

CIPFA LGPS Actuarial Summit 2014

Employer risks

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Once upon a time....

- LGPS Funds were in surplus
- HMT was more worried about over-funding than under-funding
- There were no contractors in the Scheme
- Cessations were rare and cessation valuations rarer
- FRS17 didn't exist
- Many funds operated a single, pooled contribution rate
- Employer risk barely existed

Employers were "all in this together"

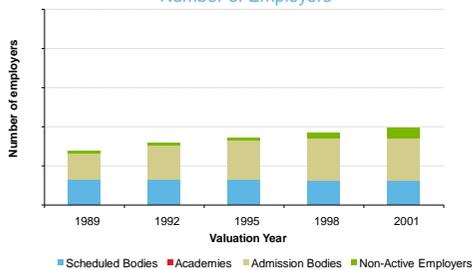
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Employer profile was reasonably stable.....

Number of Employers



Sample fund based on information provided for the actuarial valuation

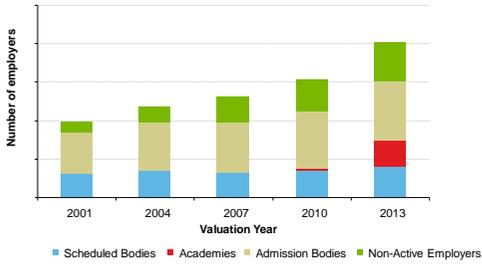
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..... but not any more!

Number of Employers



Sample fund based on information provided for the actuarial valuation

Average across our portfolio is 156

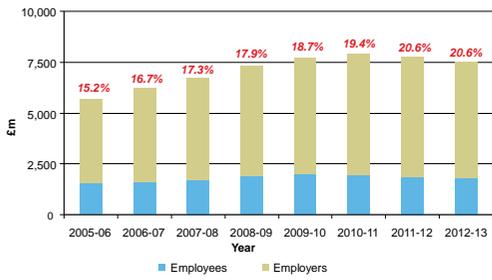
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Increased "cost" of the LGPS

Contributions to the LGPS



Auto-enrolment may increase cash contributions

Source: DCLG Statistical Releases for LGPS England. Figures in red are estimated employer contributions as a percentage of pay

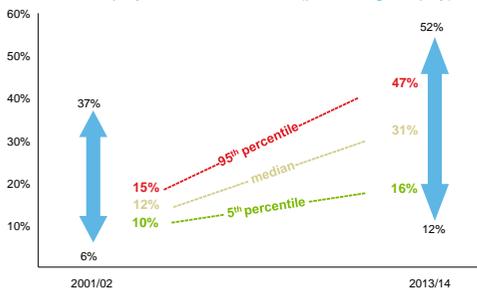
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Increasing variation

Total employer contribution rate (percentage of pay)



Sample Fund, actual employer contributions certified

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What should your approach be?

- Integrate into your wider governance framework
- Link your approach to your overall aims/strategies

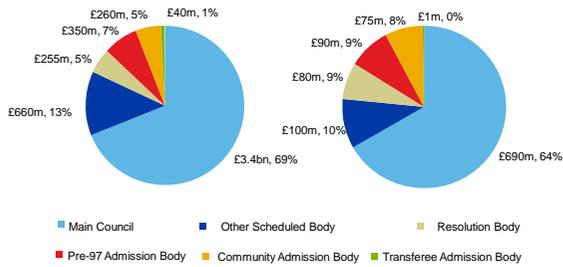
- Employer governance framework
 - Measurement
 - Risk management / Mitigation
 - Monitoring

Not all risks need to be mitigated

Measurement

Split of Total Ongoing Liabilities

Split of Total Ongoing Deficit



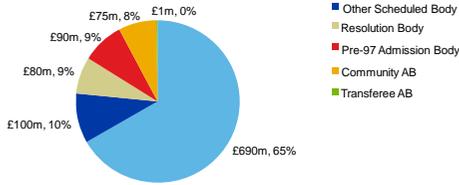
Sample Fund based on 2010 valuation results and strategy. Figures scaled to preserve anonymity. Public Sector Consulting | 14 January 2014

Whose risk is it?

