AGM – Fund Actuaries' update

Staffordshire Pension Fund

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13 November 2023

What we will cover today

- How the Fund works
- Funding & actuarial update
- Funding vs Accounting
- Accounting surplus
- Common accounting queries
- What next?

How the Fund works

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Collect money
(contributions)

- Employee contributions
- Employer contributions

Invest money
(its assets)

Pay pensions
(benefits to members & their dependants)

How the Fund works

Collect money
(contributions)

Employee contributions

Employer contributions

Invest money
(its assets)

Fixed

Pay pensions
(benefits to members & their dependants)

Variable

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A collective term

"The Fund" =
combination of all c.500 employers

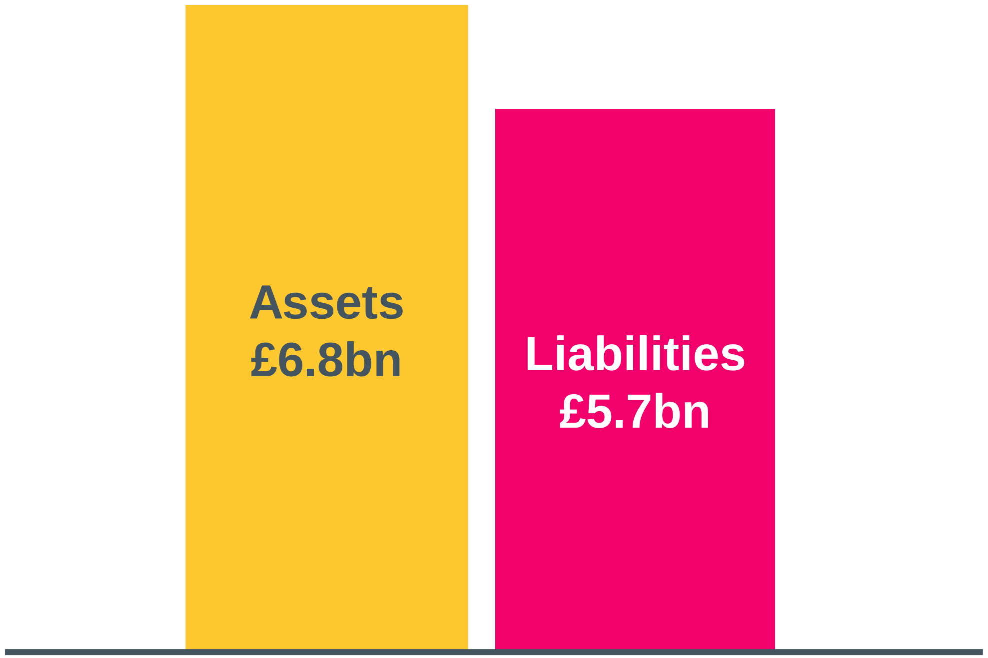
Each employer has its own valuation:
"tend your own field"

