London Borough of Southwark Pension Fund
Actuarial Valuation as at 31 March 2022

Initial results presentation to Pensions Advisory Panel

Prepared for: London Borough of Southwark Pension Fund Pensions Advisory Panel

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Date: 5 December 2022

QAS Institute and Faculty of Actuaries ®
Quality Assurance Scheme

Agenda

Part 1

Valuation process and assumptions

Part 2

Initial whole Fund 2022 results

Part 3

Expectations for employer results and contributions

Part 4

Summary, next steps and questions

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Part 1
Valuation process and assumptions

What is a triennial actuarial valuation?

1. Assess financial health

A/L = funding level (ratio); A – L = Shortfall or surplus

A

L

Assets

Market value
from Fund accounts

Past service liabilities

Calculated by Actuary:
Use Fund specific data
Make assumptions about
the future

Past service contributions

Calculated to eliminate the surplus or deficit over the recovery period

Future service liabilities

Employer contributions to meet cost of new benefits ("common" contribution rate)

2. Set employer contributions

Past plus future service contributions

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Regulatory requirement

LGPS Regulations require the Administering Authority to obtain and valuation and rates and adjustments certificate every three years, to be finalised within a year of the valuation date.

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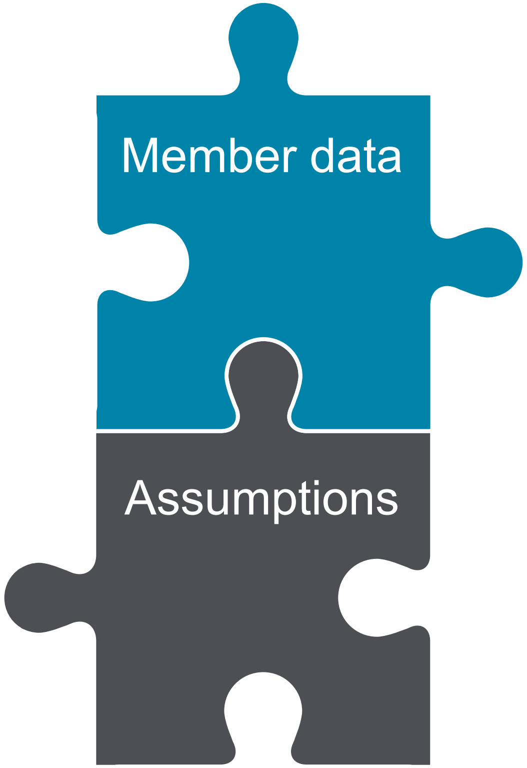
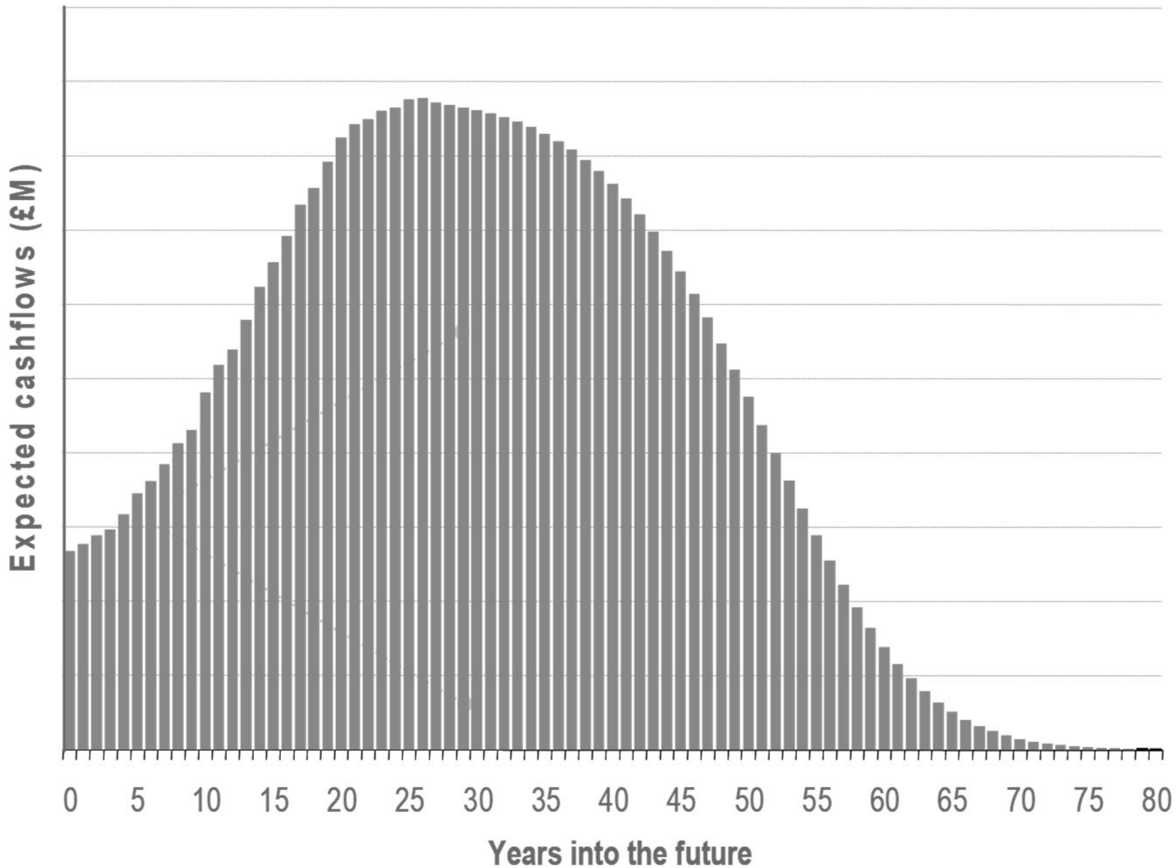
Valuing the liabilities

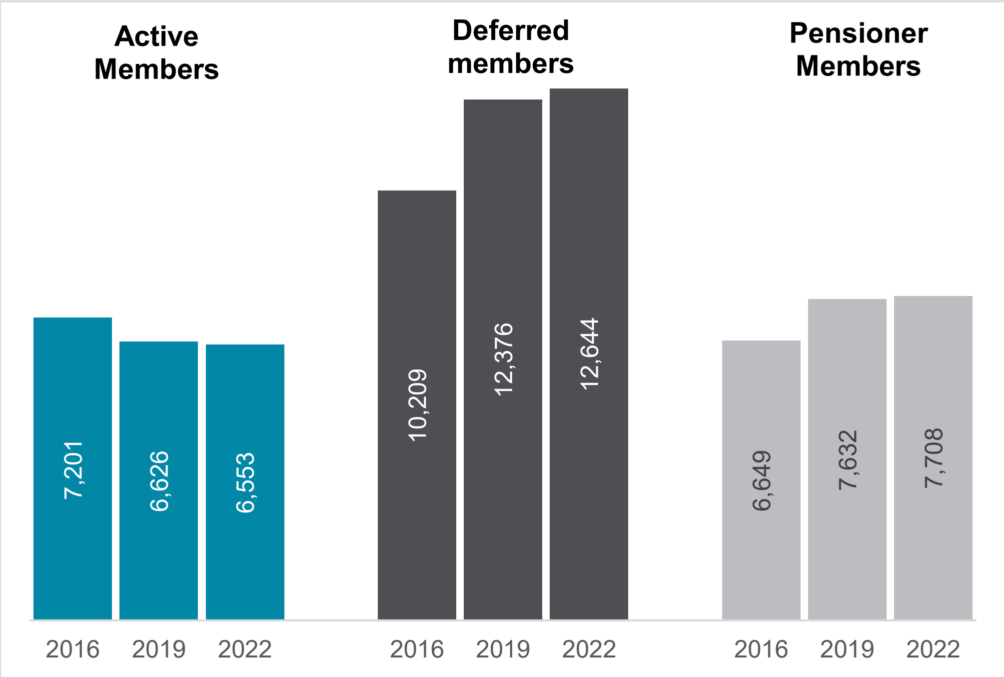




Sample fund, accrued liabilities only

Valuation assumptions are Fund-specific reflecting LB Southwark’s membership characteristics