Employer Category	Examples	Proportion of liabilities	Risk Category?	Comments
Tax-raising authorities	Councils	High (>50%)	Low	"Safe harbour" rules mean can't be insolvent?
Guaranteed sch bodies	Academies	Growing!	Low	Depends on your view of the DfE guarantee
Non-guaranteed sch bodies	Universities and Colleges	Variable	Medium?	Depends on source of funding, security of funding stream etc
Resolution bodies	Parish / Town Councils	Small	Low	Extended cessation provisions helpful here
Transferee ABs	Contractors	Small	Low	Consider covenant of Scheme Employer / security offered
Guaranteed CABs	Leisure / housing companies	Variable	Low	Check exact nature of Scheme Employer's "guarantee"
Community /pre-97 ABs (no "subsumption" commitment or guarantee)	Long-standing CABs	Variable	High	Large ABs with no guarantee likely to pose the greatest risk to the Fund

What's at risk?

Split of Total Ongoing Deficit



- How concerned are we about academies and other scheduled bodies?
- How much of the £90m is "unprotected" (i.e. no guarantor / subsumption commitment)?
- How much of the £75m is "unprotected" (i.e. no guarantor / subsumption commitment)?
- What services are these employers providing, and where?
- How does the ongoing deficit compare to the termination deficit?

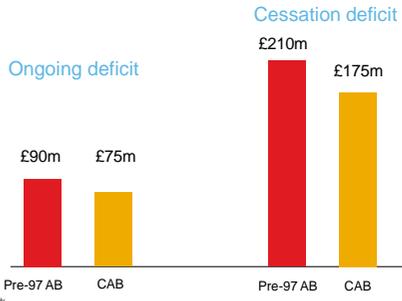
Bringing it all together



Management / Mitigation

- Taken as read:
 - Adequate documentation (admission agreements and guarantee / subsumption commitment)
 - New ABs not admitted without a guarantee (supported by the 2014 Regs)
 - Employer risk part of your overall governance framework
- Further options:
 - Identify possible guarantors / subsumers / other sources of security
 - Encourage pooling of funding risks / risk sharing
 - Align ongoing and termination funding basis
 - Consider degree of investment risk taken
 - Covenant review?
 - "Encourage" closure / change in participation

(Mis)Alignment of ongoing and termination basis



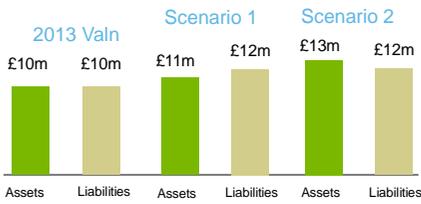
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Inappropriate investment strategy?

- Simple example
 - Closed employer - last active expected to retire in 3 years
 - 100% funded at 2013 valuation
 - Fund assets assumed to return 3% p.a. below discount rate (Scenario 1) or 3% p.a. above discount rate (Scenario 2)



Illustrative only. Cessation valuation assumed to be on a gifts basis with investment strategy predominantly growth assets. Public Sector Consulting | 14 January 2014

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Other issues

- How far are you prepared to go in funding negotiations?
 - Are members your priority or employers?
- How much do you involve guarantors in decision-making?
- Covenant reviews
 - What will you do with the information?

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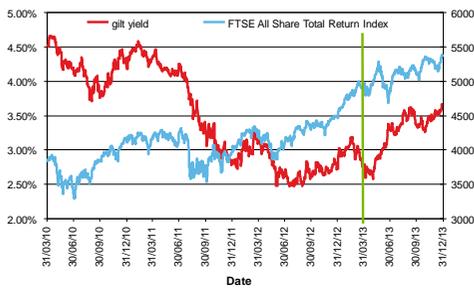


Monitoring

- Review annually as part of ongoing risk monitoring
- More frequent monitoring required for:
 - Closed employers
 - TABs with short remaining contract periods (regulatory requirement)
 - Any "problem" employers (e.g. where reduced contributions have been agreed or you've compromised on assumptions)
- What obligations do employers have to advise you of significant changes?
 - Do you join the dots internally when you do get information?

Monitoring de-risking opportunities

Market movements since the valuation date



Source: Aon Hewitt based on published market statistics. Gilt yield is spot yield appropriate to the duration of an "average" LGPS fund

Concluding comments

- Employer risks shouldn't be ignored
- Best practice would be to
 - Maintain adequate records
 - Maximise use of guarantors / other forms of security
 - Clarity over potential outcomes and trade offs
 - Clarity over who's running what risk
 - Involve guarantors appropriately in decision-making
 - Understand the magnitude of the risk and respond proportionately
 - Align ongoing and termination funding approach
 - Reduce investment risk where affordable
 - Be transparent – helping employers understand their risks
 - Ensure admissions policy and procedures adequately consider risks

If you do all of this – can anyone expect any more?