All employers are different:
funding strategy is tailored to each

Funding & actuarial update

The 2022 valuation

Solvency



Funding level: 120%

Average employer rates

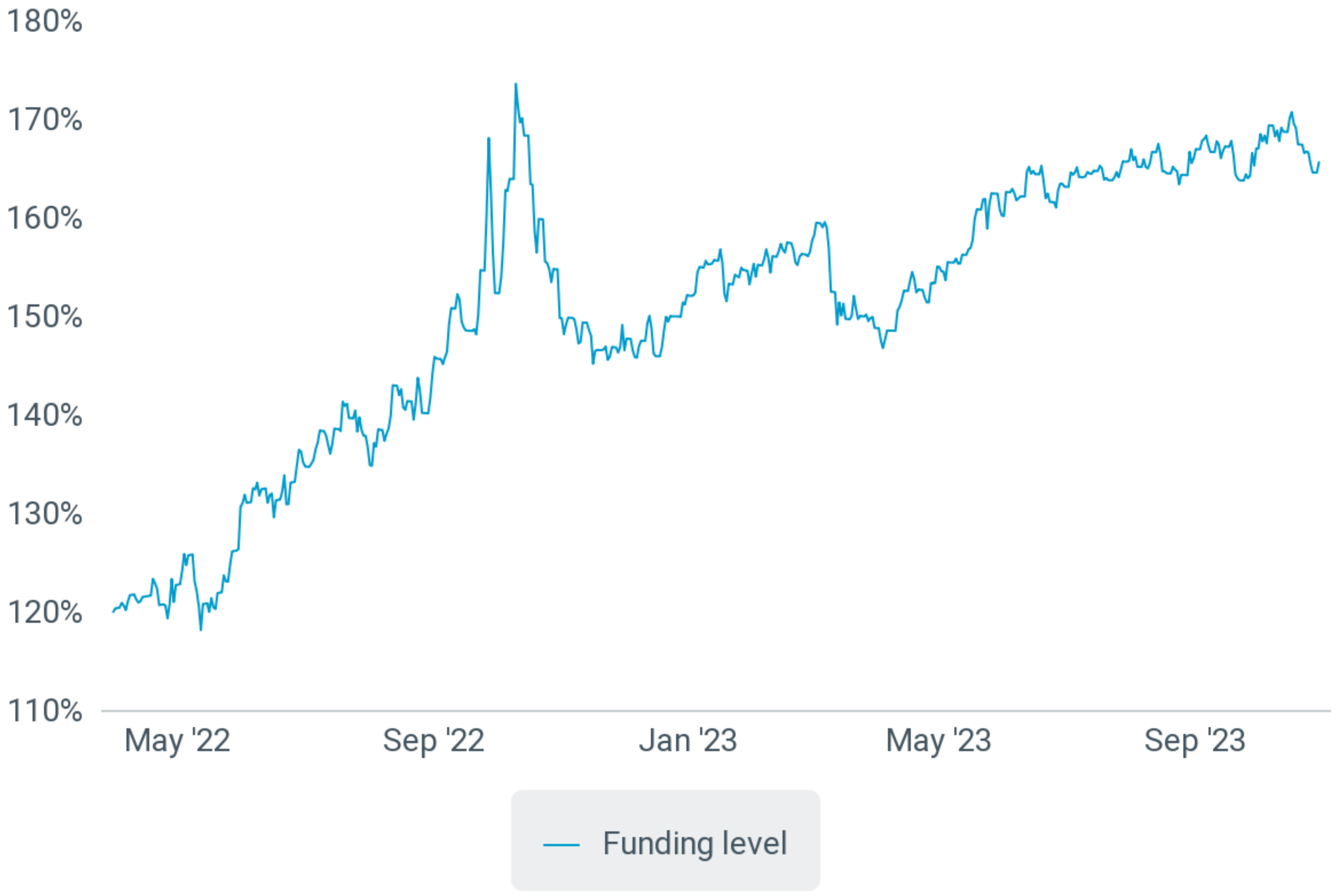
21.5% Primary rate

8.1% Secondary rate

29.6% Total rate

What’s happened since 2022

Funding levels are up, but it’s important to understand why.



