Staffordshire Pension Fund

Pensions Committee
2022 valuation update

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16 December 2022

Pensions Committee valuation timetable

December 2021	February 2022	March 2022
Approve: Actuarial valuation assumptions proposals	Approve: Climate strategy – including Net Zero goals and roadmap	Approve: ALM modelling results – high-level investment strategy and authority contribution rate proposals
June 2022	**September 2022**	**December 2022**
Note: actuarial valuation approach, key themes for 2022/hot topics Approve: investment structure, including implementation plan	Note: whole fund funding level report; Funding Strategy Statement	Approve: changes to employer funding strategies, draft Funding Strategy Statement
March 2023		
Note: final valuation report, final Funding Strategy Statement Approve: Investment Strategy Statement		

2022 valuation timetable

Q4 2021 – Q1 2022
Pre-valuation work:
- Planning
- Data cleansing
- Review of high-level funding & investment strategy
- Review of stabilisation mechanism for precepting employers

Q2 2022
Data cleansed and submitted to actuary
Review of assumptions

Q3 2022
Initial results & discussions with Officers

Q4 2022
Employer results issued to employers
Employer AGM & consultation period
Funding Strategy Statement consultation

Q1 2023
Funding Strategy Statement finalised
Final valuation report signed off by 31 March 2023

1 April 2023
New employer contributions start to be paid

What we will cover today

1. High-level results for employers
2. Funding Strategy Statement (FSS)
3. Cessation approach change
4. Climate change modelling

1. High-level employer results

Reminder: Whole Fund results

- Regulations require the Fund to report a single funding position
- 2019 valuation used a discount rate which had a 70% likelihood.
- Higher prudence level agreed at 2022 by Committee. The discount rate of 4.4% pa has a 72% likelihood at 2022.

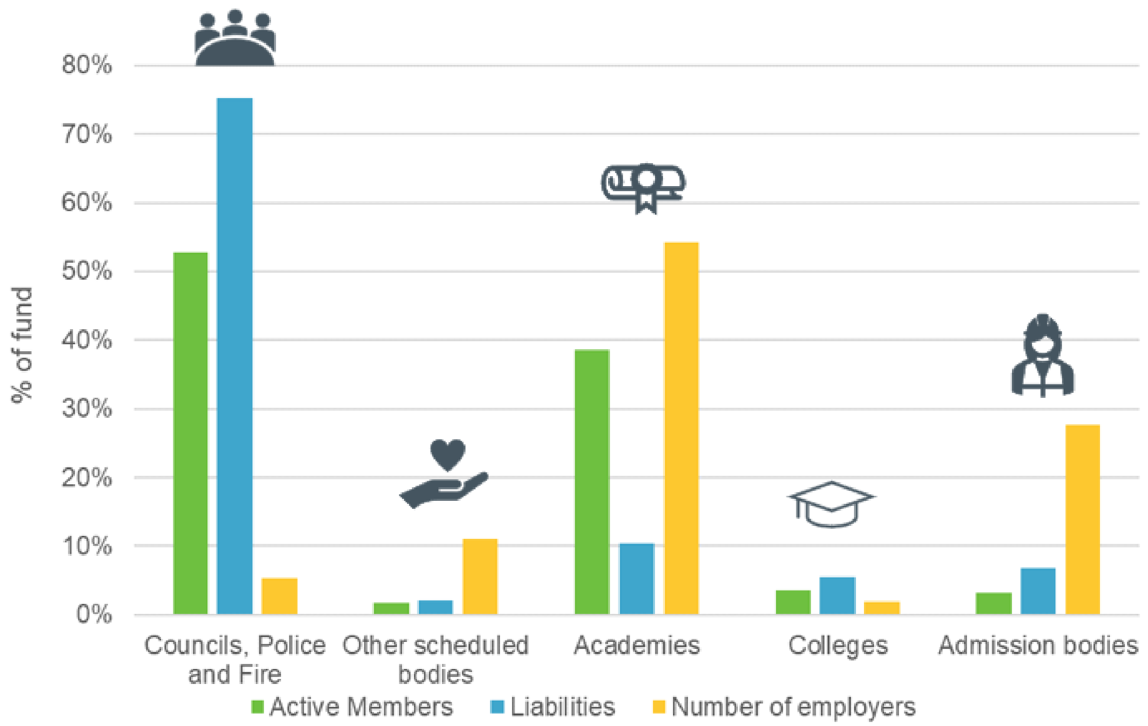
Valuation Date	31 March 2022	31 March 2019
Past Service Liabilities	**(£m)**	**(£m)**
Employees	1,764	1,666
Deferred Pensioners	1,282	1,180
Pensioners	2,651	2,359
Total Liabilities	**5,696**	**5,204**
Assets	**6,833**	**5,131**
Surplus/(Deficit)	**1,137**	**(73)**
Funding Level	**120%**	**99%**

