Mercer

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Shropshire County Pension Fund

2024 Employer Forum

November 2024

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Agenda

Valuation and Funding Basics

Funding - experience since 2022

Accounting for Employers

Admission Policy

Current Issues

Valuation and Funding Basics

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Valuation and Funding Basics

Past benefits

Has the Fund got enough assets to cover expected benefits built up to date

Depends on employer history, investment returns member profile and past experience

End result:

SURPLUS/DEFICIT (ASSETS – LIABILITIES)

£ DEFICIT CONTRIBUTIONS (OR SURPLUS OFFSET?)

Future benefits

How much will the Employers have to pay for benefits earned in the future?

Depends on the profile of active members and any benefit changes

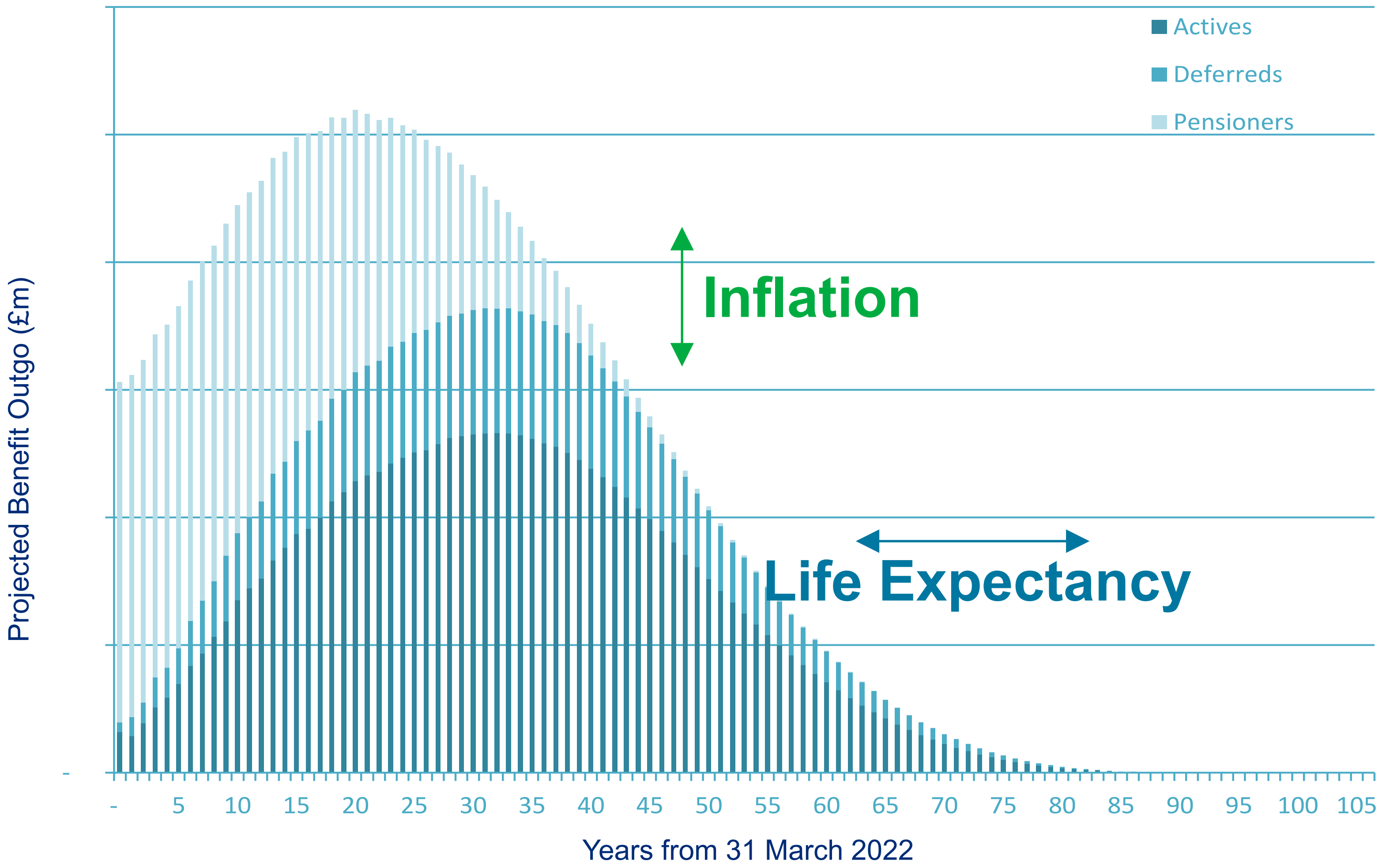
End result:

FUTURE SERVICE CONTRIBUTION RATE (% of pay)

Calculated for the Fund, but also at employer level – **each employer is responsible for their own members**

