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Agenda Item No: **8**

Pensions Committee

18 March 2015

Report Title	Funding update	
Originating service	Pension Services	
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Recommendations for noting:

The Committee is asked to note:

1. The Fund's investment performance and the associated movement since 31 March 2014.

2. The updated funding position as at 31 December 2014.

The Committee is asked to approve:

1. The next steps detailed in section 7, with particular emphasis on the de-risking strategies

1. Purpose

1.1 To provide Committee with an update on the funding position of the Fund since the 2013 actuarial valuation.

2. Background

The Fund, in conjunction with the Fund actuary, undertook a valuation of the Fund's assets and liabilities as at 31 March 2013. This report provides an update on the current position and how that has evolved since the valuation.

3. Actuarial Valuation 2013 recap

3.1 The key assumptions adopted at the 2013 actuarial valuation are as outlined in the table below:

Investment Return/Discount Rate (Funding Target)	4.6% p.a.
CPI inflation	2.6% p.a.
Short term pay restraint	1% p.a. up to 31 March 2018 for certain employers. 1% p.a. up to 31 March 2016 for all others
Long term pay growth	4.35% p.a. (CPI + 1.75%)
Life expectancy	Based on S1PA tables and future improvement based on CMI 2012 model with a floor of 1.5%

3.2 The finalised results for the whole Fund as at 31 March 2013 are as follows with the figures as at 31 August 2013 allowing for post valuation market changes shown alongside for comparison:

	31 March 2013	31 August 2013 (using yield reversion)
Deficit	£4,205m	£3,275m
Funding Level	70%	75%
Future service contribution rate	13.3% per annum	13.3% per annum

4 Funding Strategy Statement (FSS)

4.1 The key principles for the 2013 valuation were incorporated into the Funding Strategy Statement (FSS), which was consulted upon with employers, along with the associated Termination Policy.

4.2 The key changes to the 2013 FSS were as follows:

- A maximum recovery period of 22 years (25 at the 2010 valuation)
- For Transferee Admission Bodies a recovery period aligned to contract length capped at 22 years
- In order to stabilise contributions, phasing of any increases in contributions for those employers with the strongest covenant
- Employers can choose to pay in advance their annual deficit lump sum contributions and/or expected pay-related contributions by 30 April each year. This advance payment results in a discount in the monetary amount payable.
- All employers to have implemented electronic data change via bulk data imports (BDI) by April 2015
- “Ringfencing” arrangements introduced at the 2010 valuation are removed
- Early retirement strain costs are to be paid by an immediate one-off payment, except for those employers with a strong covenant for whom consideration to a short period of amortisation will be given.
- Guarantor of an employer may be kept abreast of the funding position of the relevant employer unless otherwise indicated in writing.

5. Investment performance

5.1 The Fund’s long-term investment performance history has been above benchmark when considered over a one, three and ten year timeframe, as evidenced in appendix A. However, when looked at over a five year timeframe, the performance is slightly lower than benchmark.

5.2 In the nine months up to 31 December 2014, the Fund’s performance (9.1%) has outperformed benchmark at 6.7% and this is shown in appendix A.

6. Funding updates

6.1 Set out below is an update of the funding position as at 31 December 2014, alongside that for March 2013, August 2013 and August 2014 for comparison purposes.

	31 March 2013 £bn	**31 August 2013 £bn**	**31 August 2014 £bn**	**31 December 2014 £bn**
Deficit	4.21	3.28	4.37	5.30
Funding Level	70%	75%	71%	67%
Discount Rate	4.6% p.a.	5.0% p.a.	4.3% p.a.	3.9% p.a.
CPI Inflation	2.6% p.a.	2.6% p.a.	2.3% p.a.	2.3% p.a.

