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2022 Actuarial Valuation and FSS consultation

Shropshire County Pension Fund

November 2022

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welcome to brighter

- Back to basics
- 2019 recap & what's happened since
- 2022 Valuation results
- Funding strategy statement
- Employer risk
- Next Steps
- Questions

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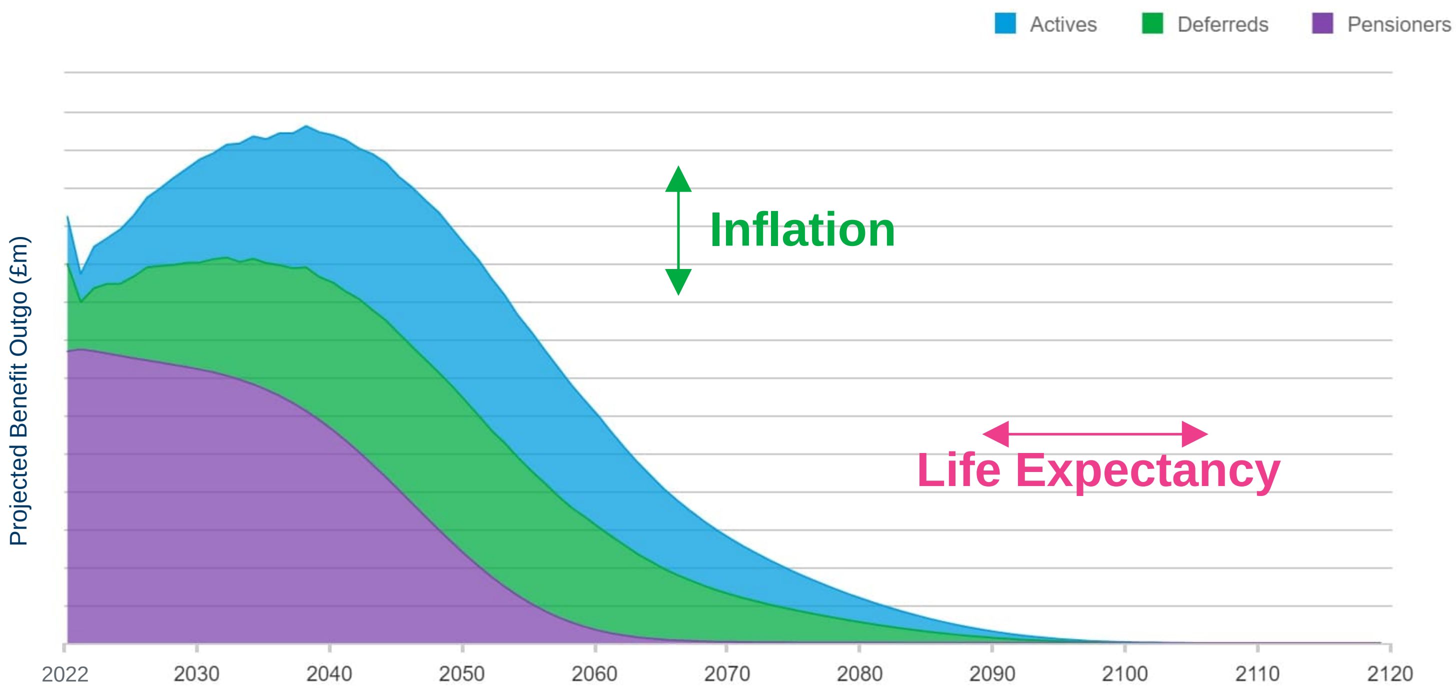
Back to basics