Numbers may not add up due to rounding

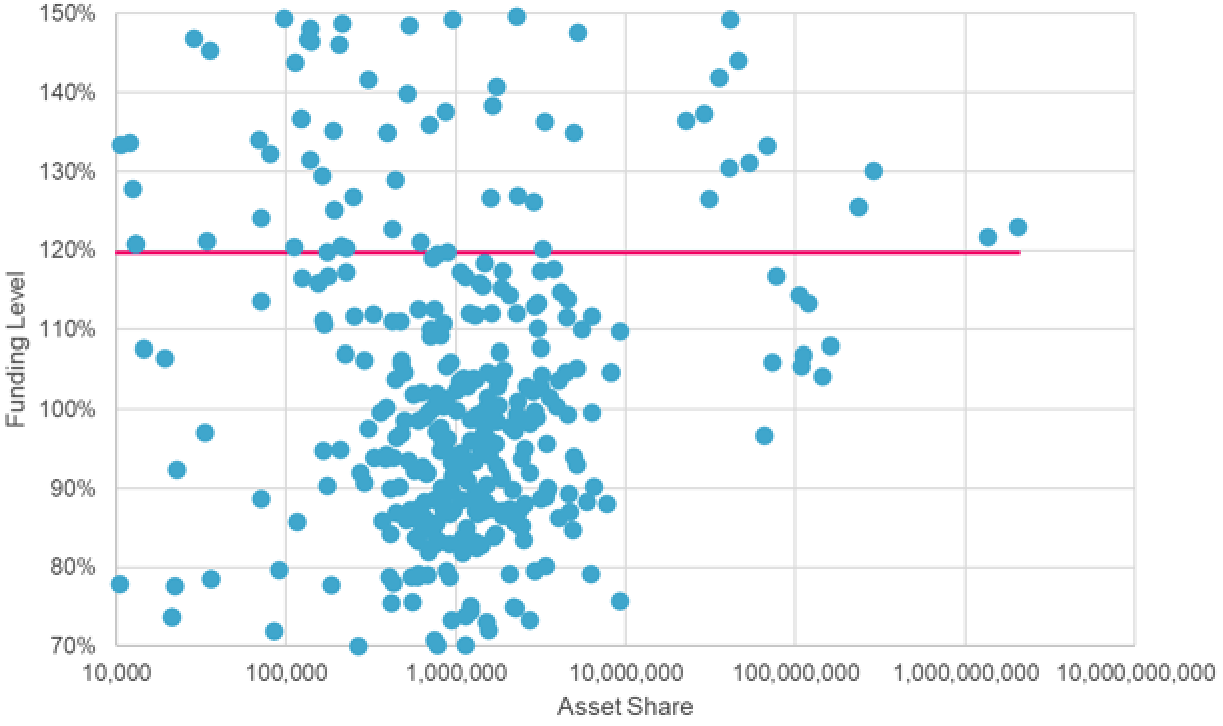
Whole Fund is the sum of all the individual employers' positions