Valuation and Funding Basics

Liabilities…it's all about the cashflows



Valuation and Funding Basics

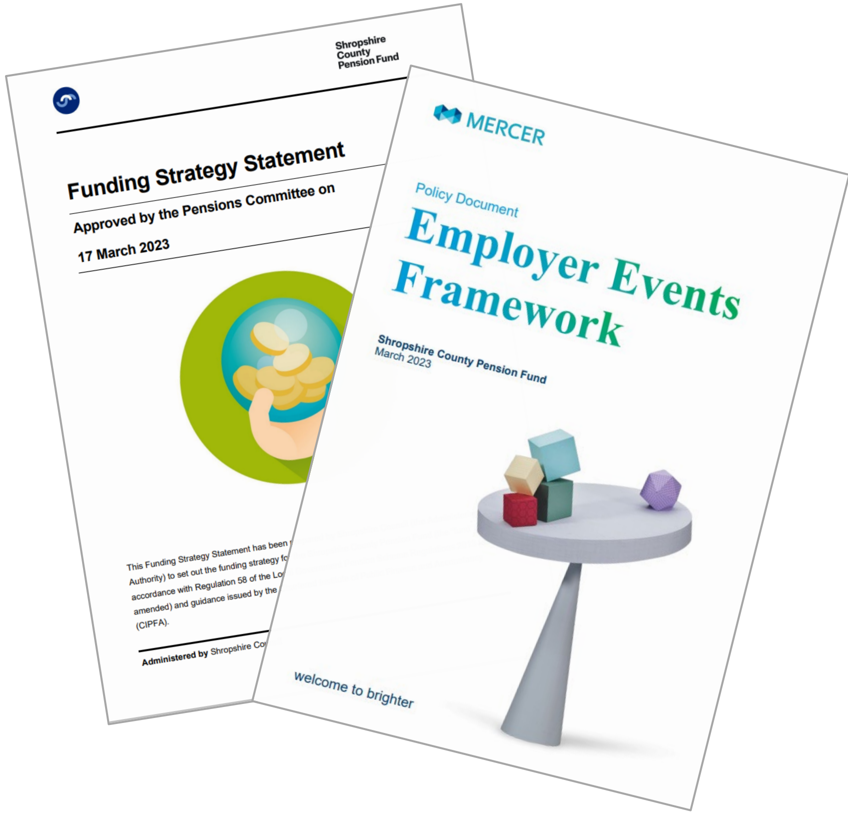
Assumption impact – what it means for contributions

Assumption	Impact on liabilities	Impact on future service contributions (% of pay)
Discount rate -0.25% pa	+4.5%	+1.4%
Inflation +0.25% pa	+4.3%	+1.4%
Salary growth +0.25% pa	+0.5%	Nil
Life expectancy improvements +0.25% pa	+0.7%	+0.2%

The impacts shown are averages across the Fund as a whole, impacts for individual employers will vary depending on profile of the membership

Valuation and Funding Basics
Funding Strategy Statement & Employer Events Framework

- Objectives of the Fund
- Solvency and long term cost efficiency
- Intergenerational fairness to taxpayers
- Managing risks including climate risk
- Employer specifics
- Fund policies



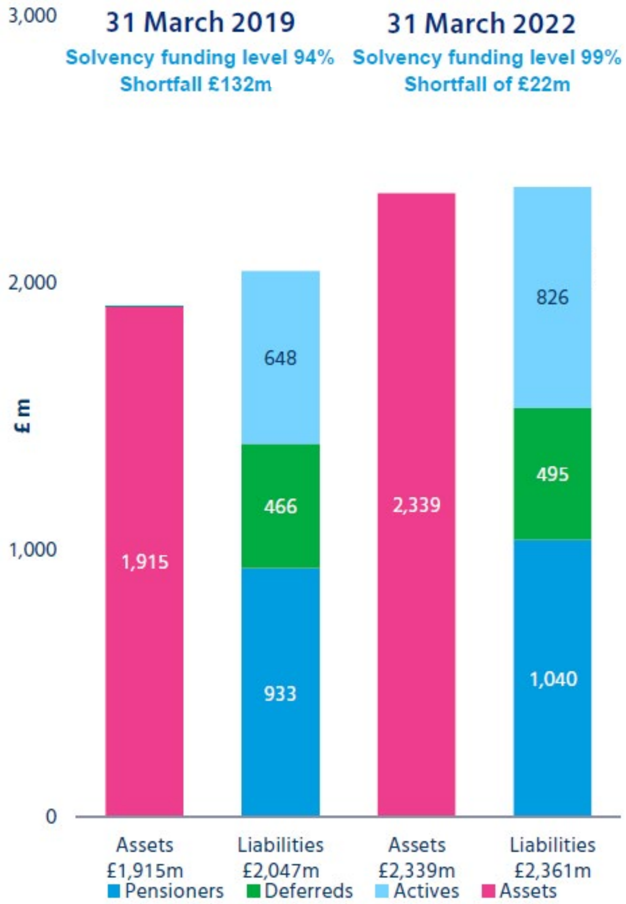
The Fund will consult with employers on proposed changes to the funding strategy as part of the 2025 valuation process. This is your opportunity to feedback views