Back to basics

Liabilities…it's all about the cashflows

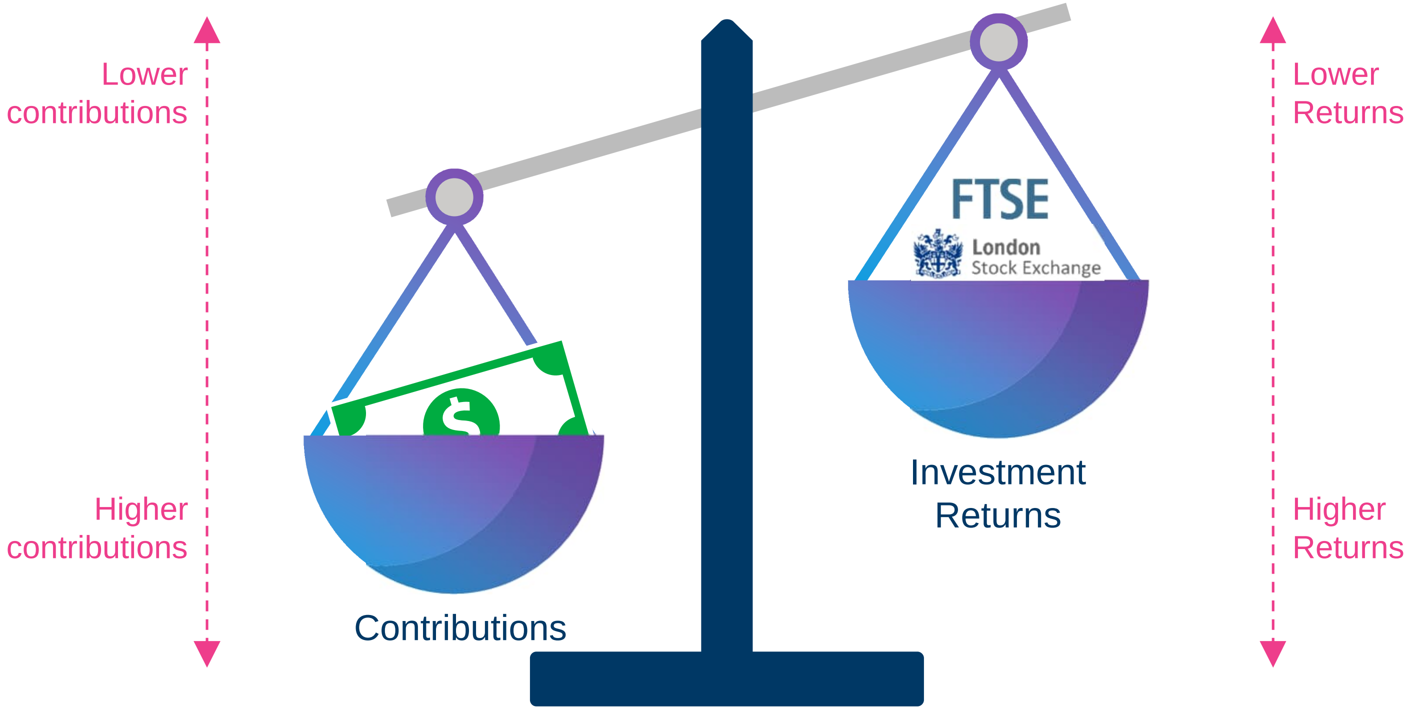
The primary responsibility is… **To ensure correct member benefits are paid as they fall due**



The biggest risk is therefore… **Running out of assets before the last member is paid**

Back to basics

Financing the Benefits



Objective is to have sufficient assets to pay benefits as and when they fall due.

Back to basics

In Simple Terms

Future benefits

Past benefits

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

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

Depends on history of the employer, investment returns achieved and experience to date

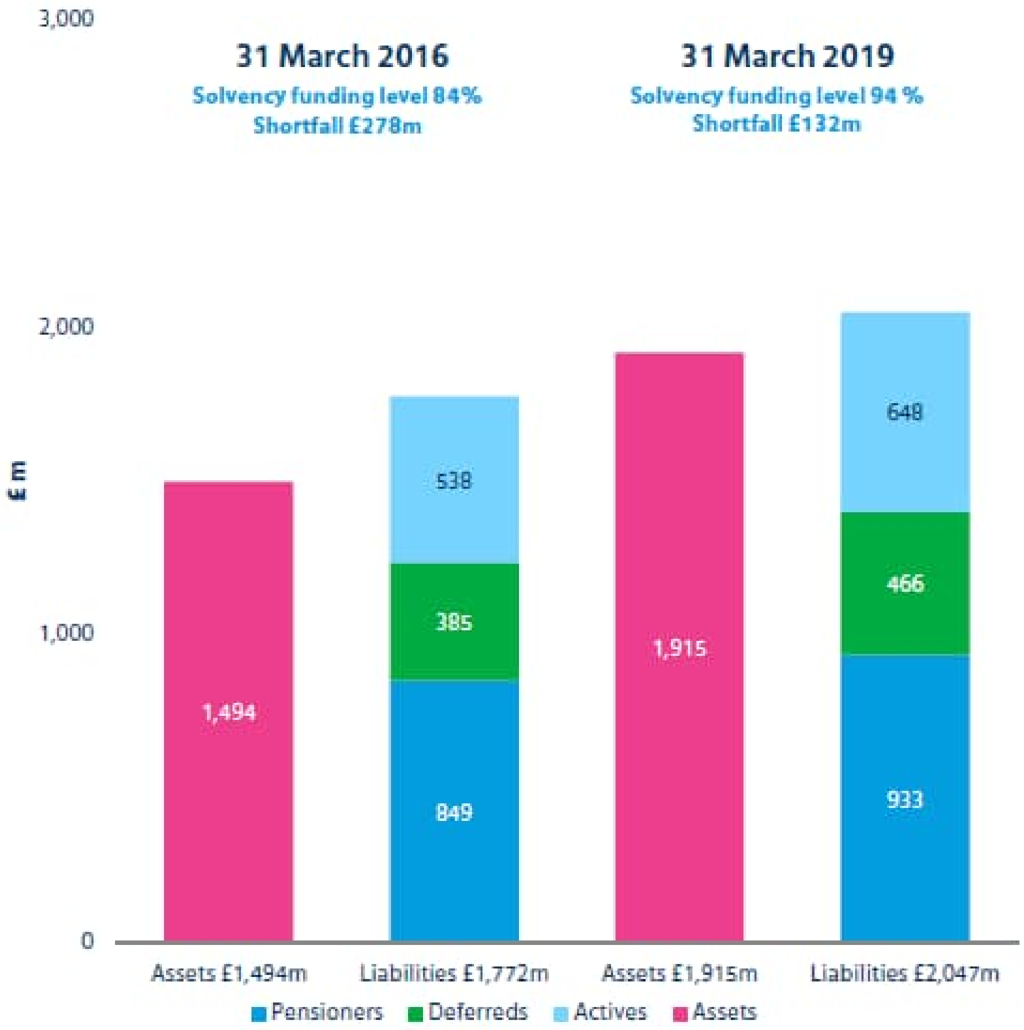
Depends on the profile of the active membership and any benefit changes