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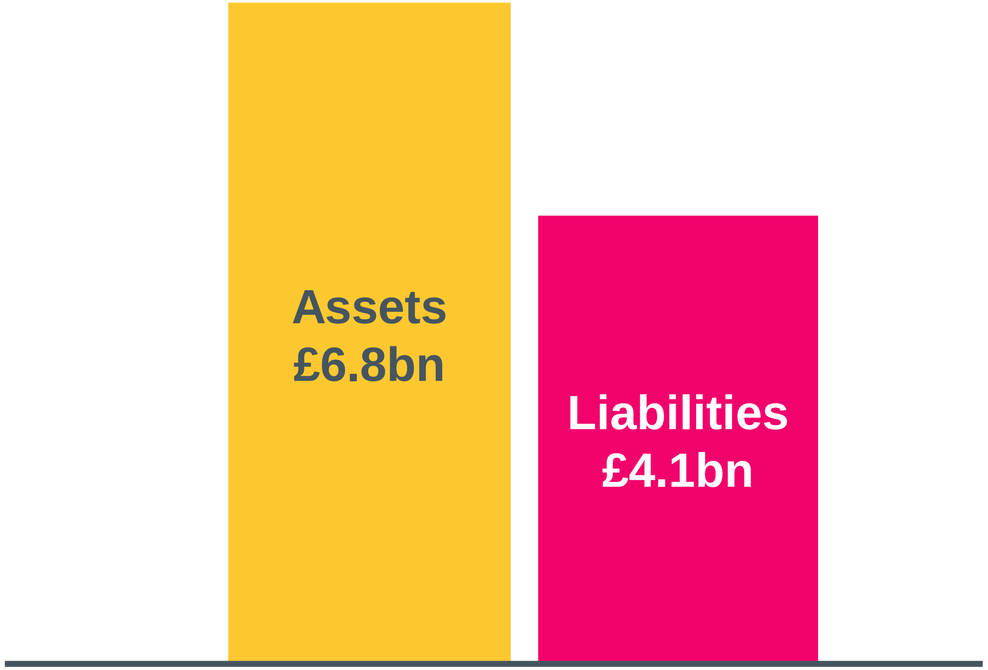
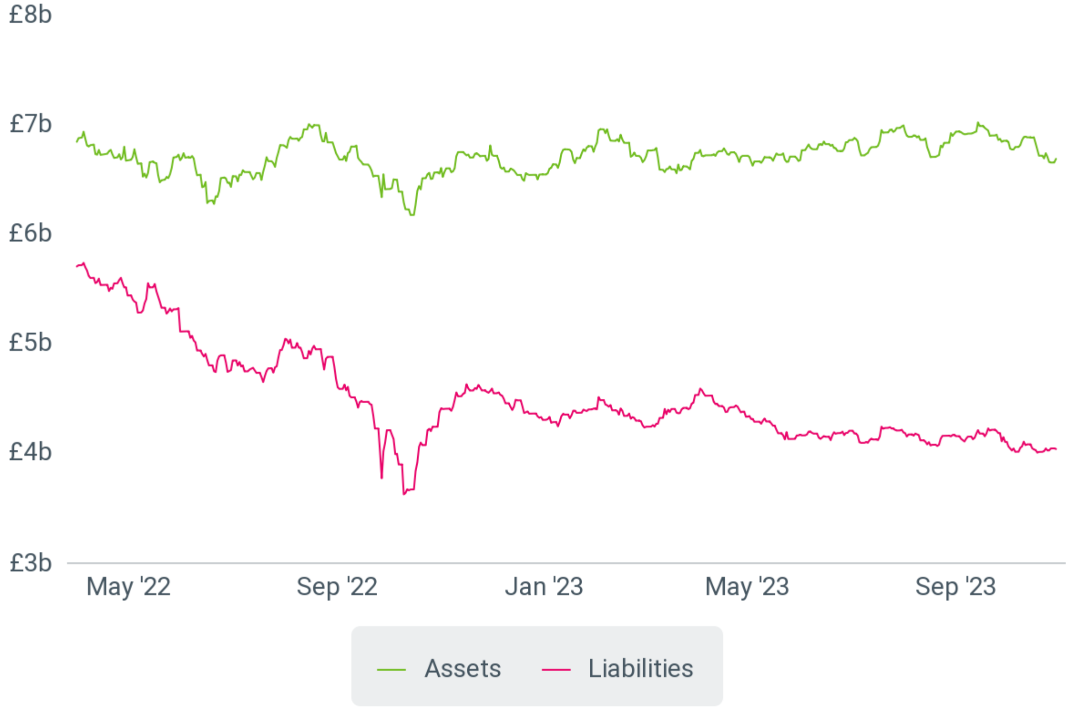
Funding update as at 30 September 2023