Data, experience and assumptions



Financial experience affecting benefit payments

	2019 assumption	2019 -2022 experience	Proposed 2022 assumption
CPI increases	2.1% pa	1.7%, 0.5%, 3.1%	2.3% pa(1)
Pay growth	3.6% pa(2)	c4.8% pa	3.8% pa(2)

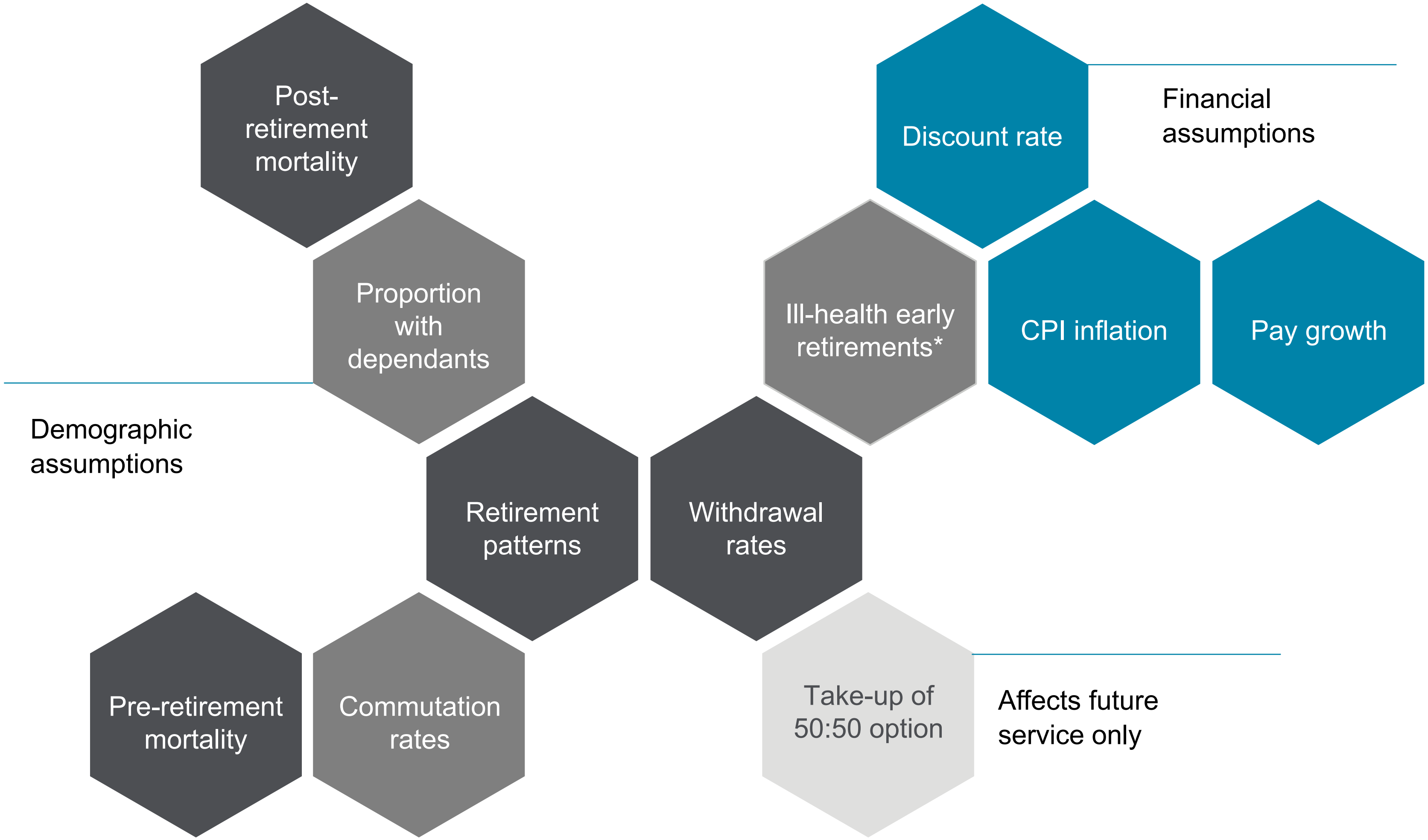
(1) Plus 5% (2019 strategy) or 10% (updated strategy) on liabilities for short term inflation
(2) Plus promotional increases

Average ages (unweighted)

	Actives	Deferreds	Pensioners
2016	45.7	47.8	71.4
2019	46.8	47.7	70.8
2022	47.5	48.3	71.8

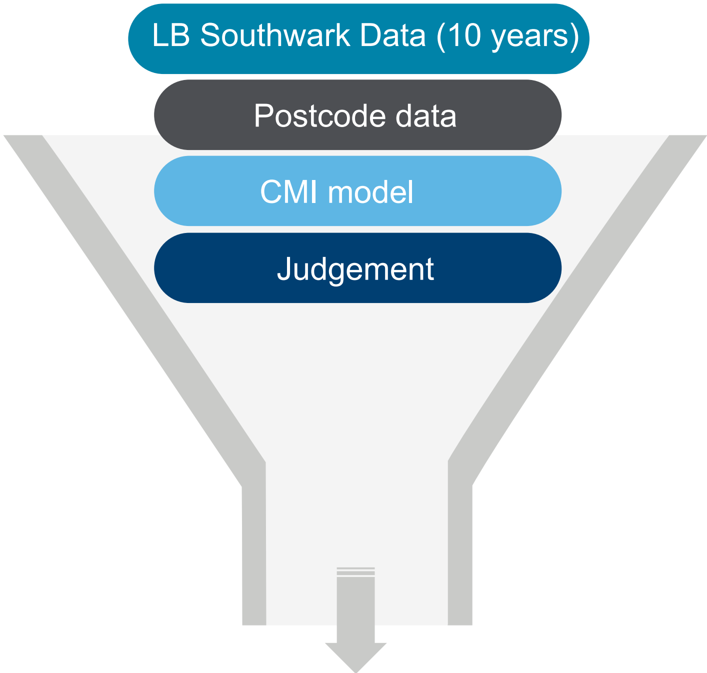
Assumptions best estimate except discount rate

Valuation of liabilities - assumptions



Not required for London Borough of Southwark Pension Fund as ill health retirements are funded through immediate payment of strain contributions

Post-retirement mortality



Best estimate Fund-specific assumptions

Base mortality

Analysed using Demographic Horizons™

Combination of LB Southwark experience and postcode data

Adjustment for experience over pandemic

Future improvements

Short-term - (CMI 2021, updated from CMI 2018) plus

Long-term – 1.5% per annum (same as 2019)

Allowance for pandemic

Life expectancy from age 65 (normal health retirements)

Years	2019*	2022 (expected)	Change
Males (active currently 45)	22.9	22.8	-0.1
Males (currently 65)	21.0	21.5	+0.5
Females (active currently 45)	25.7	25.6	-0.1
Females (currently 65)	23.8	24.1	+0.3

**Life expectancy for a member aged 45/65 at 31 March 2022 using the 2019 valuation assumptions*

Key takeaway

The overall impact on liabilities of our proposed mortality assumption changes is broadly neutral. Other demographic assumptions may have a positive or negative impact.