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

2019 recap
& what’s happened since

2019 Valuation Recap

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.**

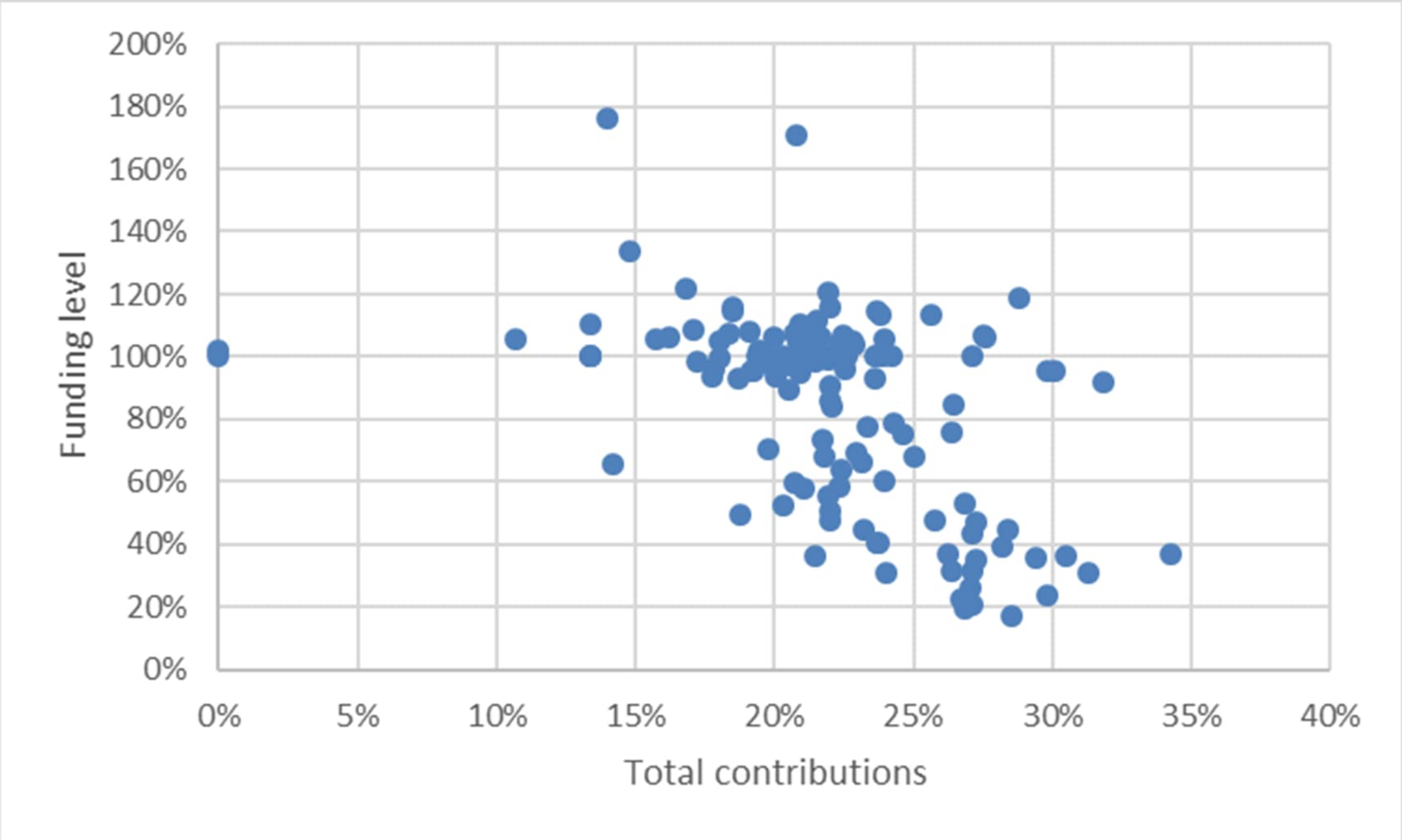
Employers:

Each employer is responsible for their own position within the Fund, and have their own contributions rates