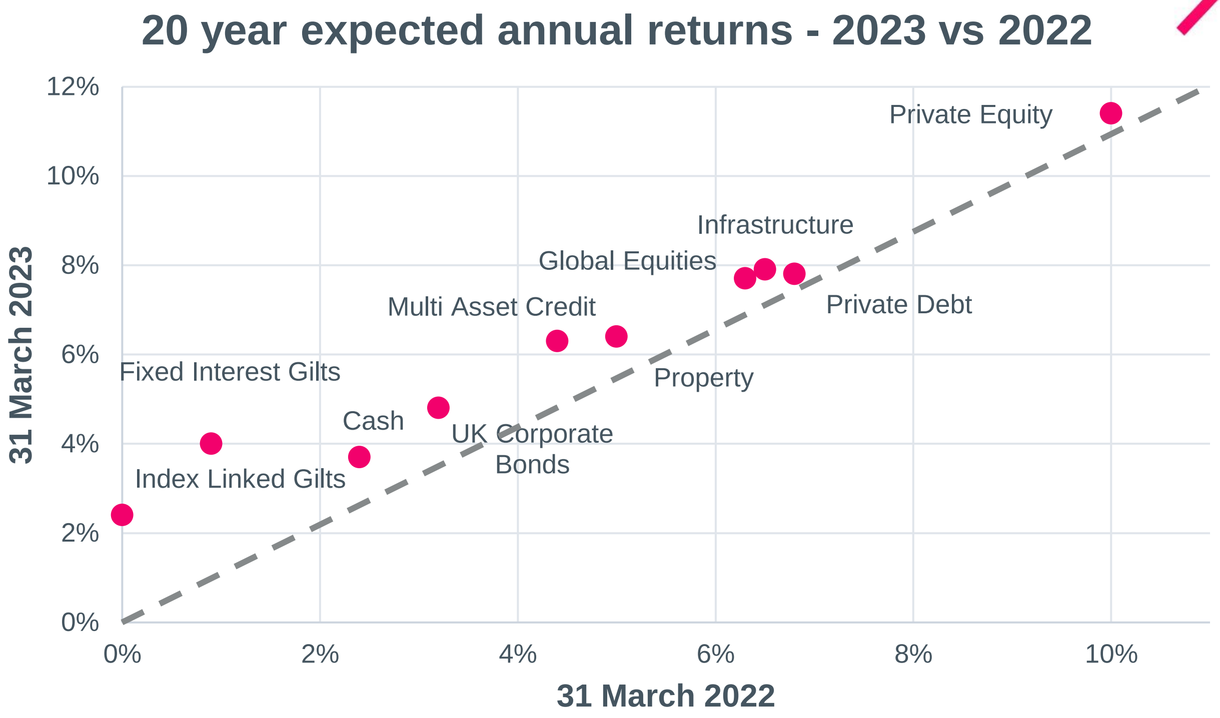


Funding level: 167%

Total investment return from 1 April 2022 to 30 September 2023 was -0.3%

What's caused the improvement?





Green line - investment returns since the valuation have been flat.
Red line - improvements due to higher expected *future* returns => lower liability present values.
The Fund does not currently hold more money to pay benefits.