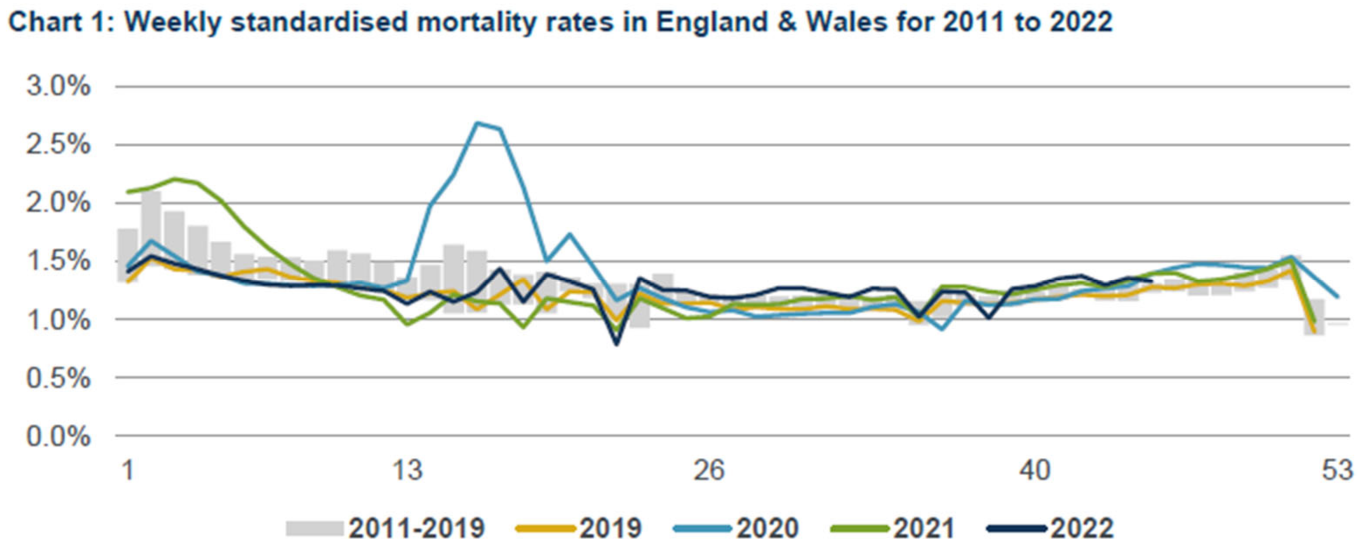
Mortality – COVID 19

Impact of COVID-19

- CMI estimate c**129,900** excess deaths in England and Wales from the start of the pandemic to 11 November 2022

But …

- Includes periods of time with record low excess deaths (i.e. excess deaths were negative)



[Mortality summary pandemic monitor Week 45 2022 v01 2022-11-22.pdf (actuaries.org.uk)]

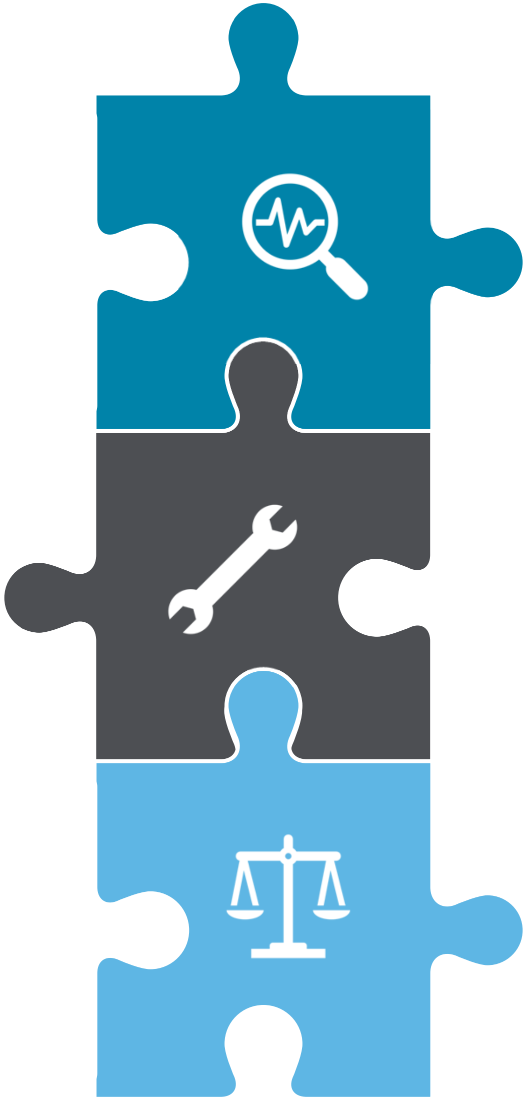
2022 valuation

We need to consider:

London v UK and pension fund membership v population as a whole

The fact that our assumptions are very long-term

How we have allowed for the impact of COVID-19



Adjustment in analysis of experience

Adjusted for pattern seen over the pandemic

Considered relative levels of mortality compared to national population

Adjust scalings for future outlook

1.5 % addition to scalings from analysis

CMI Model

No weight based on 2020 and 2021 data in model

Best estimate

Our assumption for life expectancy should be a “best estimate” of the long term position

Setting other demographic assumptions

Demographic assumptions relate to membership movements or decisions leading to benefit payments or ending of benefit payments

We recommended these assumptions are **best estimate** and, where practical and cost effective, **informed by the experience of the Fund's membership.**