2019 Valuation Recap

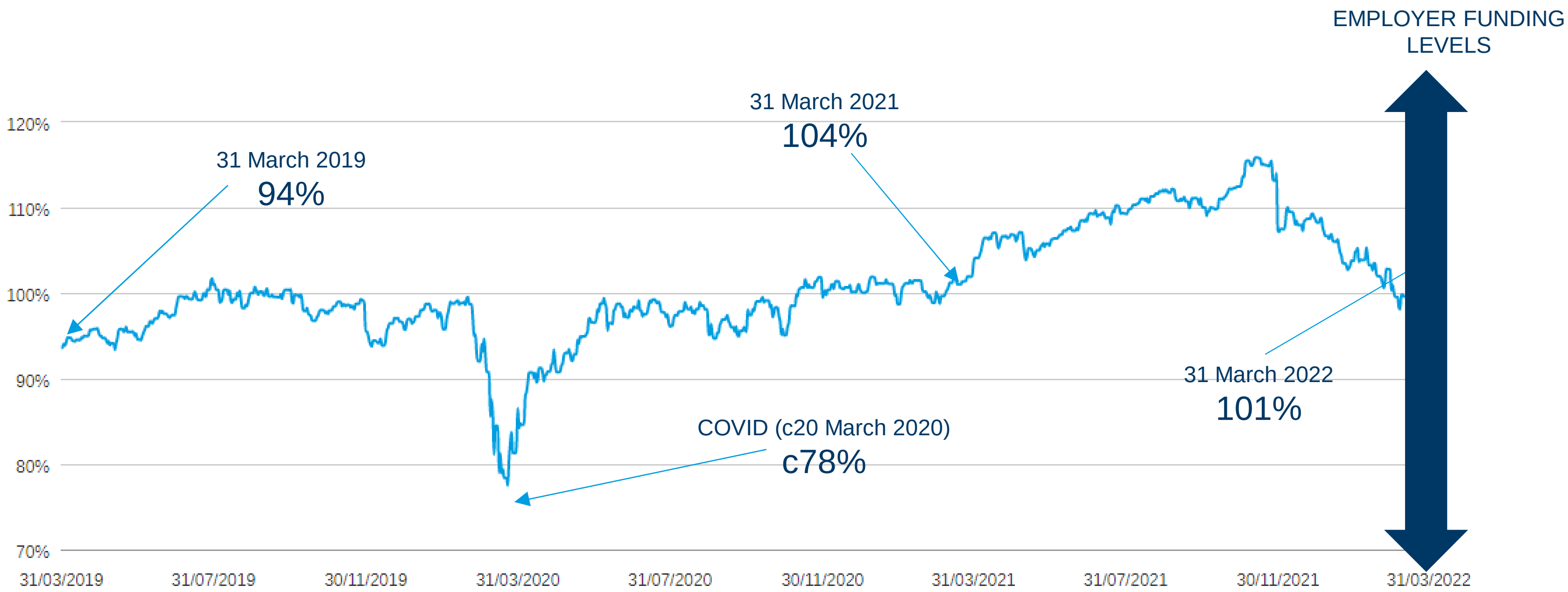
Individual employer variation

Each employer is responsible for their own position and has their own contributions rates – e.g. future service rates ranged up to **28.8%**



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

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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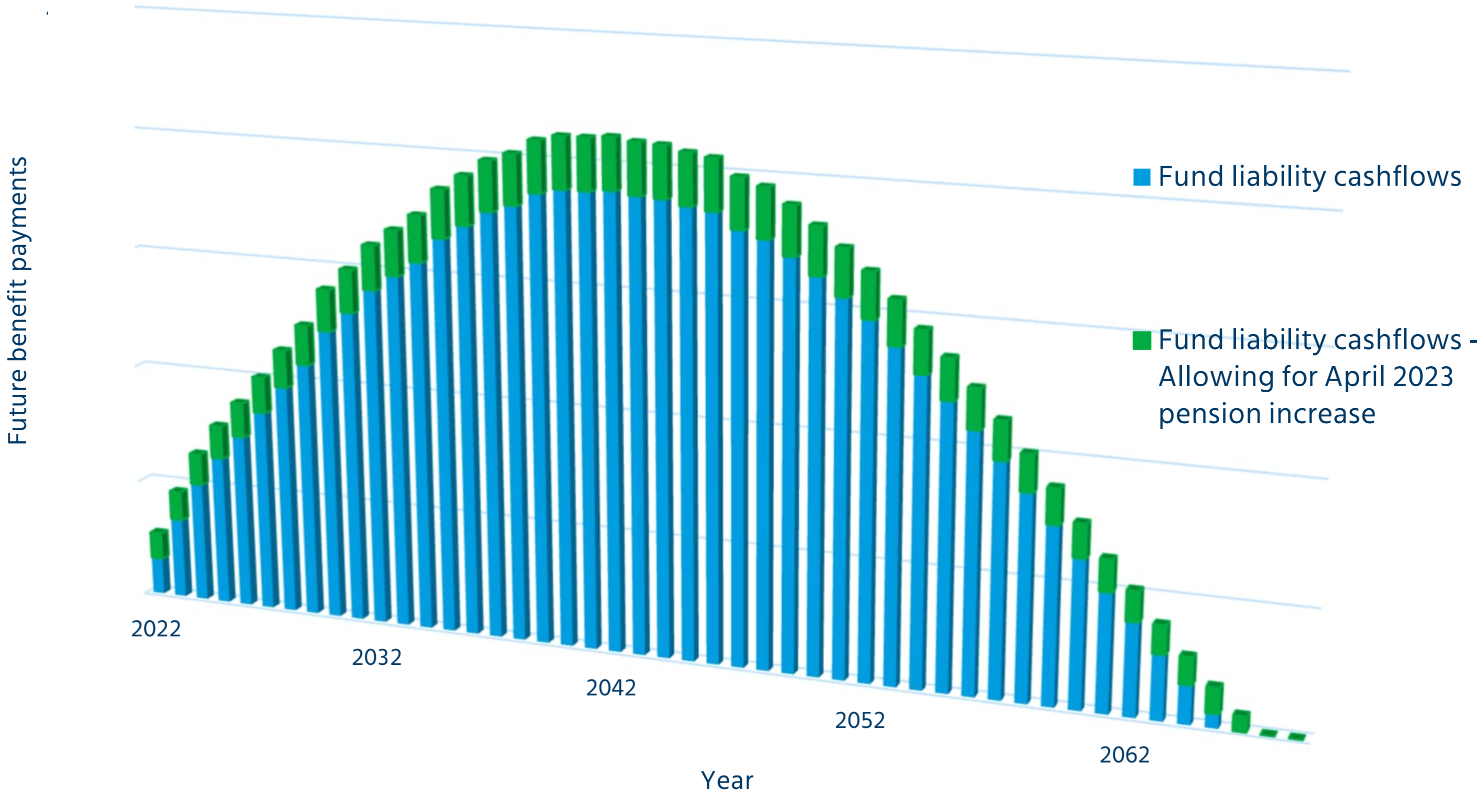
Inflation Risk – 2023 Pension Increase