Employer-level results

Fund employers by type



Employer funding level vs asset share



Ensure funding plan is appropriate for each employer

Factors causing diversity in results

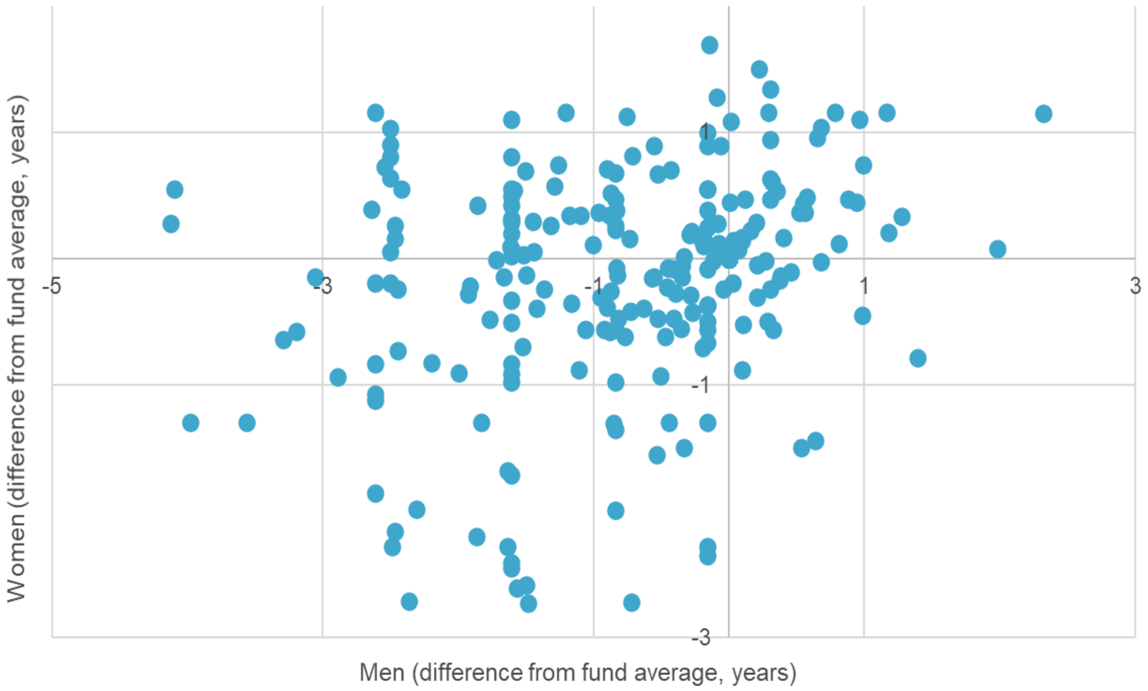
Funding profile
Balance between past and future service matters at 2022

Membership experience
Events such as ill-health retirements, salary increases will affect your funding position

Membership profile
Differences such as age and gender will affect the contribution rate

Contributions being paid
Higher contributions will result in a larger funding level improvement

Difference in average life expectancy (from fund average) for each employer



No two employers are the same

Focus on different employer groups (1)

Councils
Police
Fire

- Large precepting bodies, long time horizon, majority of Fund
- Paying stabilised contributions (current average c.34.0% of pay)
- Generally freezing rates (as % of pay) with some increases

Town & Parish Councils

- Pooled together for contribution-setting purposes
- Paying stabilised contributions (currently 25.6% of pay)
- Rate will drop by 3% in stabilised 1% of pay reductions each year

Colleges & Uni.

- Typically strong funding position
- Fund has considered risk / covenant issues
- Rate will move by maximum of 1% of pay each year (av. 25.7% of pay)

Different circumstances reflected in different funding strategies

Focus on different employer groups (2)

Academies

- Increasing diversity in this large group of employers
- Rates reducing by 1% of pay p.a. for most. Option to opt out of stabilisation and see a bigger decrease at this valuation (av. 24.2% of pay)

Housing Assoc'ns

- May or may not be heading to cessation
- May provide some degree of added explicit security to the Fund
- Contributions reflect the above, as well as own funding position