Assumptions based on experience analysis 2015 to 2021

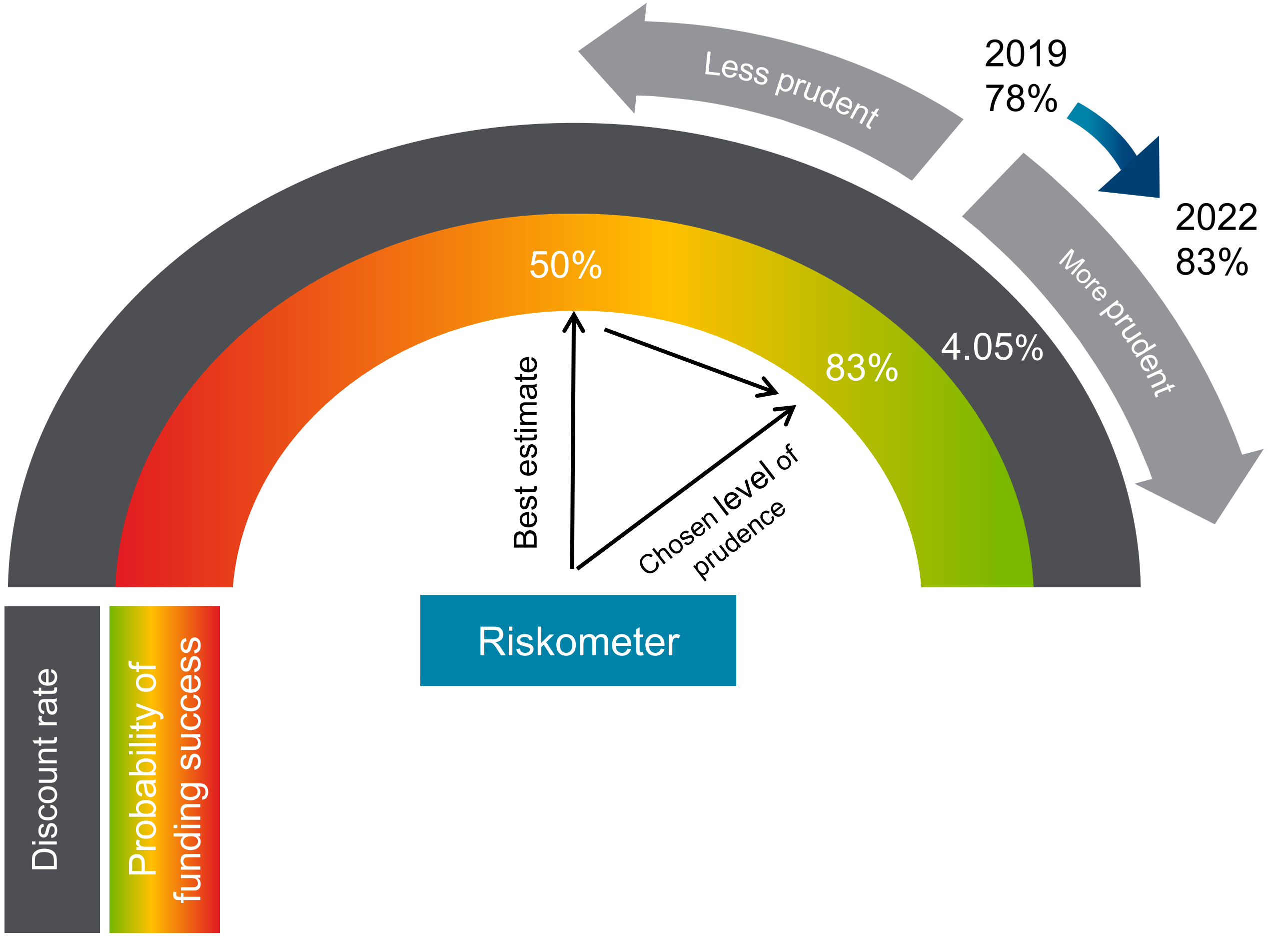
Further information

Proportions married and partner/member age differences are set based on analysis across a sample of Aon’s clients whose members are of a similar socio-economic profile as LGPS members, using our Demographic Horizons™ model

[1] Retirement age assumption based on analysis of Aon’s LGPS actuarial clients

Setting the discount rate

- Expected returns based on the Fund’s investment strategy
- Risk based – level of prudence – “probability of funding success”



Sensitivity to discount rate

Discount rate	Cost now of paying £100 in 20 years’ time
4.55%	£41 (c10% lower)
4.05%	£45
3.55%	£50 (c10% higher)

Supported by Aon’s Capital Market Assumptions
Expected return based on long term strategy is 6.2% at 31 March 2022

Summary of key financial assumptions

% p.a.	2019 assumption	2022 assumption
Probability of Funding Success	78%	83%
Discount rate	4.05%	4.05%
CPI pension increases	2.10%	2.30%
Post 88 GMP pension increases (1)	1.90%	2.00%
Pay growth(2)	3.60%	3.80%
Short-term inflation adjustment	n/a	10%

(1) For members reaching State Pension Age before 2016
(2) CPI inflation + 1.5%. Plus an age-related promotional pay scale.

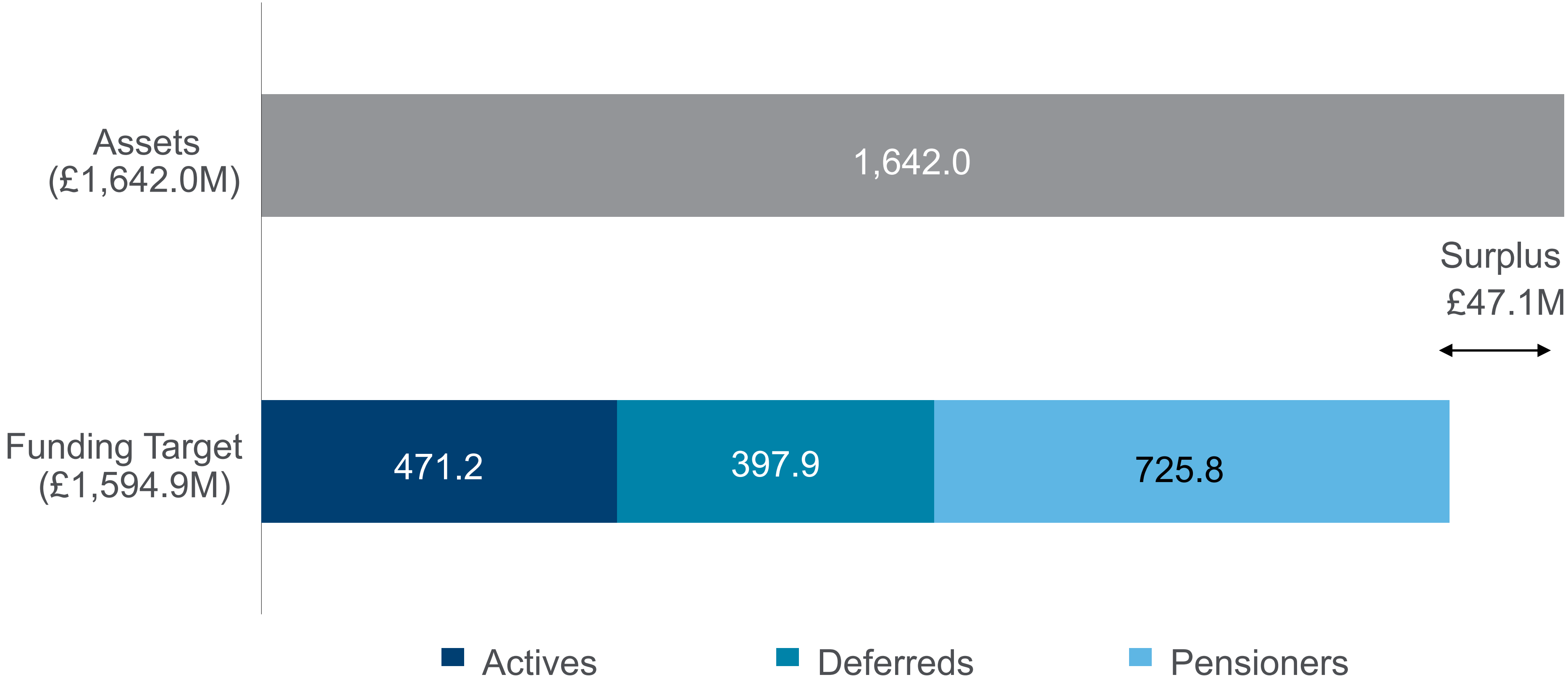
Long term best estimate inflation assumption slightly increased (additional allowance for current high levels of inflation), reducing discount rate net of inflation