2022 Valuation Recap

Whole Fund Results as at 31 March 2022

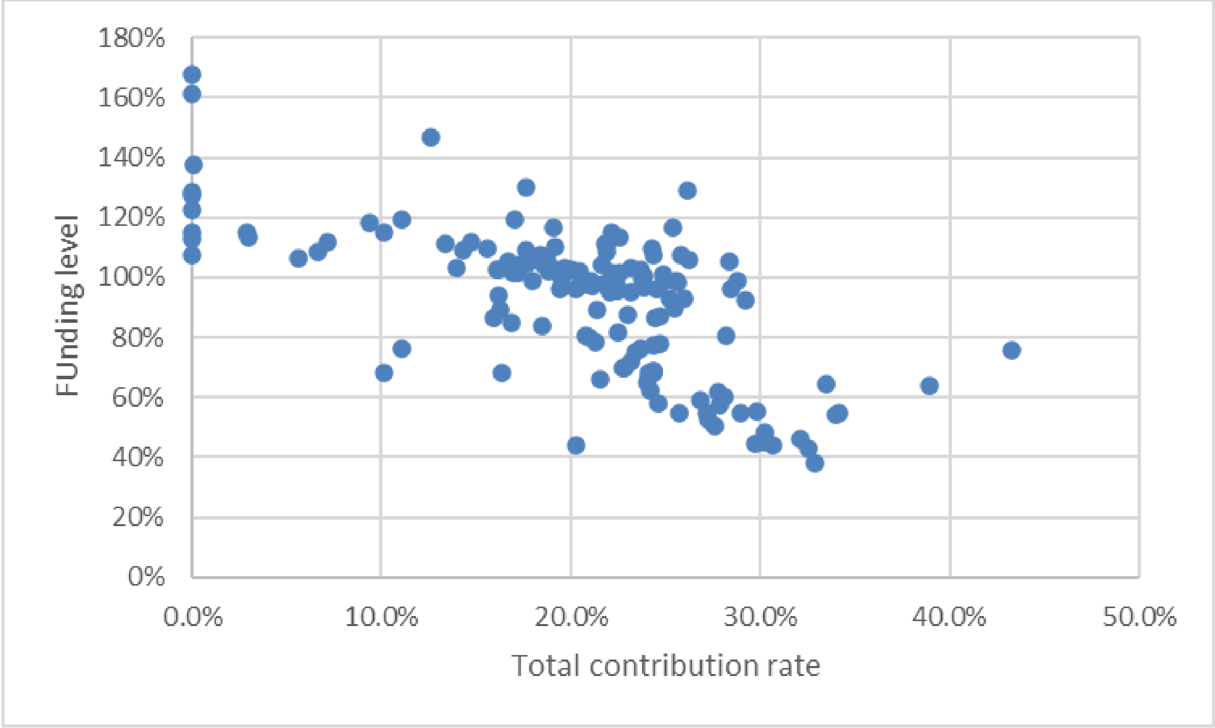
Average Future Service / Primary Rate for the Fund was **18.4%** of pay

Deficit / Secondary contributions of **c£1.7m p.a.** (around 0.5% of pay)



Employer variation

Each employer is responsible for their own position and has their own contributions rates – e.g. future service rates ranged up to **30.9%**



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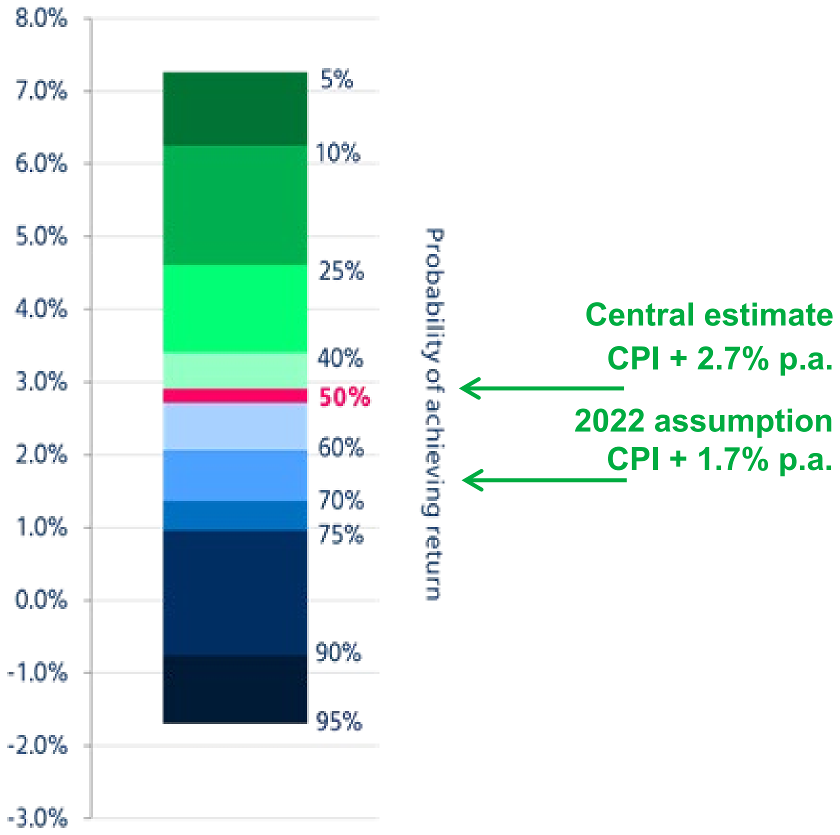
2022 Valuation Recap