Contractors

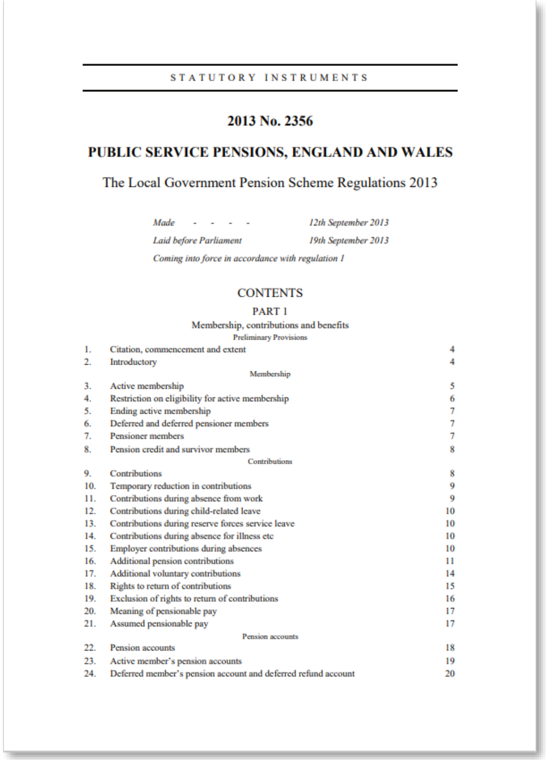
- Typically short time horizon with large current surplus
- Contribution reductions likely to apply (possibly £nil rate resulting)
- If "pass-through" then no change in contribution rate

Different circumstances reflected in different funding strategies

2. Funding Strategy Statement (FSS)

Requirements for the FSS

- Regulation 58 of LGPS Regulations 2013. Funds must:
  - prepare and publish a FSS
  - consult with ‘appropriate persons’
  - review and revise as appropriate
  - have regard to the Statement of Investment Principles
- CIPFA guidance
  - Sets out what should be included in the FSS
  - Must be followed as it is statutory



STATUTORY INSTRUMENTS

2013 No. 2356

PUBLIC SERVICE PENSIONS, ENGLAND AND WALES

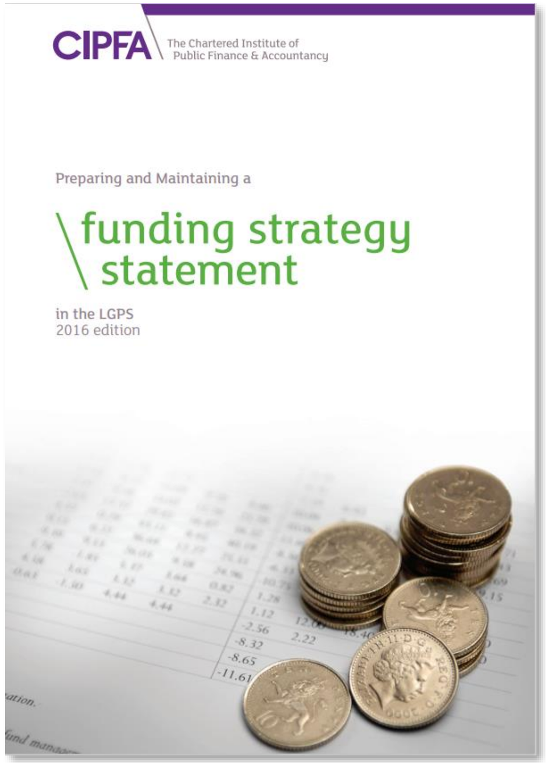
The Local Government Pension Scheme Regulations 2013

Made - - - - 12th September 2013
Laid before Parliament 19th September 2013
Coming into force in accordance with regulation 1

CONTENTS

PART 1

Membership, contributions and benefits



SPF complies with these requirements

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Key FSS updates since last time

1. Structural changes so more user friendly and practical
   - Streamlined core FSS document (around 20,000 fewer words!)
2. Time horizon for academies increased to 20 years
3. Low risk exit basis updated to a risk-based corridor approach
4. Approach to climate risk documented