Strategy / Assumptions subject to agreement by Administering Authority

Part 2
Initial whole Fund 2022 results

Recap – 2019 valuation

London Borough of Southwark Pension Fund's balance sheet position at 2019 valuation



Funding ratio = 103%

Initial 2022 whole fund past service position

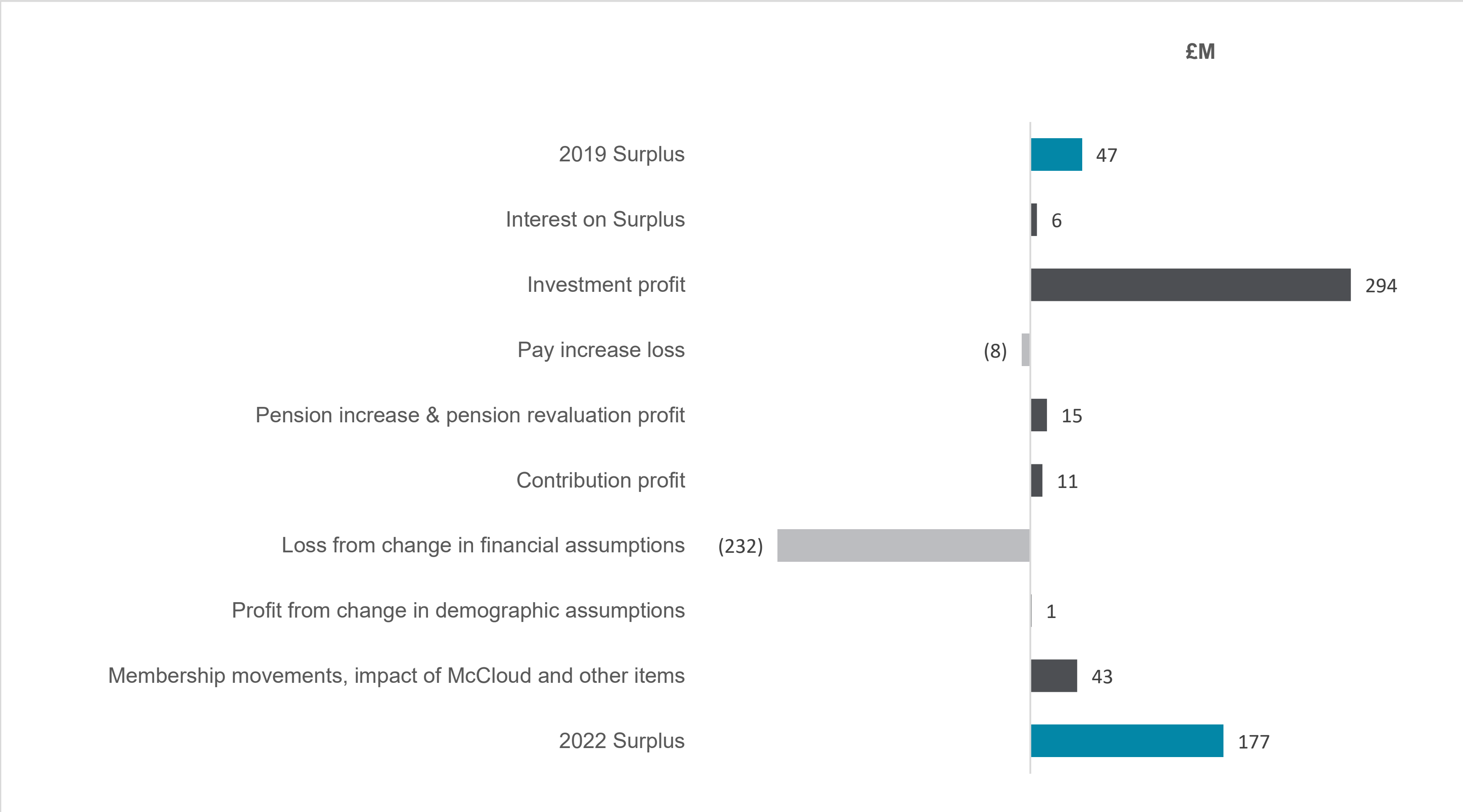
£M	2019 valuation	Initial 2022 valuation
Value of past service benefits for:		
Actives	471.2	608.6
Deferreds	397.9	446.9
Pensioners	725.8	892.6
Value of liabilities	1,594.9	1,948.2
Value of assets	1,642.0	2,125.4
Past service surplus/(deficit)	47.1	177.2
Funding ratio	103.0%	109.1%

Note: The 2022 results and may change as we finalise the valuation calculations

83% Probability of Funding Success for the updated strategy results
Additional 10% short-term inflation allowance in updated strategy 2022 results

Change in funding position (2019 to 2022)

The initial valuation result has increased from a surplus of £47M at the 2019 valuation to a surplus of £177M at the 2022 valuation.



Investment gains partially offset by changes in financial assumptions

Initial 2022 whole fund employer contributions

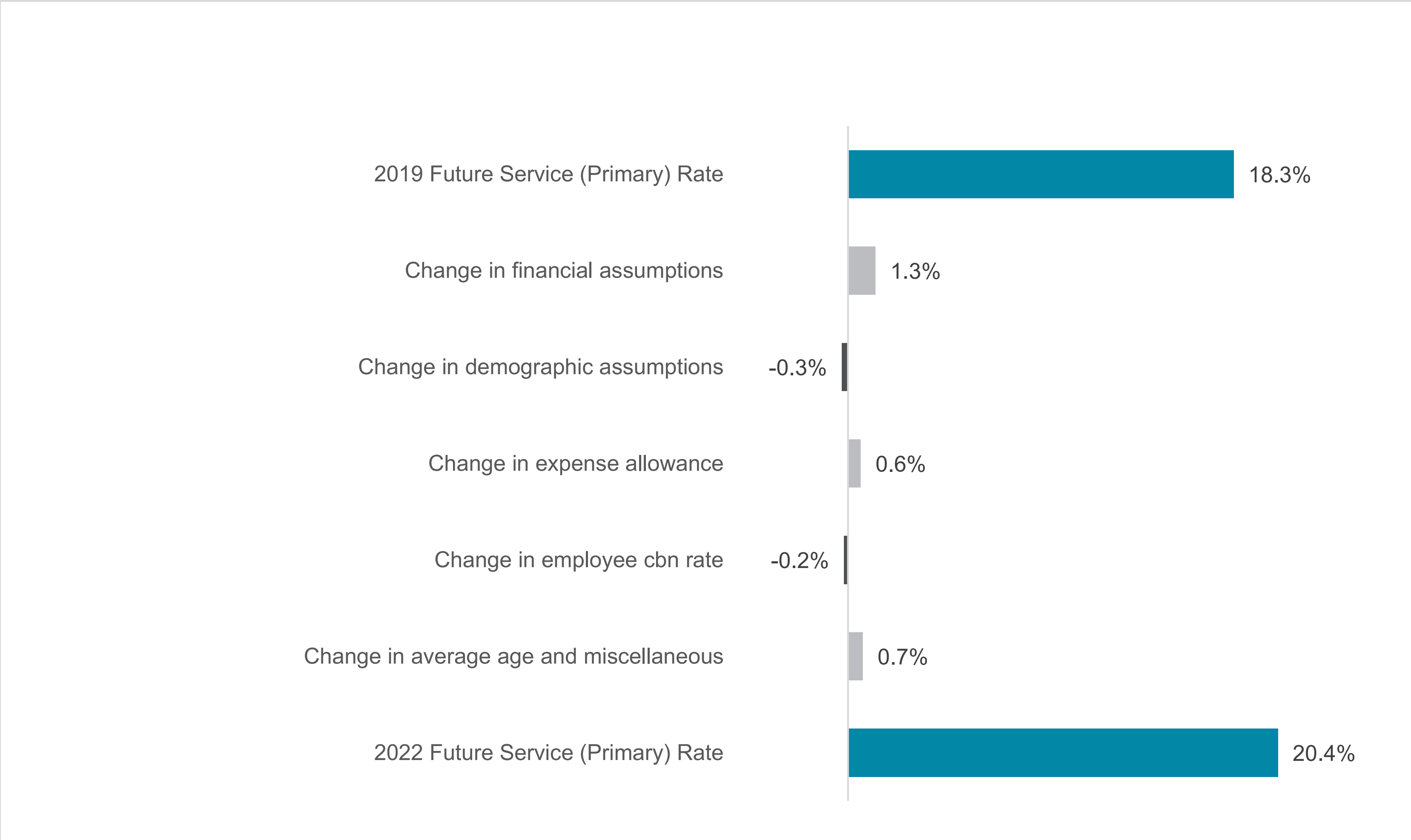
% of Pensionable Pay	2019 valuation	Initial 2022 valuation (updated strategy)
Value of benefits accruing	24.0%	25.7%
Expenses	1.0%	1.6%
Expected cost of death in service cash sum	0.2%	0.2%
Member contributions	(6.9%)	(7.1%)
Net employer cost (Primary Rate)	18.3%	20.4%
Surplus only recovered above	110%	110%
Past service (Secondary) contribution rate	0.0%	0.0%
Allowance for regulatory uncertainty	1.5%	n/a
Total employer rate as % Pay	19.8%	20.4%