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

2022 Valuation Results

Whole Fund Results & Assumption Considerations

Updated results and sensitivities

	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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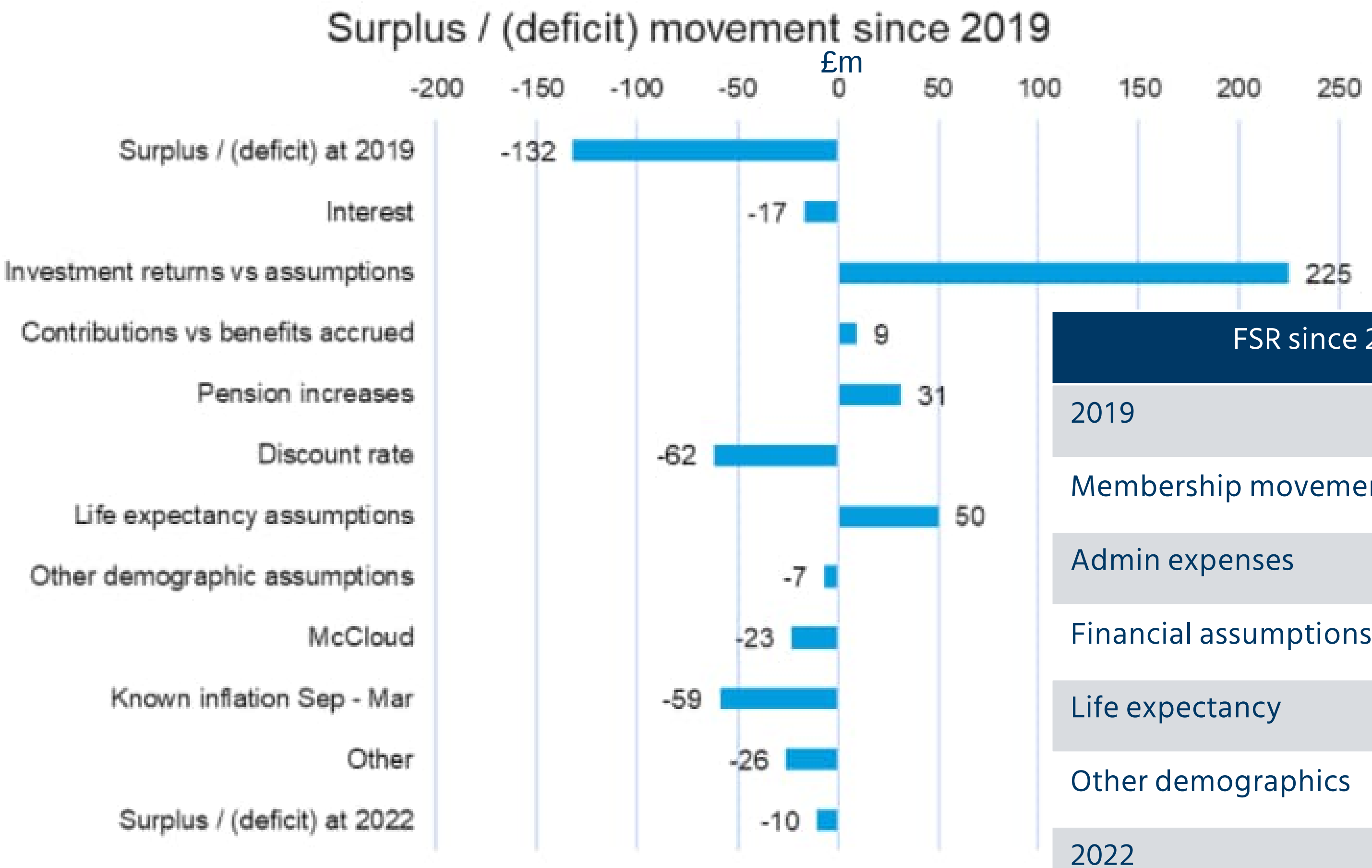
Whole Fund Results & Assumption Considerations

Reconciliation to previous results



FSR since 2019	
2019	16.6%
Membership movements	+0.6%
Admin expenses	+0.2%
Financial assumptions	+0.8%
Life expectancy	-0.6%
Other demographics	+0.4%
2022	18.0%

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Employer Contributions Outcomes

What might we expect?