Structural changes

Core document

- Maps an employer's journey through the Fund
- Provides key information for employers and advisors
- Signposts relevant policies
- Reviewed by external copywriter
- Compliant with CIPFA guidance

Appendices

- Key information about the Fund
- Regulatory Framework
- Roles & responsibilities of key parties
- Risks & controls
- Actuarial assumptions
- Satellite policies

Core document covers general queries, satellite policies manage specific areas (eg exit credits)

Specific funding strategy updates

Employer type	Typical long-term objective	Typical priority at the valuation
Councils	Remain in the Fund	Stable contributions
Academies	Remain in the Fund	Stable contributions
University/Colleges*	Remain in the Fund	Strong balance sheet in accounts, affordable exit payment?
Town and Parish Councils	Remain in the Fund	Stable contributions
Charities	Exit the fund	Protect funding position, affordable exit payment
Contractors	Exit the fund	Protect funding position, fixed rates?

** The DfE recently announced that colleges, and their subsidiaries, have been reclassified into the 'central government sector'. The provision of a formal pension funding guarantee from the government is currently under discussion.*

Align academies with funding strategy of councils by extending time horizon to 20 years

3. Cessation approach change

Cessation valuations for employers with no guarantor

Approach to assessing the final funding position of an exiting employer

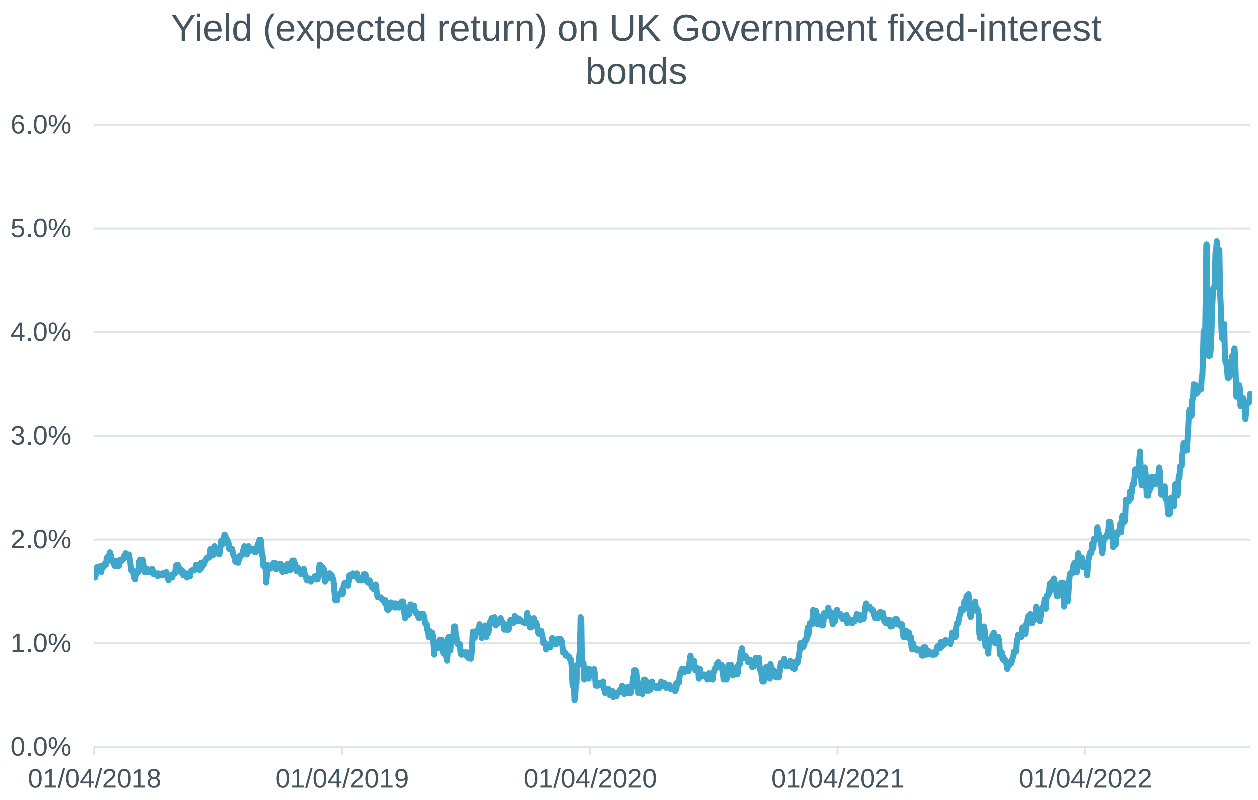
Objective is to hold enough assets to pay all the exiting employer's members benefits