Notes:

- *Value of benefits accruing includes value of death in service lump sum benefit.*
- *The employer rate certified in 2019 included an uplift for regulatory uncertainties (McCloud and Cost Management). In the 2022 valuation, the expected McCloud cost is included wholly within the past service liabilities because the remedy period ended on the valuation date.*
- *The 2019 valuation contribution rates were based on a 20 year recovery period and changes were stepped over 6 years for some employers, i.e. a contribution rate of 21.1% is payable over 2022/23*
- *The updated strategy results allows for the 10% short-term inflation allowance*

Change in future service rate (2019 to 2022)

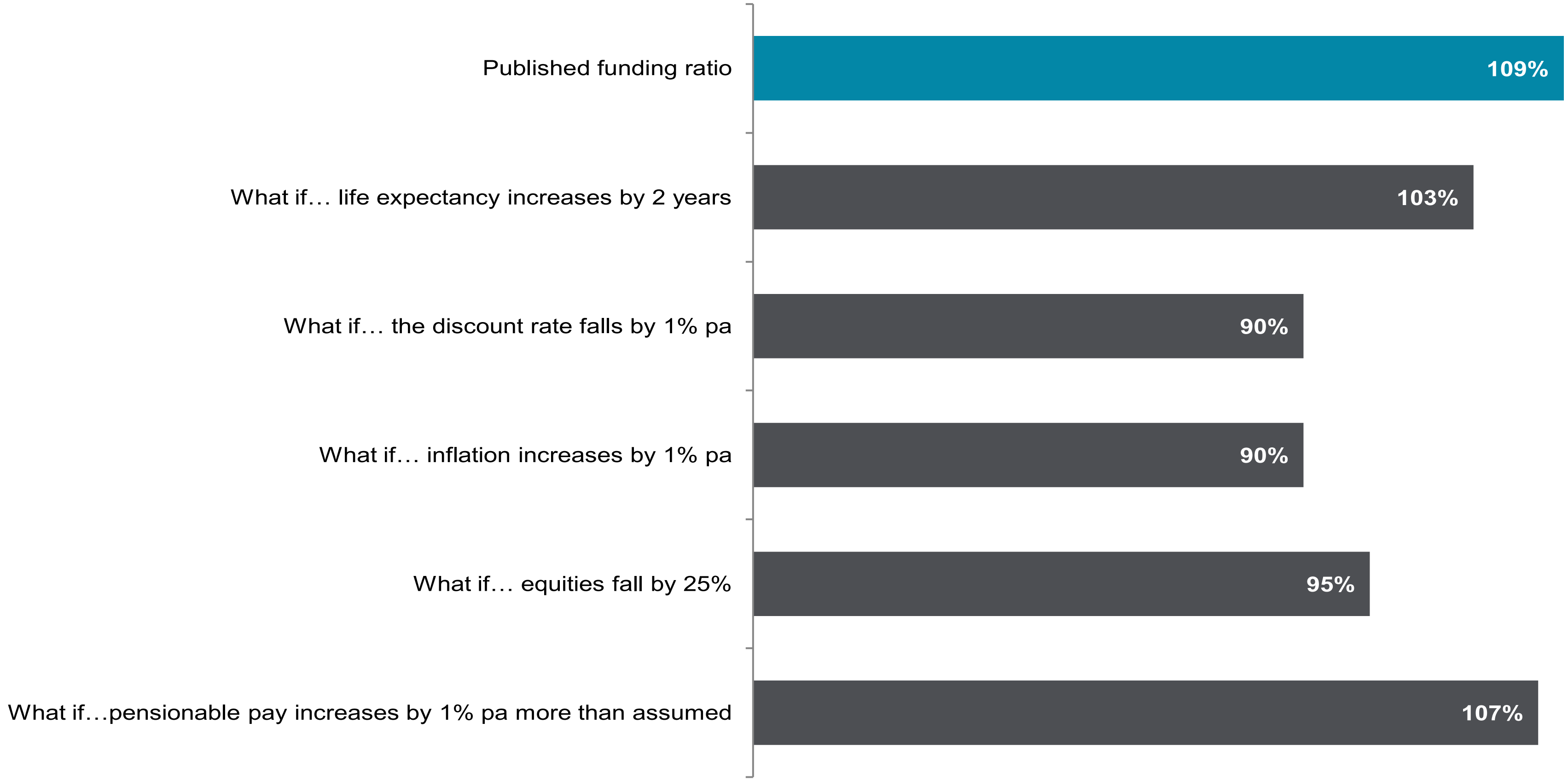
The cost of future benefits (as a percentage of Pensionable Pay) on the initial 2022 valuation result has increased from 18.3% of pay to 20.4% of pay.