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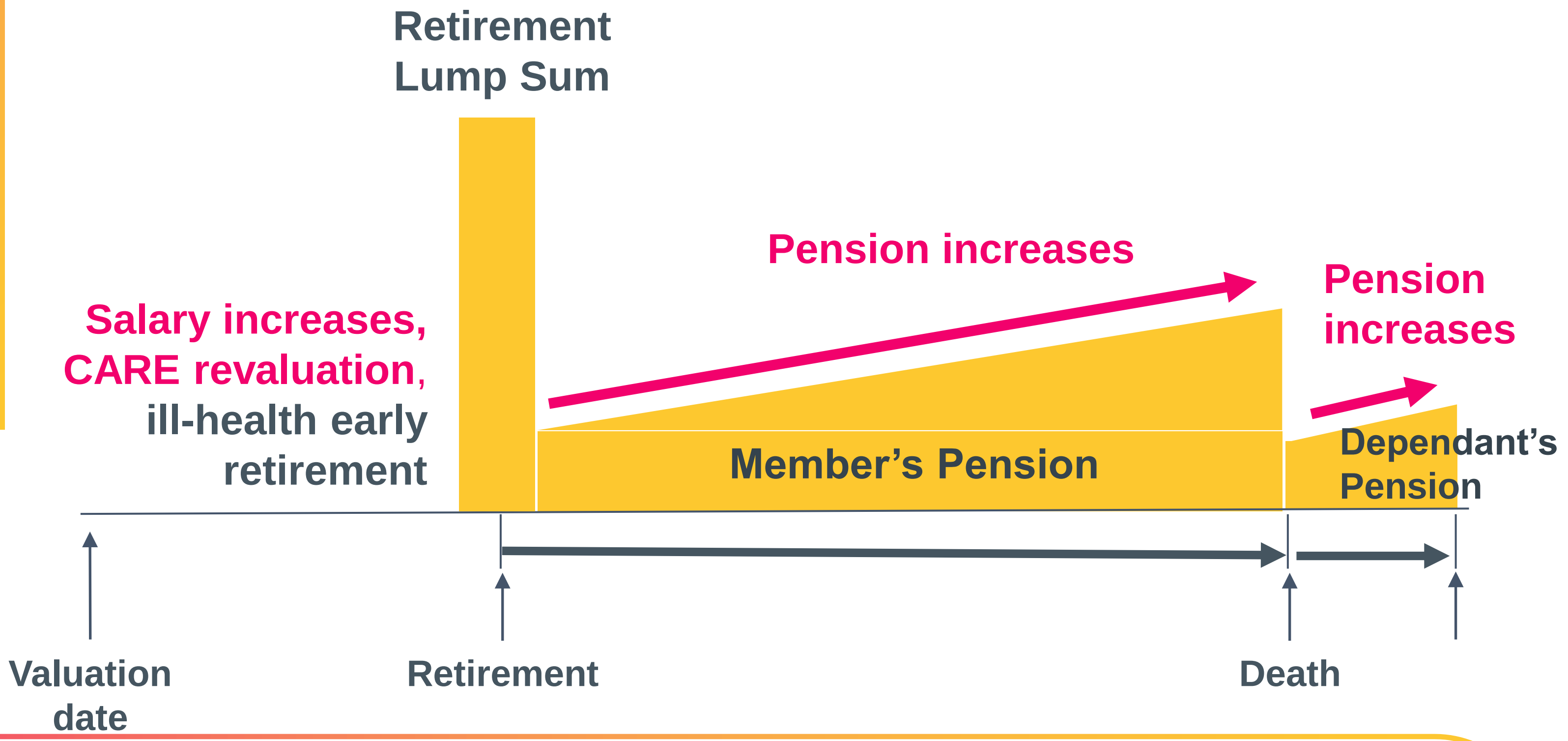
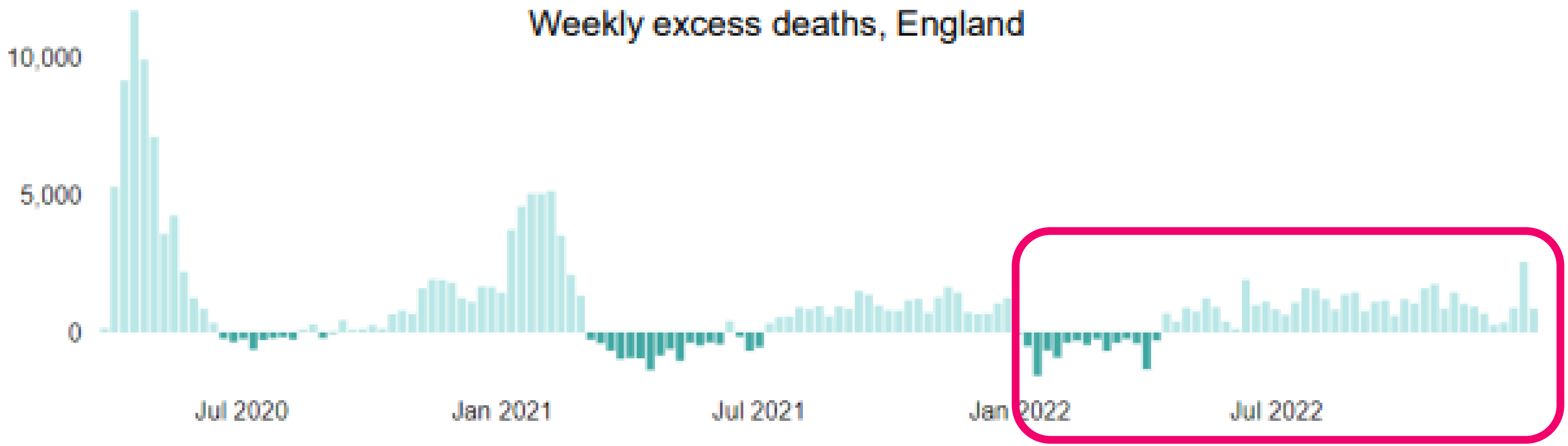
Beware of inflation