The Fund has a duty to protect the interests of all other employers

Actuary allows for this added protection by assessing liabilities using a more prudent investment return assumption

Low-risk exit basis – current approach

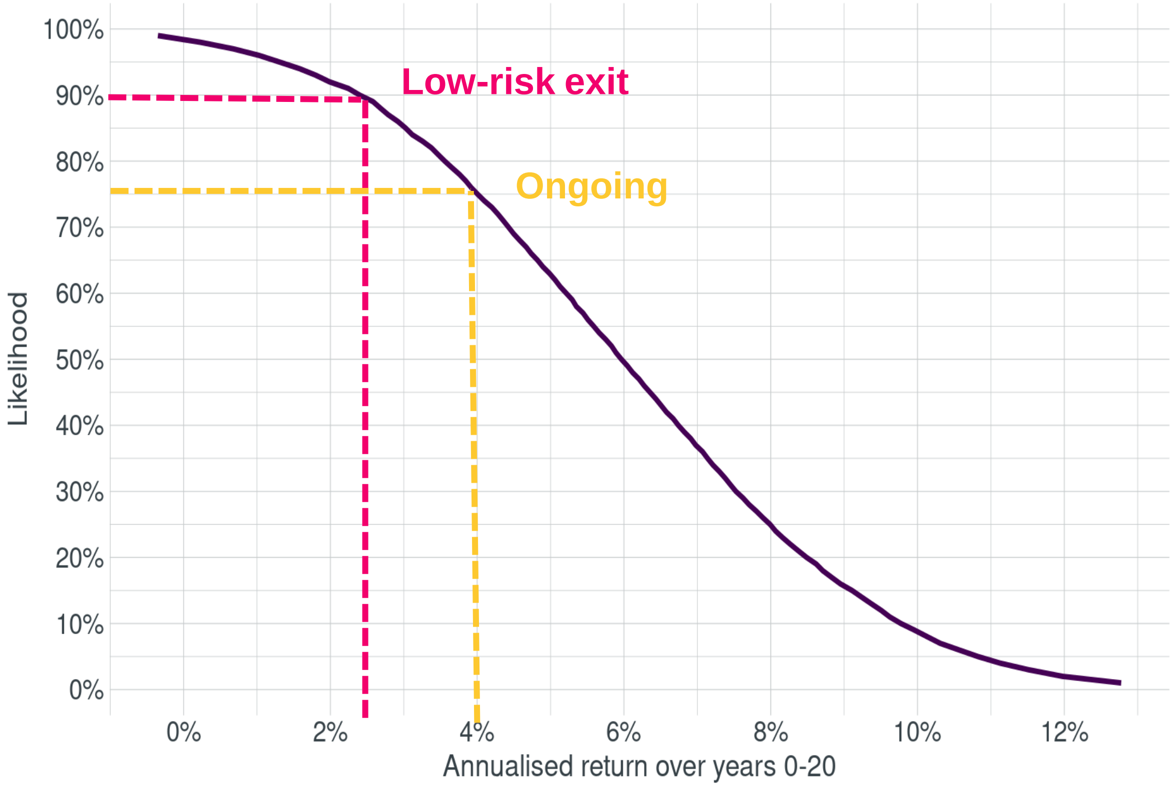
- Future investment return assumption based on yield of UK fixed-interest gilts at exit date
- No allowance for outperformance from other assets – this is how we get our prudence (in theory, this is analogous to a risk-free return rate)
- Easy to understand and recreate
- BUT…doesn't actually reflect what the Fund does with assets post-cessation
- Aiming for a single point, which has inherently more volatility