Setting the (real) discount rate

Real discount rate - takeaways

- The Fund requires long term investment returns in excess of CPI - drives contribution rates and liability values
- So real discount rate is the single most important valuation assumption
- A lower rate means greater chance of exceeding target (and so less risk), but higher contributions – and vice versa

Range of outcomes



2022 Valuation Recap

Funding strategy – key points

1. Taxpayer-backed employers:
   Discount rate for past service – CPI + 1.7%
   Discount rate for future service – CPI + 2.1%

2. Non-guaranteed employers:
   Discount rate for past service – CPI + 1.45%
   Discount rate for future service) – CPI + 1.6%

3. Default recovery periods reduced by 3 years from 2019 to ensure a continuation of the current plan. Surplus off-set contributions applied where no deficit on termination basis.

4. Introduction of an ill-health captive insurance arrangement for employers with less than 200 active members.

2022 valuation – Section 13 review
(2022 in Green, 2019 in Blue)

FUNDING LEVELS	
2022 LOCAL BASIS	SAB STANDARD BASIS
99%	107%
94%	104%

SOLVENCY MEASURES				
Risks already present			Emerging risks	
SAB Funding Level	Open Fund	Non - Statutory Employees	Impact on core spending post asset shock	Deficit or Surplus post Employer Default
106.8%	Yes	8.8%	2.8% (deficit)	N/A – Surplus
104.1%	Yes	9.5%	2.1%	N/A - Surplus

LONG TERM COST EFFICIENCY MEASURES				
Relative considerations		Absolute considerations		
Deficit Period (Rank)	Required Return (Rank)	Repayment Shortfall	Return Scope (Rank)	Deficit Recovery Plan
N/A – Surplus	3.8% (75)	N/A - Surplus	1.3% (59)	Green
N/A - Surplus	3.5% (59)	N/A - Surplus	0.6% (69)	Green

Funding – experience since 2022

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Experience Since 2022

Key factors

Investment performance

- To the end of September, the Fund has returned c12% in total. This is broadly in line with the long-term actuarial assumption from the 2022 valuation of 4.8% p.a. for tax-payer backed employers. The result of this in isolation is to a **very slight decrease in the funding level by less than 1%** (the impact will be greater for non-guaranteed employers where the investment return assumption was lower)

High levels of CPI

- Since 2022, we have seen pension increase of 10.1% and 6.7% in April 2023 and 2024 respectively, with total CPI over the period of **14.3% (5.7% p.a.)** This compares to the valuation assumption of 3.1% p.a. assumption.
- Allowing for actual CPI experience since the valuation has resulted in **a reduction in the funding level of c5%**.

Increases in future investment return outlook

- The significant increase in yields / interest rates since the 2022 valuation has a knock-on effect on expected future returns on other asset classes like equities. While for some assets (e.g. gilts, fixed interest investments) the impact is measurable, for others, it requires judgment.
- Ultimately the impact of this will be to **increase the funding level**. However, the **size of the increase is a judgment for the Fund** and will depend on a number of factors, including the regulatory requirement to aim for contribution stability.

Experience Since 2022

Additional factors

DEMOGRPAHICS

- National trends revealed slow-down in life expectancy improvements
- This is reflected in the national models underpinning the funding position
- Increases funding level by 1%-2% in isolation
- Analysis of Fund's own experience will follow later this year, and feed into the 2025 valuation