At the total Fund level you would expect the overall theoretical contribution requirements to reduce. This is due to the reduced secondary contributions (due to the reduced deficit), partially offset by an increased future service rate.

The contribution outcome for each employer will depend on a number of factors:

- The 2019 valuation funding position
- The maturity profile versus the whole Fund
- The contributions that have been paid including if prepaid
- Changes in membership profile since 2019 (e.g. leavers, new joiners, retirements etc)
- The pay growth that has been granted (versus assumptions)

The combination of these factors can mean a very different outcome for individual employers compared with the Fund as a whole. Given the experience since 2019 and the future outlook, the variance in employer positions could also be much wider than seen in previous valuations.

Employer Contributions Outcomes

Individual Schedules

2022 ACTUARIAL VALUATION SUMMARY

Shropshire County Pension Fund - Example (400)

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EMPLOYER RESULTS SUMMARY

VALUATION BALANCE SHEET

Assets	£1,000,000
Liabilities	£1,050,000
Surplus / (Deficit)	(£50,000)
Funding Level	95%

EMPLOYER CONTRIBUTION REQUIREMENTS

Contributions requirements	Future Service Rate	(Surplus) / Deficit Contributions
2023/24	18.0%	£5,000
2024/25	18.0%	£5,400
2025/26	18.0%	£5,800

TERMINATION POSITION

Assets	£1,000,000
Liabilities	£1,400,000
Surplus / (Deficit)	(£400,000)
Funding Level	71%

SUPPORTING INFORMATION

Employer Information	
Employer Type	Part 2 – Designated Body
Open/Closed	Open
Ill Health Captive	Yes
Funding Basis	Ongoing
Guarantor in Fund	n/a

Future Service Prepayment Selected	None
Surplus / Deficit Prepayment Selected	None
Recovery Period from 1 April 2023	13 years

This schedule should be read in conjunction with the valuation report of the Shropshire County Pension Fund and the Funding Strategy Statement 2022. The contributions will be reassessed as part of the 2025 Actuarial Valuation and new contributions will be payable from 1 April 2026.

Whilst reasonableness checks on the data provided by employers and the Fund have been carried out, they do not guarantee the completeness or the accuracy of the data. Consequently, we do not accept any liability in respect of our advice where we have relied on data which is incomplete or inaccurate.

Employer Contributions Outcomes

Individual Schedules

2022 ACTUARIAL VALUATION CONTRIBUTION PROJECTIONS

Shropshire County Pension Fund - Example (400)

DETAILED RESULTS

	Final results at 31 March 2019		Actuarial Valuation Results at 31 March 2022	
Assets	£800,000		£1,000,000	
Liabilities	£900,000		£1,050,000	
Surplus / (Deficit)	(£100,000)		(£50,000)	
Funding Level	89%		95%	
Employer Future Service Rate (% of pay)	17.0%		18.0%	
2023/24 Projected Payroll	£217,800		£217,800	
Recovery Period	16 years		13 years	
BASE RESULTS - like for like comparison before prepayment and phasing				
2023/24 Future Service Amount (% and £)	17.0%	£37,000	18.0%	£39,200
2023/24 (Surplus) / Deficit Amount	4.8%	£10,500	2.3%	£5,000
2023/24 Total Contributions	21.8%	£47,500	20.3%	£44,200
FINAL RESULTS - allowing for prepayment and phasing				
2023/24 Future Service Amount (£)			18.0%	£39,200
2024/25 Future Service Amount (£)			18.0%	£40,900
2025/26 Future Service Amount (£)			18.0%	£42,700
2023/24 (Surplus) / Deficit Amount (£)			£5,000	
2024/25 (Surplus) / Deficit Amount (£)			£5,400	
2025/26 (Surplus) / Deficit Amount (£)			£5,800	
Total Contributions 2023/26			£139,000	
Prepayment saving			£0	