- 2023 benefit increase was **10.1%**
- 2024 benefit increase expected to be **6.7%**



Higher inflation leads to higher liabilities
We allowed for this when setting your contributions at the March 2022 valuation

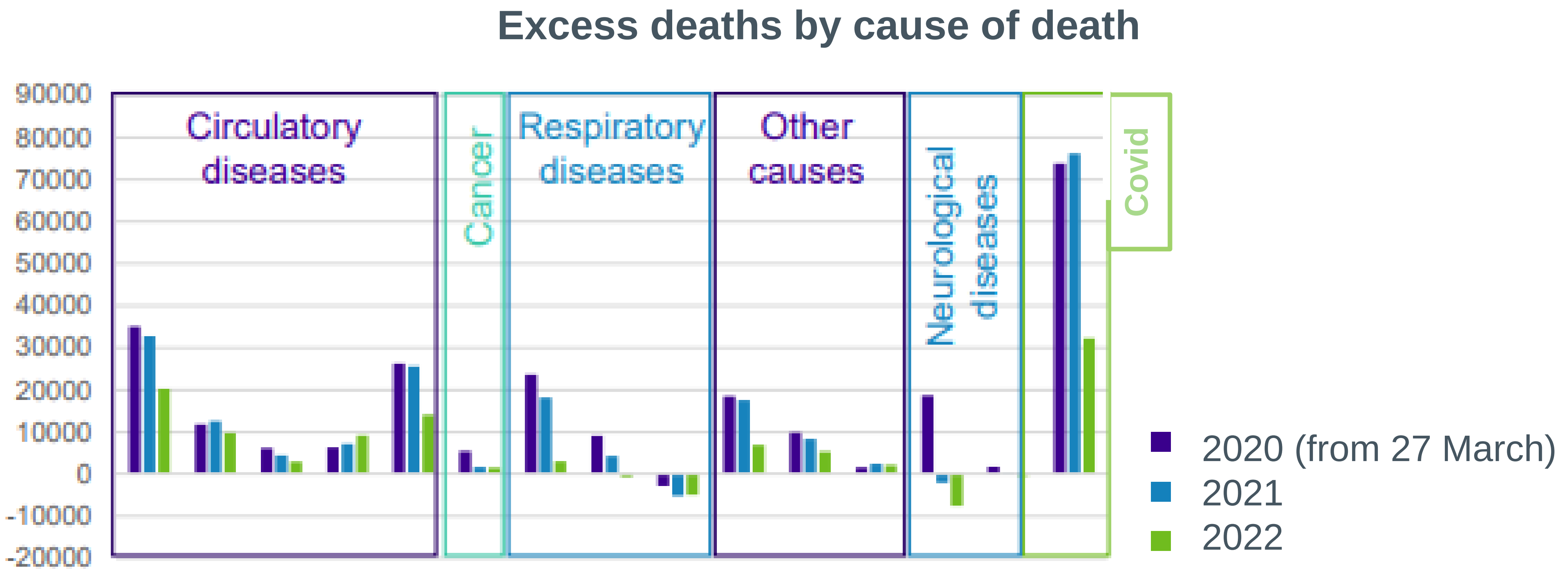
Mortality: What happened in 2022?