AFFORDABILITY

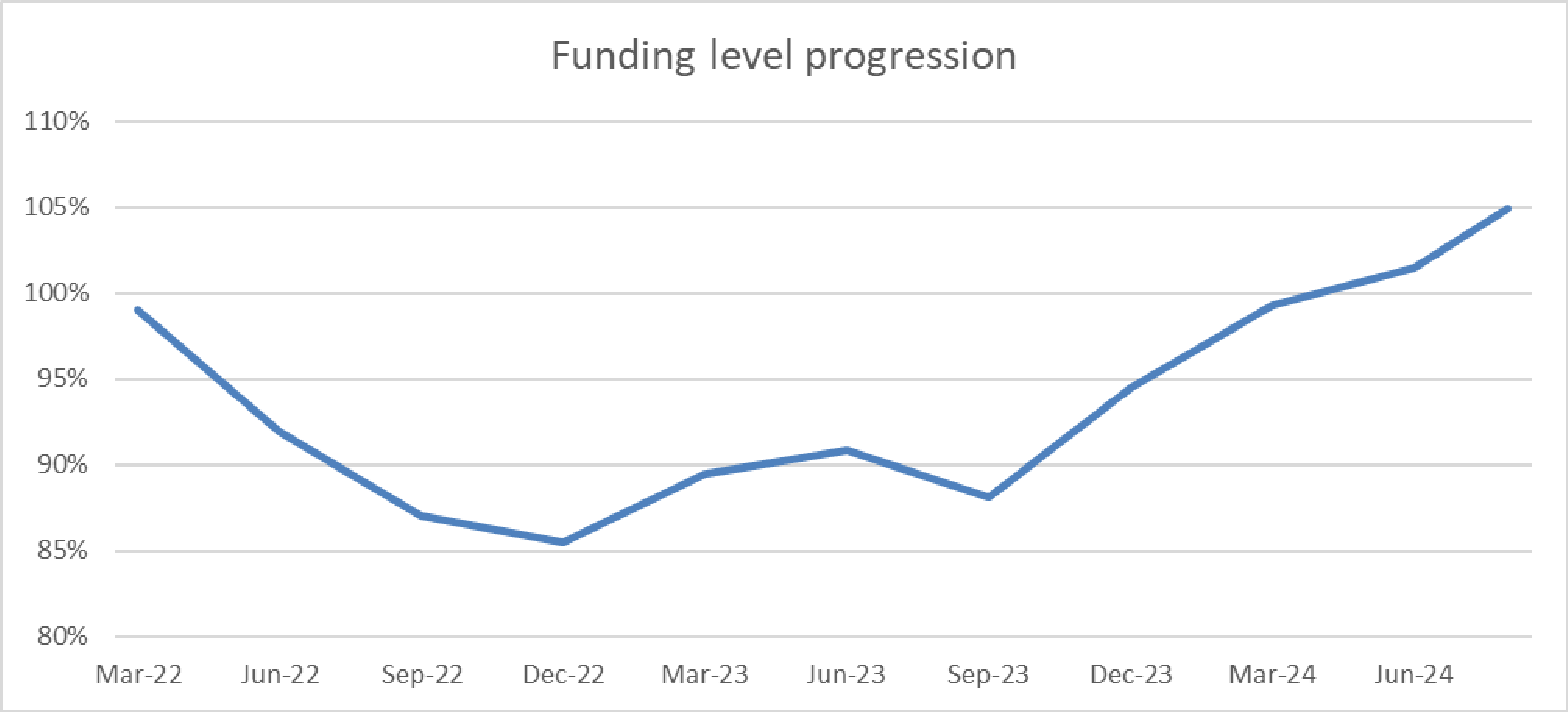
- Pressure on LG funding has increased significantly since 2022
- Also pressure on other employers, increasing covenant risk
- One of the key roles of the Fund is to balance current funding challenges with future challenges and the need for intergenerational fairness

NATIONAL OUTLOOK

- Consolidation / pensions review – may impact investment and funding strategy
- FSS Guidance will be updated which will be taken into consideration for the 2025 valuation
- Section 13 risk parameters expected to change, to also consider distribution of surplus as well as deficit payment plans

Experience Since 2022

Estimated movement in funding position



The above shows the progression of the funding position since 2022 on an approximate basis. Whilst this includes an allowance for the impact of the change in future investment return outlook, a full assessment will be undertaken as part of the 2025 valuation, taking into account market conditions and other key factors at that time.

2025 Valuation – Key Themes

Funding progression since 2022 is a story of two halves. Whilst the position is currently estimated to be above a fully funded position at the whole Fund level, individual employer results will vary and depend on your own characteristics.

Over the next 12 months funding strategy will be reviewed and detailed analysis will be undertaken for the 2025 valuation reflecting market conditions at that time and the proposed funding strategy.