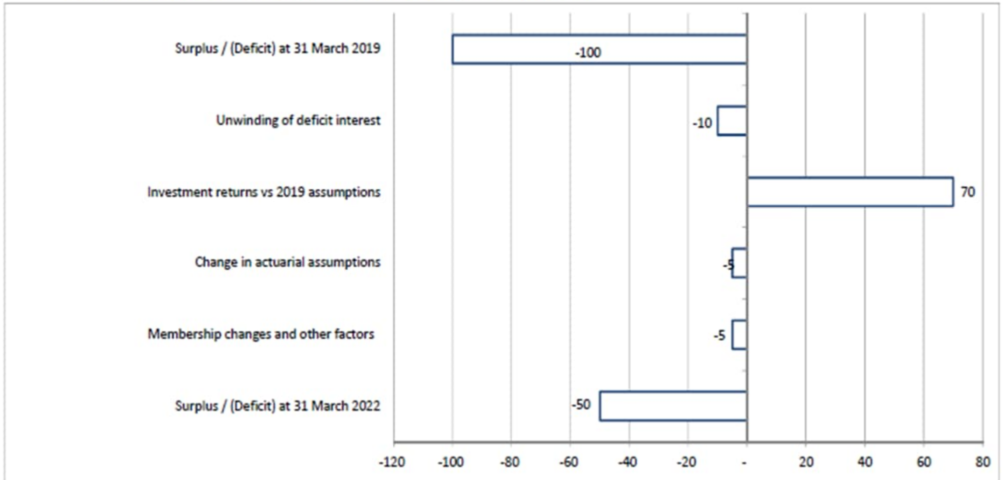
Employer Contributions Outcomes

Individual Schedules

2022 ACTUARIAL VALUATION FURTHER INFORMATION

Shropshire County Pension Fund - Example (400)

ANALYSIS OF CHANGE IN FUNDING POSITION (£000s)



ANALYSIS OF CHANGE IN FUTURE SERVICE RATE

	% of Pay
2019 Future service rate	17.0%
Change in employee contribution rate	+0.0%
Change in profile of membership & other factors	+0.4%
Change in actuarial assumptions	+0.6%
2022 Future service rate	18.0%

#N/A

KEY MEMBERSHIP EXPERIENCE - 2019 TO 2022

	Actual	Actual vs Expected
Pensioner Deaths	2	100%
Ill-health Retirements	0	0%
Pay Growth (liability weighted)	15%	