Risks and uncertainties

The Fund faces a number of key risks

The chart below shows approximate impact of changes to assumptions / fund experience



Short-term inflation uncertainty is a key consideration for the 2022 valuation

The scenarios considered are not ‘worst case’ scenarios, and could occur in combination (rather than in isolation)

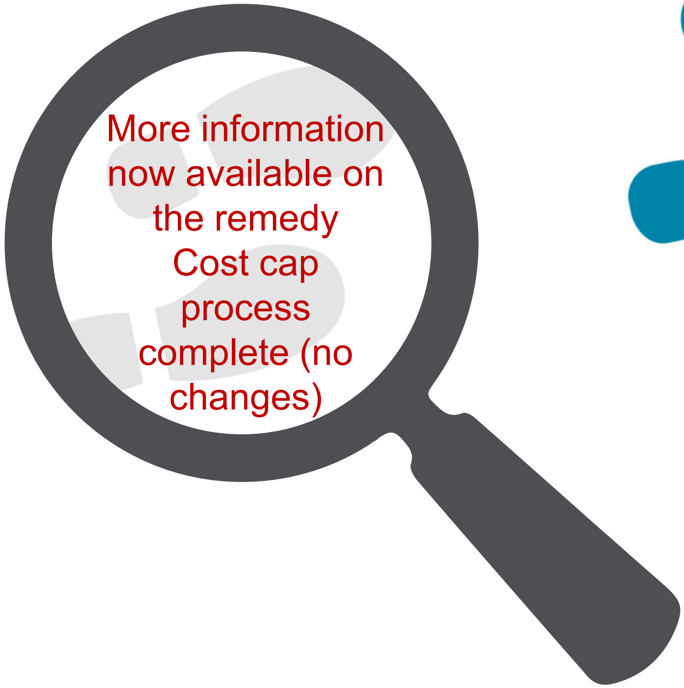
Part 3
Expectations for employer results and contributions

McCloud/cost cap allowance within actuarial calculations

2019 valuation

1.5% allowance in contributions

Average across the Fund as a whole (minimum of cost management changes).



2022 valuation

Make approximate allowance at employer level allowing for individual employer profile

In line with guidance from DLUHC (no equivalent from DfC)

Include allowance within past service liabilities

2016 process – not yet quite resolved

Initial results

SAB process – 0.9% floor breach

HMT process – breach much higher

Process paused

Jan/Feb 2019 – due to McCloud judgement

Process restarted

July 2020 (alongside consultation on McCloud)

SAB letter to Minister

Published 7 October 2021 (dated 18 August 2021) – no recommendation to change benefits

HMT Directions

Published 7 October 2021

Judicial review

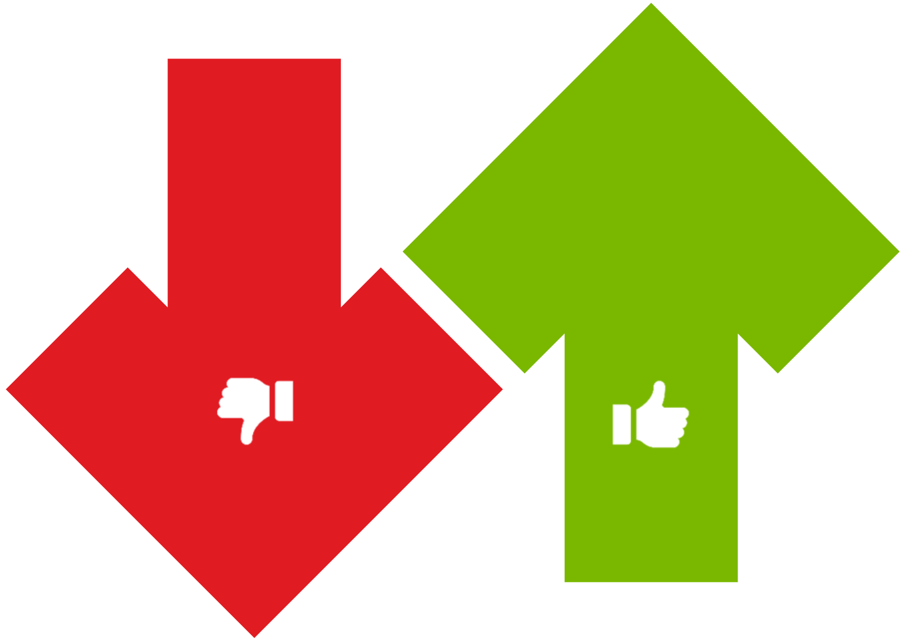
TUs have challenged allocation of McCloud costs to members

Need to keep a watching brief on this for 2022 valuation. SAB committed to reviewing member contributions at lower pay ranges (but unlikely to be in place before valuation signed off)

Market movements since 31 March 2022

2023 PI

Expected to be 10.1%
(set based on Sept
CPI increase)



Liabilities

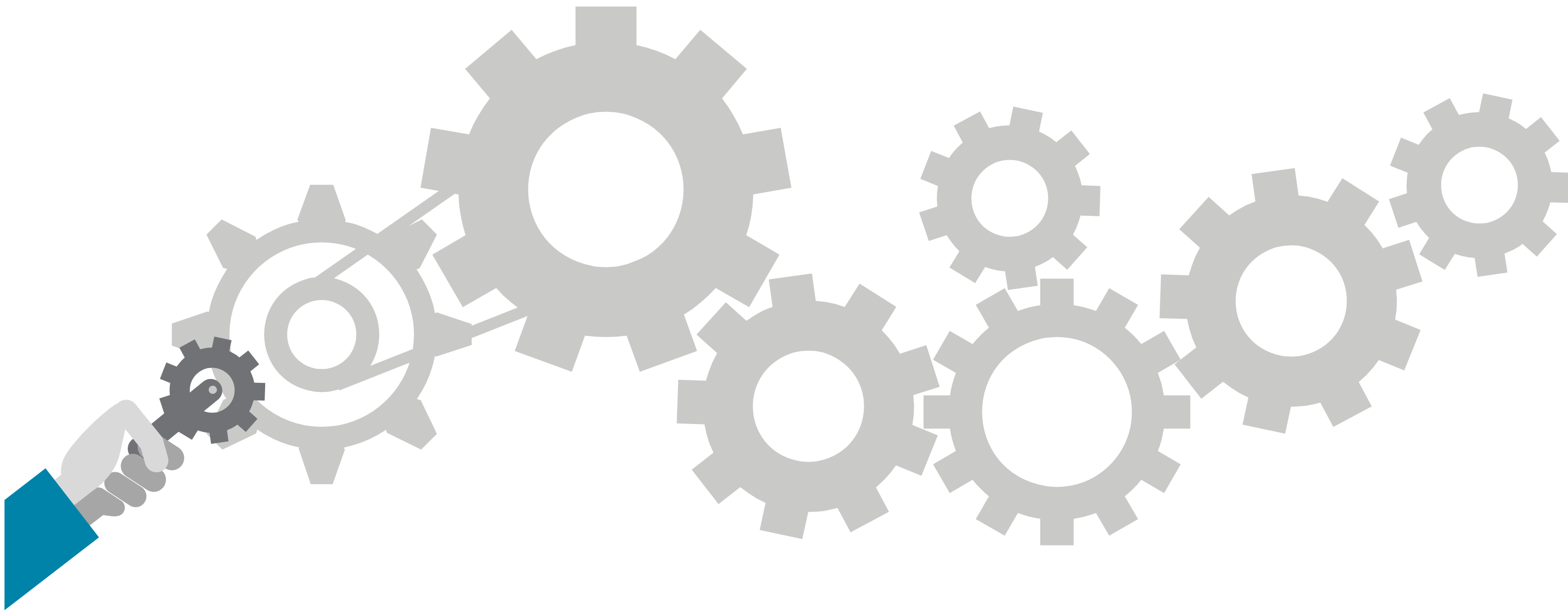
Net discount rate up c0.3%
(30 June 2022)