6.2 From the above table, it can be seen that since 31 August 2014, the funding level has fallen to 67%. The main reason for this has been the continued fall in gilt yields which has led to an increase in the value of the liabilities. The “net” yield (i.e. discount rate less

CPI inflation) as at 31 December 2014 was 1.6% p.a., which was lower than that seen at 31 August 2014 (and also 31 March 2013) of 2.0% p.a.

6.3 Gilt yields remain at historically low levels at present and it still remains to be seen as to whether markets will revert back to the levels seen in August 2013 (on which many contribution rates following the valuation were set).

6.4 Despite the continued fall in gilt yields, greater than expected asset returns since 31 August 2013 have served to offset some of the impact.

6.5 It should be noted that the position remains volatile at the moment (in terms of gilt yields and asset returns) and indeed, since 31 December 2014, although the funding level would have fallen during January 2015, we now expect the position to have improved slightly compared to the December position (c68% as of 11 February 2015).

7. Next steps

7.1 De-risking options

7.1.1 The Fund is exploring various de-risking options in the context of the overall deficit and risk management of the Fund. In looking at de-risking options, the Fund has considered whether funding requirements and risk for certain groups of employers can be managed more effectively. Aligned to this, the first of these de-risking options to be progressed in the summer of 2015 will be that of cash-flow matching for “orphan liabilities”.

7.1.2 “Orphan liabilities are those for whom no employer exists in the Fund to take on responsibility and therefore this responsibility falls back on all other participating employers in the Fund.

7.1.3 As at 31 March 2013 there were c£300m of orphan liabilities in the Fund equating to around 2% of the Fund’s overall liabilities.

7.1.4 Implementing a cash-flow matching strategy is essentially an opportunity to stabilise the funding position i.e. to sustain a fully funded position in current market conditions.

7.1.5 The focus will be on structuring investment to “fit” with the funding plan and match actual cash-flows from income generated by the investments. This structuring of investments is being covered in more detail in a report to the Investment Advisory Sub-Committee.

7.1.6 This strategy will reduce materially other participating employers’ exposure to the orphan liabilities and can accept future orphaned or other liabilities.

7.1.7 Importantly this cash-flow matching strategy would not have an impact on the funding position of the wider Fund.

7.1.8 In a wider context, this strategy can be utilised as essentially a “low risk bucket” for a longer term strategy if different investment strategies are evolved for different employer buckets.

7.2 Data cleansing

7.2.1 The Fund is looking to drive forward improvements in data quality in partnership with participating employers.

7.2.2 Having “cleaner” data will help to ensure the provision of more accurate valuation results and therefore, in turn, tighten up the funding position for each individual employer. This will be borne out through the employer contribution rates and liabilities shown on annual accounting standards.

7.2.3 Data quality will now also fall under closer scrutiny from the Pensions Regulator (TPR).

7.2.4 The Fund has implemented initiatives to increase the flow of data electronically and is looking at means to improve data quality overall, predominantly through its own internal resources.

7.3 Employer engagement

7.3.1 As with most strategies the Fund looks to implement, engagement is vital. The Fund will look to commence wider engagement with employers on the deficit and risk management of the Fund, taking into consideration differing risk appetites and covenant strengths. This engagement will form an important part of the consideration and ultimately implementation of de-risking strategies.

8. Financial implications

8.1 The report contains financial information which should be noted.

There are financial implications associated with the overall funding level of the Fund, particularly as this will be played out at the 2016 actuarial valuation in terms of the contributions rates set for participating employers.

9. Legal implications

9.1 The report contains no direct legal implications, however indirectly the governance of deficit and risk management strategies will need to be considered..

10. Equalities implications

10.1 The report contains no direct equalities implications.

11. Environmental implications

11.1 The report contains no direct environmental implications.

12. Human resources implications

12.1 The report contains no direct human resources implications.

13. Corporate landlord implications

13.1 The report contains no direct corporate landlord implications.

14. Schedule of appendices

14.1 Appendix A: Fund’s ten year investment performance history versus benchmark and recent investment performance against the market environment