 2019	1,522,534	1,506,309	16,225	101%	19.0%	0.0%	19.0%	4.4%	4.4%
31 Dec 2019	1,507,589	1,489,490	18,099	101%	18.5%	0.0%	18.5%	4.4%	4.4%
31 Jan 2020	1,478,239	1,480,233	(1,994)	100%	18.1%	0.1%	18.2%	4.4%	4.4%
29 Feb 2020	1,460,361	1,478,177	(17,816)	99%	18.0%	0.8%	18.8%	4.4%	4.5%
31 Mar 2020	1,433,830	1,475,129	(41,299)	97%	17.8%	1.8%	19.6%	4.4%	4.5%

Appendix 2 Data, method and assumptions

Data

In completing our calculations we have used the following items of data, which we received from Westminster City Council:

- The results of the valuation as at 31 March 2019 which was carried out for funding purposes;
- Actual whole Fund income and expenditure items for the period to 31 March 2020; and
- Estimated Fund returns based on Fund asset statements provided to 31 March 2020, and Fund income and expenditure as noted above.

The data has been checked for reasonableness and we are happy that the data is sufficient for the purpose of this report.

Full details of the benefits being valued are as set out in the Regulations as amended and summarised on the LGPS website and the Fund's membership booklet. We have made no allowance for discretionary benefits.

Method

To assess the value of the Fund's liabilities as at 31 March 2020, we have rolled forward the value of the liabilities calculated for the funding valuation as at 31 March 2019 using the financial assumptions below and actual cashflows paid to and from the Fund.

It is not possible to assess the accuracy of the estimated value of the liabilities as at 31 March 2020 without completing a full valuation. However, we are satisifed that the approach of rolling forward the previous valuation data to 31 March 2020 should not introduce any material assumptions in the results provided that the actual experience of the Fund is broadly in line with the underlying assumptions and that the structure of the liabilities is substantially the same as at the latest formal valuation. From the information we have received there appears to be no evidence that this approach is inappropriate.

We have been provided with the Fund assets at various dates but for dates that these are not available, we calculate the Fund assets by rolling forward the previous assets provided allowing for investment returns (estimated where necessary), and actual cashflows paid to and from the Fund. The latest date that we have been provided with the Fund assets is 31 March 2020.

Assumptions

For the purpose of this exercise it is appropriate to use the method and assumptions consistent with those set by the Fund actuary for the purpose of the 31 March 2019 actuarial valuation, updated where necessary to reflect market conditions.

A summary of the main financial assumptions adopted is set out in the main body of this report.

The main demographic assumptions are:

- The post retirement mortality tables adopted are the S3PA tables with a multiplier of 110% for males and 105% for females. These base tables are then projected using the CMI 2018 Model with a smoothing parameter of 7.5, an initial mortality improvement addition of 0.5% p.a., and a long term rate of improvement of 1.25% p.a.;

- The dependant post retirement mortality tables adopted are the S3DA tables with a multiplier of 70% for males and 85% for females. These base tables are then projected using the CMI 2018 Model with a smoothing parameter of 7.5, an initial mortality improvement addition of 0.5% p.a., and a long term rate of improvement of 1.25% p.a;
- Members retire at a single age, based on the average age at which they can take each tranche of their pension; and
- It is assumed that members will exchange 50% of their commutable pension for cash at retirement.

Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report.