Assets

Investment return c –4.4%
(to mid November)

We will report the results as at 31 March 2022 but post-valuation factors may be borne in mind when setting employer contributions, given overriding objective of stability of contributions

Southwark-specific practicalities



LB Southwark Group

Admitted Body Pass-Through

Academies and MATs

Ill health strain costs

RI / Climate change strategy

Funding Strategy specifics

Managing a surplus

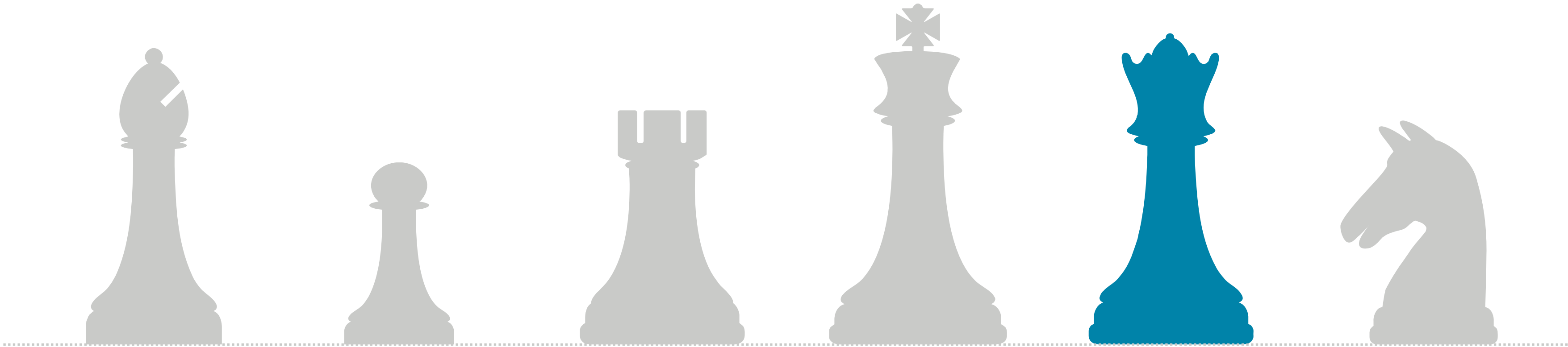
Where an employer is in surplus*, and where an employer's expected exit date is unknown or expected to be later than the date the revised rates and adjustments certificate will come into force following the next valuation, this* ***surplus will only lead to an adjustment*** *in an employer's contributions to the extent that this surplus is in excess of 10% of the value of that employer's liabilities valued relative to the appropriate Funding Target (i.e.* ***to the extent that the employer's funding level is greater than 110%****).*

Grouping and pooling of risks

All employers in the Fund are grouped together in respect of the risks associated with payment of ***lump sum benefits on death in service*** *– in other words, the* ***cost of such benefits is shared across the employers*** *in the Fund….*

Funding Strategy specifics

Grouping and pooling of risks



Multi Academy Trusts:

In some circumstances it may be desirable to group employers within the Fund together for funding purposes (i.e. to calculate employer contribution requirements). Reasons might include ***reduction of volatility of contribution rates for small employers****, facilitating situations where employers have a* ***common source of funding*** *or accommodating* ***employers who wish to share the risks*** *related to their participation in the Fund.*

…The Administering Authority's policy is to ***consider the position carefully*** *at the initial grouping and at each valuation and to notify each employer that is grouped which other employers it is grouped with and details of the grouping method used.* ***If the employer objects to this grouping, it will be set its own contribution rate.***

Draft results for Southwark Council

The initial 2022 valuation results, calculated using the proposed 2022 basis, for Southwark Council as instructed by the Administering Authority are as follows.

Initial 2022 valuation results (83% PoFS / 10% short term inflation / 110% surplus buffer)

Employer Name	Balance Sheet at This Valuation (£M)		Current Contributions 2022/23	Theoretical Contributions 2023/24			Proposed contributions 2023/24		
	Surplus / (Shortfall)	Funding Level	Current Rate	Recovery Period (years)	Primary Contribution Rate	Secondary Contribution % pay	Primary Contribution Rate	Secondary Contribution % pay	Total Contribution % Pay
London Borough of Southwark	157.4	108.4%	21.5%	n/a	20.5%	-	20.5%	1.0%	21.5%

Comments

- Theoretical contribution rates are lower than the current rate for Southwark Council by 1% of pay per annum
- Maintaining the current level of contributions given post valuation economic uncertainty around Cost Management (slide 23) would not be inappropriate, and would be consistent with Scheme Advisory Board expectations regarding limiting reductions to contributions

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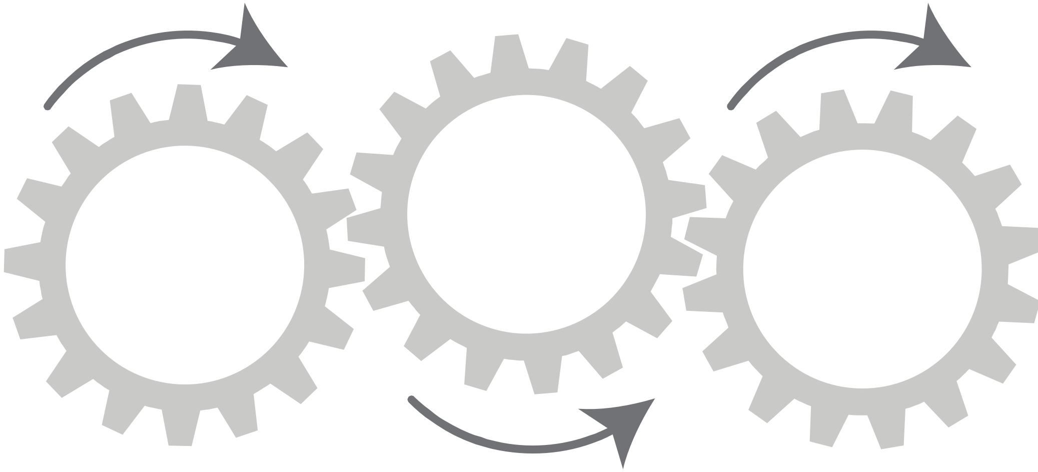
Outlook for employers



Past service position

Funding level has improved for some

Surplus reduced for those paying lower contributions

All employers now are very close to or over 100% funded

Surplus/deficit to be recovered over 20 years

Future service position

Future service (primary) rate has increased

McCloud now all in past service

Strategic Decisions

Reduce risk / increase prudence in discount rate

Short term inflation allowance

Avoid material contribution reductions given post valuation experience and ongoing Cost Management uncertainty

Note

Individual employer rates apply (Multi – Academy Trusts are grouped)

Objective is be to keep contributions stable

Part 4
Summary, next steps and questions

Summary and next steps

Results

Asset returns and deficit contributions have improved the position, offset by changes in financial assumptions increasing the liabilities

Short term inflation allowed for in liabilities

Surplus recovered only where employers over 110% funded

Employer rates

All employer contributions communicated

Finalise rates and outputs

London Borough of Southwark to provide individual employer schedules and agree contributions for all employers

Aon to finalise results for all employers and sign off valuation by 31 March 2023

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