Treatment of surplus if / where applicable

Future return outlook

Inter-generational fairness

Approach for different employer groups

Short term volatility risks

Longer-term risks

Regulatory requirements

2025 Valuation Practicalities

What you'll receive

- Balance sheet: assets, liabilities, funding level
- Contributions: Split between past and future service
- Exit position (where applicable)

Importance of Data

- Good data is needed for reliable results
- Where data is poor / unavailable, **prudent** assumptions are made…
- …meaning higher contributions

Employer Considerations

- Position can vary significantly from Fund overall
- Reflects your own circumstances. Profile and decisions made
- Treatment can vary by employer type
- All employers will have the opportunity to engage directly with the Fund

2025 valuation timeline for employers

Q4 2024 - Q2 2025

Fund preparatory work

High level principles agreed

Q3 2025

Whole Fund results finalised

October / November 2025

Employer results
FSS consultation with employers

December 2025 – Janary 2026

FSS consultation finalised
Employer results updated (as needed)

Janary 2026 – February 2026

Final employer discussions
Sweep up exercise for employers joining the Fund post 31 March 2025

March 2026

Report signed and issued

Valuation sign off

Accounting for Employers

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Basics of LGPS accounting

1. **Aim** – to account for pension costs as they accrue rather than when they are paid
2. Realistic total cost (rather than annual cash contributions paid) and “best estimate” of employer’s liability, but…
3. …discount rate based on corporate bonds. Other assumptions should individually be best estimates
4. Mercer provide standard assumptions for the exercise – but employer ultimately selects the assumptions (with approval from their auditor)

This section provides general information and background on LGPS accounting. **It is not advice** – each employer must determine their own accounting approach and policies, in conjunction with their accountants and auditors

Basics of pensions accounting
Actuarial assumptions

- Mercer provide standard assumptions – discussed extensively with auditors
- But assumptions are the employer's responsibility (subject to auditor approval) – so you can choose alternatives
- Should be "unbiased" and consistent
- Assumptions set at (or in some cases close to) balance sheet date
- Key assumptions:

Discount rate	Inflation	Salary growth	Pension increases	Demographics
Based on high quality corporate bond yields	Based on rate implied by market	Based on employer expectations	Based on inflation assumption	Typically based on funding assumptions with margins for prudence removed

Basics of LGPS accounting
Accounting vs. Funding

Accounting

- Employer responsibility with advice
- Discount rate to an extent prescribed (not linked to actual asset strategy)
- Other assumptions 'best estimate'
- Assumptions must reflect market conditions at disclosure date
- Consistent approach from year to year
- Does not affect contributions
- Requires auditor sign-off

Funding

- Fund responsibility, with advice from Fund Actuary
- Discount rate linked to Fund's actual investment strategy
- 'Prudent' assumptions overall & not prescribed
- Market conditions at valuation date but with significant flexibility
- In line with policies agreed in FSS
- Dictates contributions
- Oversight and analysis from GAD (section 13)

Numbers will differ – often significantly. Accounting figures are not used by the Fund and **do not affect contributions**

Asset ceiling / surplus recognition

Background on recent shifts

Accounting balance sheets

Corporate bond discount rates rose by 2% over 2022/23

Reduced liabilities by 20%-50%, with service costs halved on average

Changes in life expectancy reduced costs further

Offset to some degree by high inflation

Funding / contribution impact

These shifts **will not be replicated in the funding results**

Fund does not invest in only corporate bond => different discount rate impact

Liabilities and contribution rates **started from a far lower point** than accounting equivalents

Fund required to target stable contributions

Auditor requirements
Documents to support you

Document	Description
Audit FAQ	Designed to address typical / expected queries Auditors should be directed to review this before raising queries
Assumptions paper	Details how we derive assumptions. Also contains our approach on other areas, e.g. McCloud approach Auditors should be directed to review this before raising queries – contains lot of the detail they might need / want
Assumptions paper (audit compliance)	Covers Mercer's approach, and includes various standard declarations and certification that auditors might need
NewsAlert	Contains the standard financial assumptions for the exercise, with commentary. Read in conjunction with the assumptions paper

Asset ceiling / surplus recognition
What is the issue?

In theory, the issue here is simple:

- If an employer has an accounting surplus…
- …but they can never actually access / use that surplus…
- …then they should not recognise it on their balance sheet

But the application in practice is complicated. The approach varies with:

- the accounting standard
- the employer's circumstances
- the views of the employer / their auditor

Asset ceiling / surplus recognition
Typical approaches

The approaches we typically see are broadly:

	Approach	Description
1	Employer has “unconditional right” to a refund without limitation	Surplus recognised in full
2	Employer has “unconditional right” to a refund – surplus limited to termination surplus	Accounting surplus capped at termination surplus
3	Surplus limited based on future accounting service cost (SC)	Usually only applied under FRS 102. Logic is the cost of future benefits (the SC) can be funded by the surplus – so the employer can gain an “economic benefit” from the surplus
4	Surplus limited based on comparing SC and future contributions	If SC is higher than future contributions, the difference can be funded by the surplus, so the employer again gains an “economic benefit”

The first option requires no further calculations. Option 2 requires bespoke calculations. Options 3 and 4 ae the most common approaches we see, and are offered as standard.