Source: Office for Health Improvement and Disparities

2022 excess mortality rates were surprisingly similar to 2021

Covid is still with us



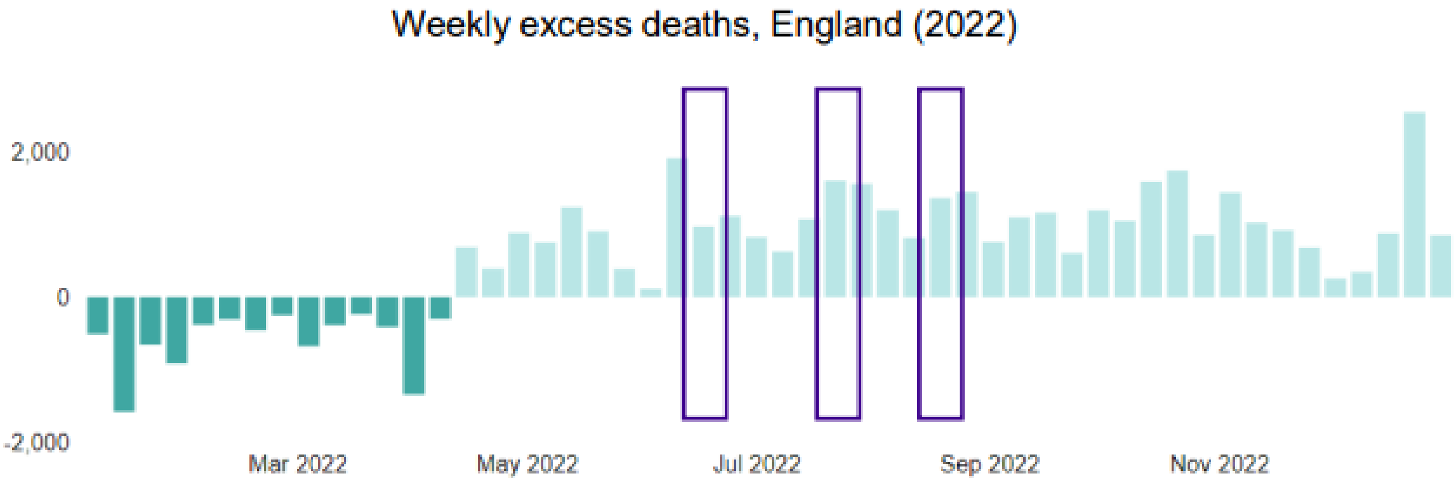
Beginning to understand potential long-term effects of Covid

Heatwaves

3 ‘waves’ of extreme heat in 2022:

- 15-17 June 2022: **32.7 °C**
- 17-19 July 2022: **40.3 °C**
- 9-13 August 2022: **34.2 °C**

Source: Met Office (metoffice.gov.uk)



Source: Office for Health Improvement and Disparities

Periods of extreme heat relatively short lived in 2022, but how common will these periods be in the future?

Three climate scenarios considered

Green Revolution

- Concerted policy action starting now e.g. carbon pricing, green subsidies
- Public and private spending on "green solutions"

Delayed Transition

- No significant action in the short-term …
- … followed by shorter and sharper period of transition

Head in the Sand

- No or little policy action for many years
- Growing fears over ultimate consequences leads to market uncertainty and price adjustments

Scenario	Level of disruption			
	Years 1-5	Years 6-10	Years 11-15	Years 16-20
Green Revolution	Very High	Moderate	Moderate	
Delayed Transition		Very High	High	
Head in the Sand			High	Very High

We tested the main Fund contributions under all three scenarios as part of the 2022 valuation, and are satisfied these are suitably robust

Wider outlook

- **Pooling Consultation -** government looking to support levelling up agenda.
- **McCloud Regulations -** big administration task, very minimal impact on LGPS benefits for most members or employers.
- **LGPS Cost Sharing Valuations** are unlikely to result in changes in member benefits.
- **Other Public Sector Valuations** (Police, Fire, Teachers etc.) are likely to result in increased employer contributions.