Is there a better approach to carrying out cessation valuations

Low-risk exit basis – alternative approach

- Risk-based approach to align with ongoing funding basis
- Based on future expected return from investment strategy
- Higher likelihood of success to reflect need to be more certain about having sufficient monies to pay benefits
- Reflects what actually happens with assets post-cessation and can clearly state prudence levels
- Leads to more stable cessation valuations
- Need to decide what level of likelihood to adopt

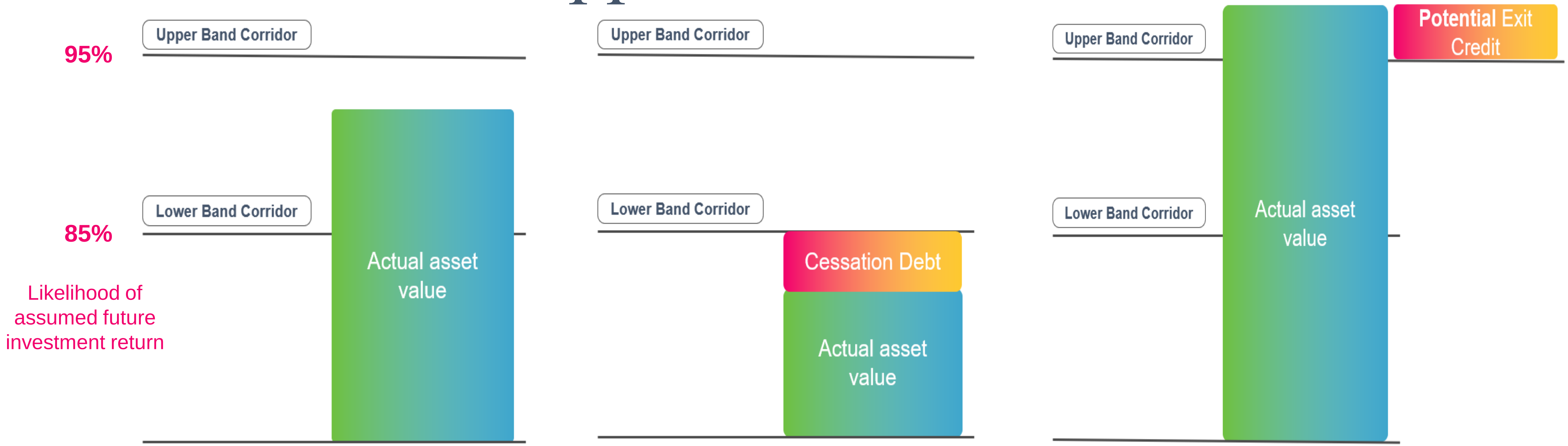


Move to risk-based approach to align with wider funding strategy

Selecting a likelihood

- Analysis of current (gilts-based) approach shows gilt yield equivalent to around 85-90% likelihood under risk based approach
- This feels a reasonable level of prudence (remembering that 100% is not achievable!).
- But still potential for volatility and cliff edge between deficit and surplus
- Potential to enhance the risk-based approach to further improve approach – a corridor approach
  - Benefits to employers: further reduces volatility in their exit valuation
  - Benefit to fund: better manages exit credits

Enhance new approach with a corridor



- 85% likelihood: appropriate balance between employer affordability and prudence for the fund
- 95% likelihood: higher level of prudence for paying out exit credits

Reflects the uncertainty and volatility with funding LGPS pensions, and only pays exit credits when very well funded

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4. Climate change modelling

Exploring the impact of climate change risk

- Climate change is too uncertain to “build in” to our model directly like we do with, for example, inflation risk
- Instead we see how the results change if we stress the model in three different scenarios
  - Given it is a stress test, all three scenarios are “bad”
  - Consider all three scenarios to understand the strategy’s resilience
- Purpose is to test resilience, not re-run all the previous analysis

Climate scenarios give us extra information to help make our decision, they don’t replace existing modelling results