Neither Mercer nor the Fund can advise the employers of the appropriate approach – this must be agreed with your accountants and ultimately your auditors

Admission Policy

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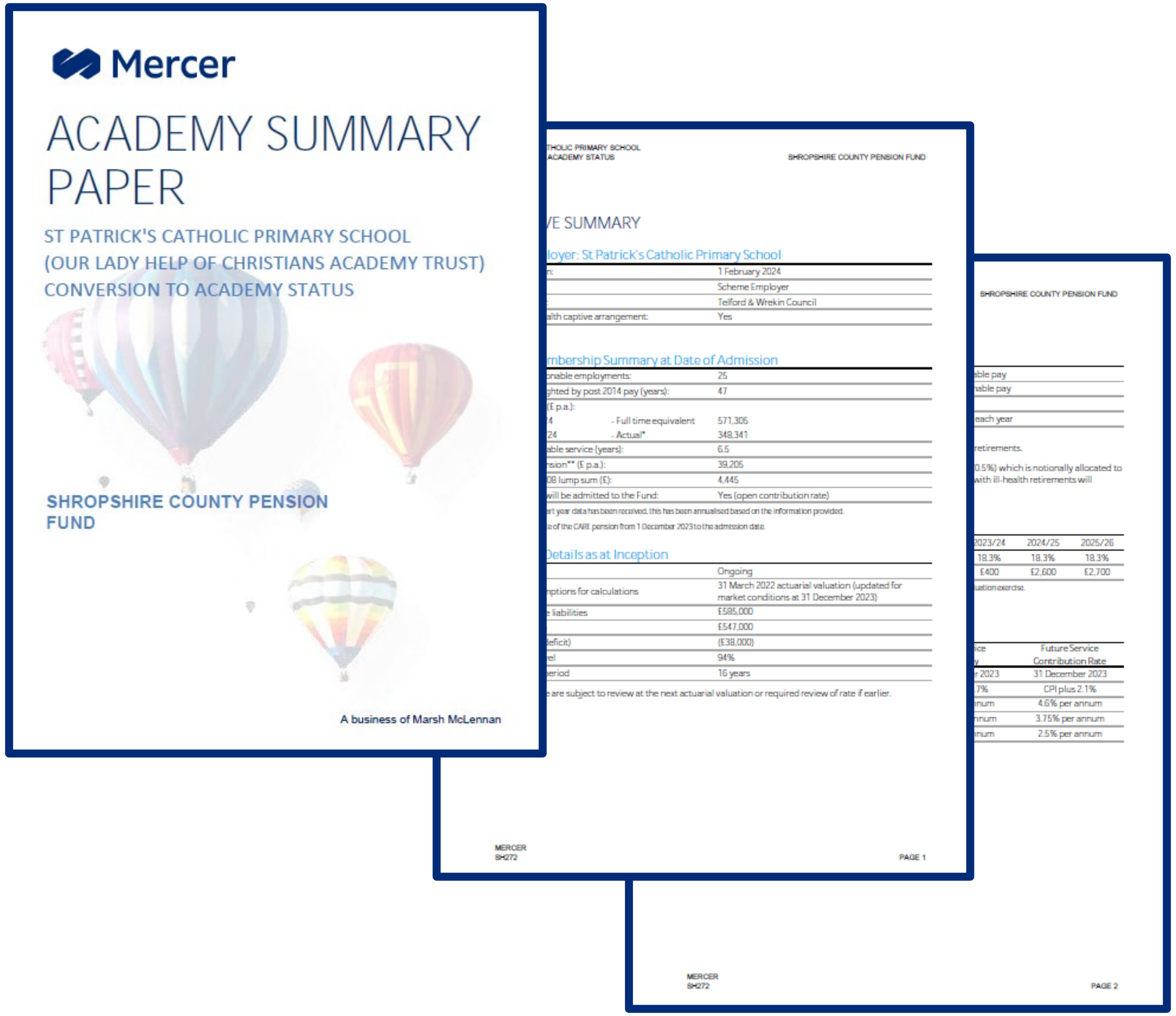
Admissions – Basics