Summary

INVESTMENTS

- Markets have struggled
- Returns have been less than anticipated

INFLATION

- Benefit increases have been greater than long term assumption (2023 increase was 10.1%, 2024 increase expected to be 6.7%)
- Partly anticipated at 2022 funding valuation

INTEREST RATES

- Interest rates have increased significantly
- This puts upwards pressure on expected future returns across asset classes

MORTALITY

- Life expectancy improvement rates remaining lower than previous levels

What does it mean for employers?

Funding positions

- Higher than at 2022 valuation
- Increased volatility and uncertainty, especially around inflation

Contribution rates

- Not reviewed until the 2025 valuation
- Past service funding position is a small element of the total rate
- Stability of contributions is key

Situation will be monitored in lead up to 2025 valuation

Funding vs Accounting

Funding vs accounting

Change to	Triennial Funding Valuation	IAS19 / FRS102 Accounting
Purpose	To set cash contributions	For inclusion in Employer Accounts
Assumptions	Set by the Fund	Responsibility of the Employer
Discount Rate	Based on the Fund's prudent expectation of *future* asset returns	Based on high quality corporate bond yields *on the accounting date*
Methodology	Based on full membership data	Projected from last funding valuation (31 March 2022)

Your annual accounting disclosure does not influence cash contributions

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How the accounting valuation is done

Funding valuation → **Accounting valuation (year 1)** → **Accounting valuation (year 2)** → **Accounting valuation (year 3)**

A funding valuation is carried out every three years.

Each year, the assets and obligations are projected forward from the last valuation

The projection allows for:
- Known asset returns
- Contributions paid
- Changes in assumptions

Every three years the projection is updated to be based on the latest funding valuation

Where we are in 2023, for accounting

Funding valuation → **Accounting valuation (year 1)** → **Accounting valuation (year 2)** → **Accounting valuation (year 3)**

- The most recent formal funding valuation was at 31 March 2022
- Impact of 2022 valuation was first shown in 2023 accounting disclosures
- Membership & asset experience shown through remeasurement / OCI
- Other assumptions re-set as part of valuation e.g. new demographics

Impact of accounting assumptions

Discount rate (assumed future investment return)

Future pension increase rate assumption (CPI)

Future life expectancy assumption

Future salary increase rate assumption

Higher impact

Lower impact

Financial assumptions adopted must reflect market conditions on 2023 accounting date – usually much higher discount rate

The key demographic assumption is for future life expectancy

Accounting surplus

Many employers showing surplus accounting position in 2023

If employer's share of assets is greater than the present value of its obligations (liabilities) then it has a **net asset position** in accounting disclosures

The accounting standard places a limit on the net asset that can be recognised

i.e. employer may not be able to recognise the full surplus in its asset statement

But accounting standards do not prescribe what that net asset limit (ceiling) is

Asset ceiling calculations

But what future service cost rate to use?

Common asset ceiling calculation:

A. present value of *future service costs* over an agreed future period

… and what period to use?

less

B. present value of *future contributions* over an agreed future period

Does a *minimum funding requirement* exist in the LGPS?

And if requirement does exist, what future contributions to take account of in the asset ceiling?

Common accounting queries

Common queries (and starting answers)

How did my asset/obligation remeasurement items arise? (the 2022 valuation)

Membership data has changed a lot since last year's report (the 2022 valuation)

How have you allowed for the 2023 10.1% Pension Increase? (identified in table)

Can we see investment allocation breakdown of asset share? (Not really)

Why is my change from 2022 different from my peers? (2022 valuation, cashflows)

How much of the surplus can be shown as net asset? (it depends)

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What next?

What should employers be doing?

Auditor queries: point them to the cover report in the first place

If you have an accounting surplus, check how much can be recognised

Tell the Fund of any major changes to your business or membership

Flag up to officers any affordability concerns as early as possible

Thank you