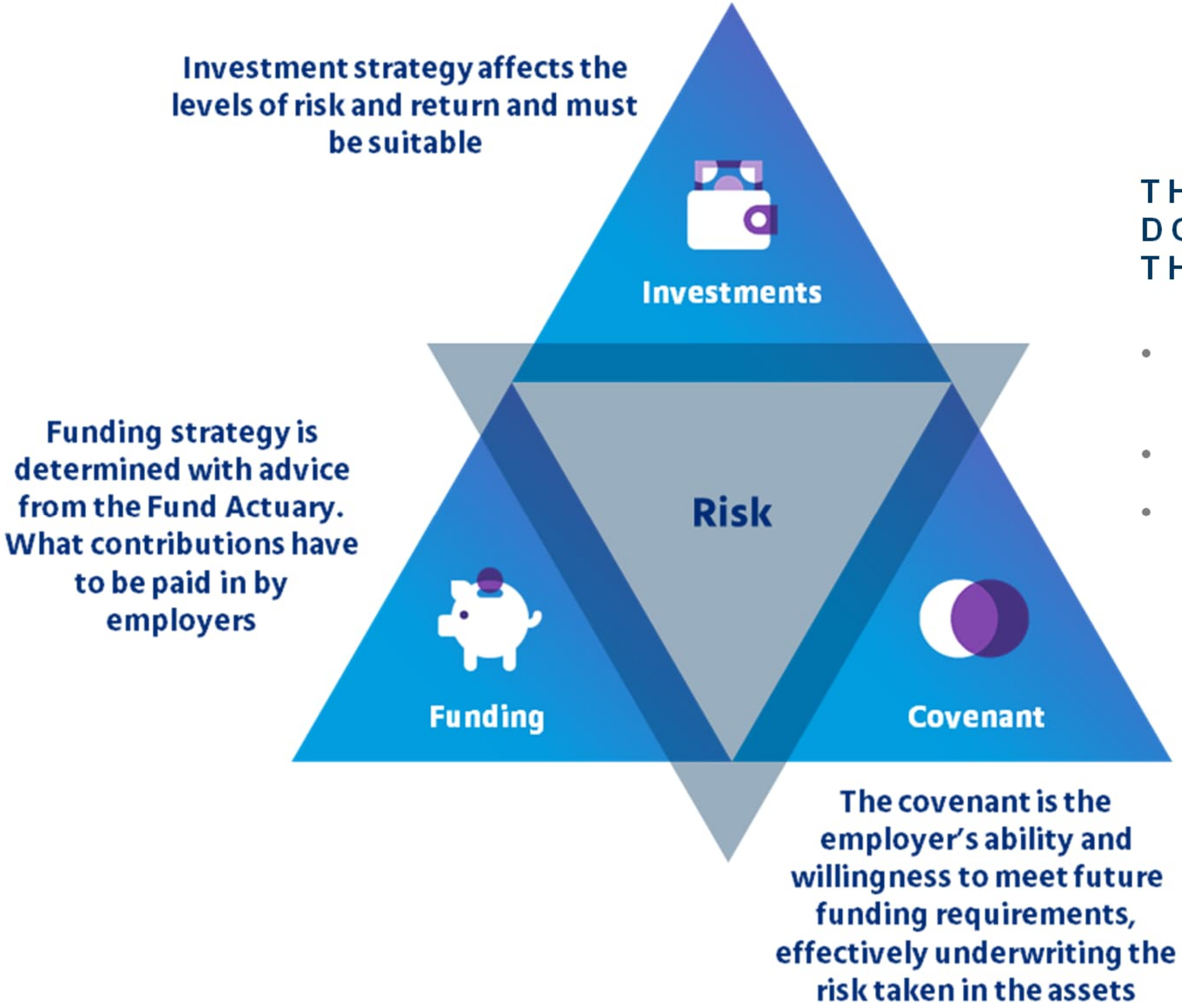
SUMMARY OF MEMBERSHIP DETAILS

	31 March 2019	31 March 2022
Number of Active members	12	20
Total Post 2014 Actual Salaries (£ p.a.)	180,000	200,000
Average Age (weighted by CARE pay)	54.0	54.0
Average Employee Rate (% of pensionable pay)	6.5%	6.5%
Number of Deferred Pensioners	10	10
Total Deferred Pensions at the Valuation Date (£ p.a.)	20,000	22,000
Number of Current Pensioners and Dependants	10	11
Total Pensions Payable at the Valuation Date (£ p.a.)	40,000	43,000

Funding Strategy Statement (FSS)

Funding Strategy Statement

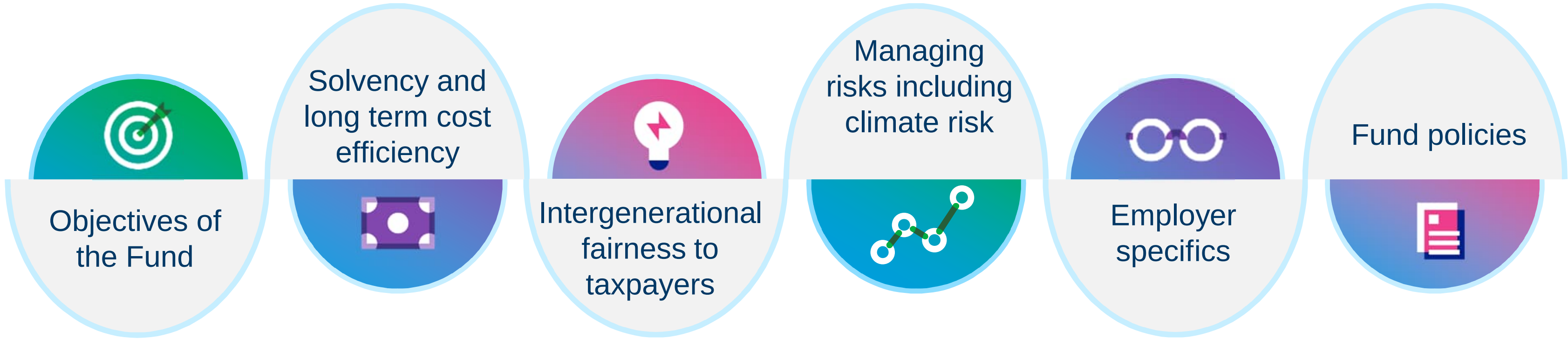
A strategy not a snapshot…



THE FUNDING PLAN COMES DOWN TO MANAGING RISK IN THE SHORT AND LONG TERM

- Agree a plan to balance affordability versus long term sustainability
- What level of risk is acceptable?
- What is the ultimate objective e.g. termination?

Funding Strategy Statement & Employer Events Framework



The Employer Events Framework supplements the FSS. It describes the various "life stages" of an employer that participates in the Fund. It describes the events and possible outcomes from those events right through until it withdraws from the Fund.

Employers should review this policy document and consider how it impacts their own circumstances, including the potential financial and operational implications.

Funding Strategy Statement

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

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

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Employer Risk

Employer Risk

Employer types

- Wide variety of employers in the Fund. Only some have **taxpayer guarantee**.
- For others, the Fund relies on the strength of the employer.

Exits / orphaned employers

- When employers with a Fund guarantor exit, they are subsumed by the guarantor. Otherwise they are "orphaned", and become the **responsibility of all employers**.

	Number	Taxpayer-backed
Councils, Fire	3	Yes (direct, DfE, or Fund guarantor)
Academies	51	
Contractors	41	
Designated bodies	41	
FE*/HE	3	No
Community admissions	12	
Orphans	16	

**Guarantor status currently under review*

- To protect the remaining employers, the orphan exit debts allow for stronger assumptions – meaning higher exit debt. This is designed to leave a margin for protection.

Non guaranteed employers – the risk

- The risk is that those with no taxpayer guarantee can't meet their obligations, and so it falls to other employers.

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Addressing the Risk

So what if anything should the Fund should do about the risk?

- Could **do nothing?** But this leaves the remaining **employers exposed to the risk of unfunded exit debts**, and the Fund has a responsibility to consider this.

- We could **focus on the highest risk employers only**? A targeted approach is valuable. But even the best category B employer covenant is **not at the level of 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 at the 2019 valuation (if not 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 Fund is introducing 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

- Late Nov 2022
- Individual employer results issued
- Employer presentation

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

Mid Dec 2022
- Employer consultation on FSS

Dec / Jan 2022
- Consultation closes

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…”

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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