What we do

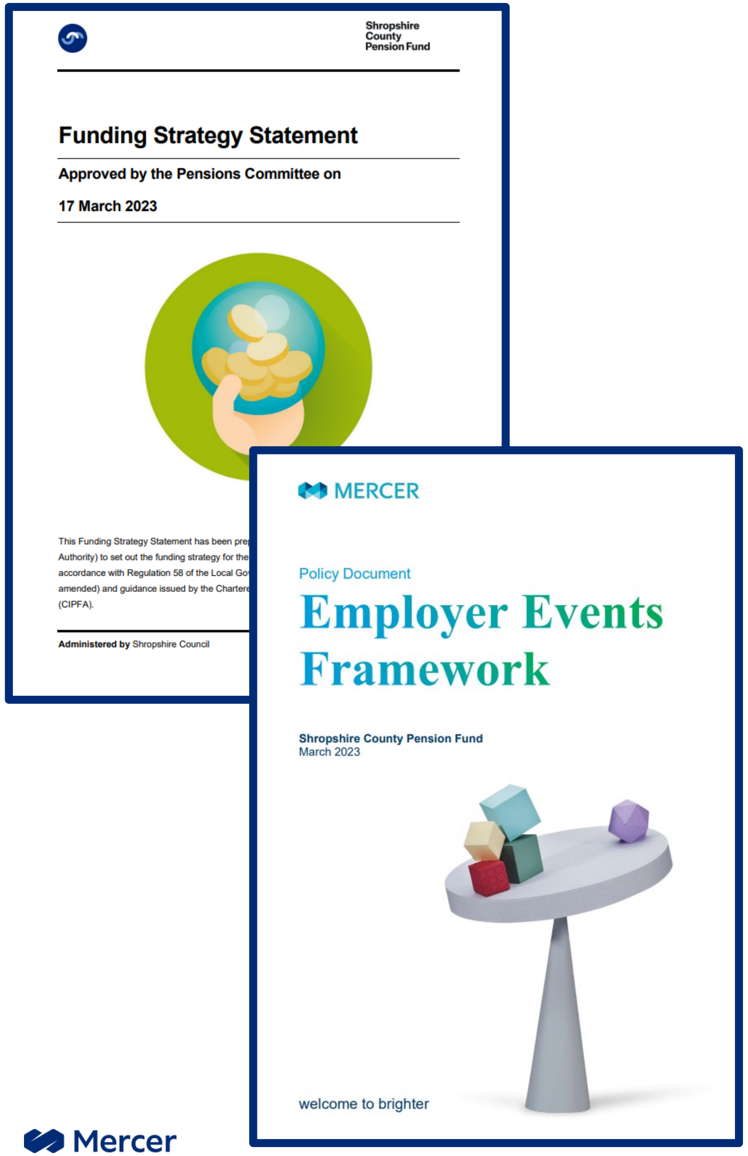
- Primary (future service) contributions
- Secondary (deficit / surplus) contributions including recovery period
- Initial assets and liabilities
- Contractors – bonds and risk assessments
- Academies – alternative approach to funding



All based on actuarial assumptions in line with the Funding Strategy Statement

Admissions - Fund policies

Transferee admission bodies (TABs)



- Admitted bodies providing services to an academy / MAT
- Usually closed to new entrants (so new employees can't join the LGPS)
- Transferring employer is guarantor
- May be pass through – see next slide. Otherwise…
- Almost always start fully funded
- Fund generally requires a bond and risk assessment – to protect the guarantor (or Fund where there is no guarantor). Bond is based on deficit / surplus plus potential early retirement strain costs

Admissions – Pass Through

A "pass-through" agreement states how pension risks are allocated between employers. It is between outsourcing employer and contractor – the **Fund is not party to this.** So it isn't something the Fund can "offer", or would typically be involved in.

However, the Fund can offer treatment that aligns with pass-through – particularly pooling where pension risk is fully / largely retained by the academy. ***The Fund will look to recorded the details in the admission agreement.***

Pass-through arrangements can vary a lot – the table to the right shows the two extremes (full and no transfer of risk), and the most common approach.

The agreement would also dictate the contractor's contributions payable – again there are various options, but the most common is the contractor pays the academy's primary rate. (But again, this is a decision for the employers.)

Risk	Full pass-through	Partial pass-through (most common approach)	Full risk transfer
Low investment returns	Letting authority	Letting authority	Contractor
Changes in assumptions	Letting authority	Letting authority	Contractor
High inflation	Letting authority	Letting authority	Contractor
High salary increases	Letting authority	Contractor / letting authority	Contractor
Life expectancy improvements	Letting authority	Letting authority	Contractor
Other demographic changes	Letting authority	Letting authority	Contractor
Ill health retirement costs	Letting authority	Letting authority	Contractor
Redundancy early retirement costs	Letting authority	Contractor	Contractor
Discretionary decisions by the contractor	Letting authority	Contractor	Contractor
Non-payment of ongoing or termination contributions by contractor. Although this can be removed by using a surety bond	Letting authority	Letting authority	Letting authority

DfE guidance is that academy new outsourcings should generally be pass through. If this is not the case, then you should engage with DfE and confirm that the DfE guarantee will extend to the admission

Admissions – Common Issues

Identifying employers – **you must inform the Fund when a contract covering Fund members begins / ends**

All parties, including the Fund, should understand the nature of the admission (pass through), Future return outlook

Agree at the start what happens at the end of the contract – termination treatment

Understand Fund policies and requirements. See website. Employer Events Policy is a guide to the outsourcing process

Understand and follow DfE guidance and requirements for outsourcings

Current issues

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Current issues

McCloud

Gender Pension Gap

Dashboard

Lobbying

General Code

Autumn Budget

Cyber Security

Outsourcing

…and a pensions review…

Questions?

Notes

- We have prepared this document for the Administering Authority for the purpose of providing a training session to employers.
- "Technical Actuarial Standard 100: Principles for Technical Actuarial Work (v2)" 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 2022.
- 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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