The scenarios

Green Revolution

- Concerted policy action starting now e.g. carbon pricing, green subsidies
- Public and private spending on “green solutions”
- Improved disclosures encourage market prices to shift quickly
- Transition risks in the short term, but less physical risk in the long term
- High expectation of achieving <2°C

Delayed Transition

- No significant action in the short-term, meaning response must be stronger when it does happen
- Shorter and sharper period of transition
- Greater (but delayed) transition risks but similar physical risks in the long-term
- High expectation of achieving <2°C

Head in the Sand

- No or little policy action for many years
- Growing fears over ultimate consequences leads to market uncertainty and price adjustments
- Ineffective and piecemeal action increases uncertainty
- Transition risks exceeded by physical risks
- Low/no expectation of achieving <2°C

Timing of disruption **Immediate** → **10+ years**

Intensity of disruption **High** → **Very high**

All three scenarios are ‘difficult’ so we are testing the base

Further detail on the scenarios

Our scenarios assume that

- There will be a period of disruption linked either to the response to climate risk (transition risks) or the effects of it (physical risks)
- This disruption will lead to high volatility in financial markets
- The later the period of disruption, the more pronounced it will be

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

Level of disruption 'tilts' the modelled results towards simulation with higher volatility in time periods

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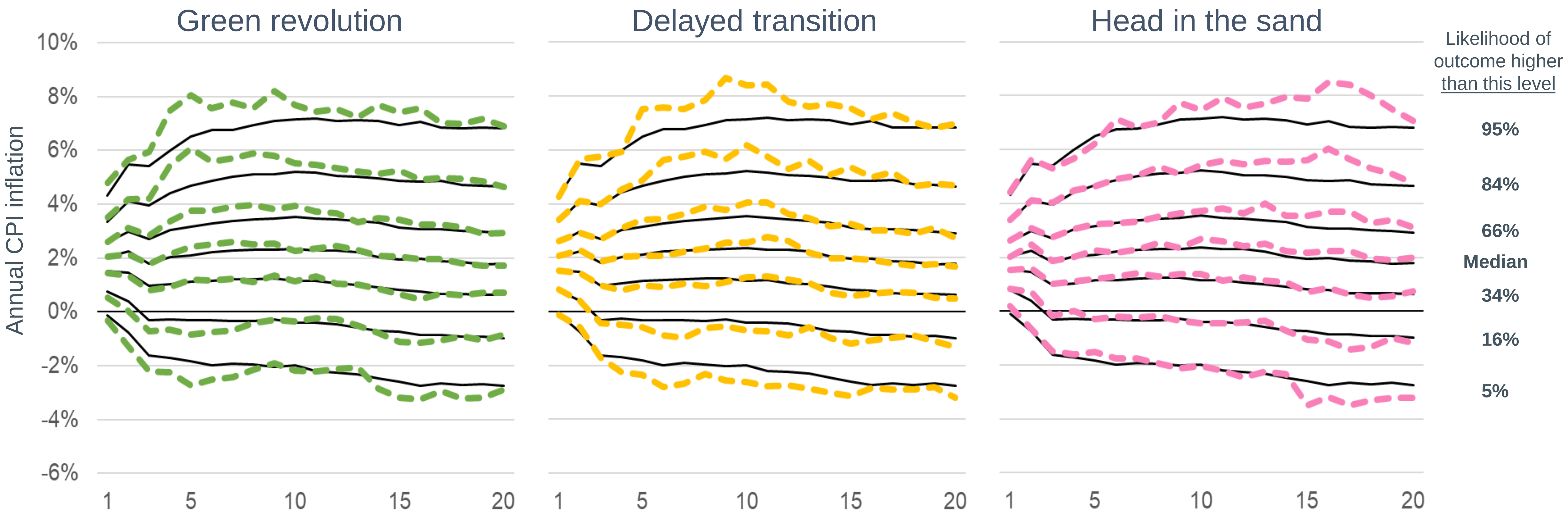
Volatility criteria: Moderate = 60th percentile, High = 75th percentile, Very high = 85th percentile

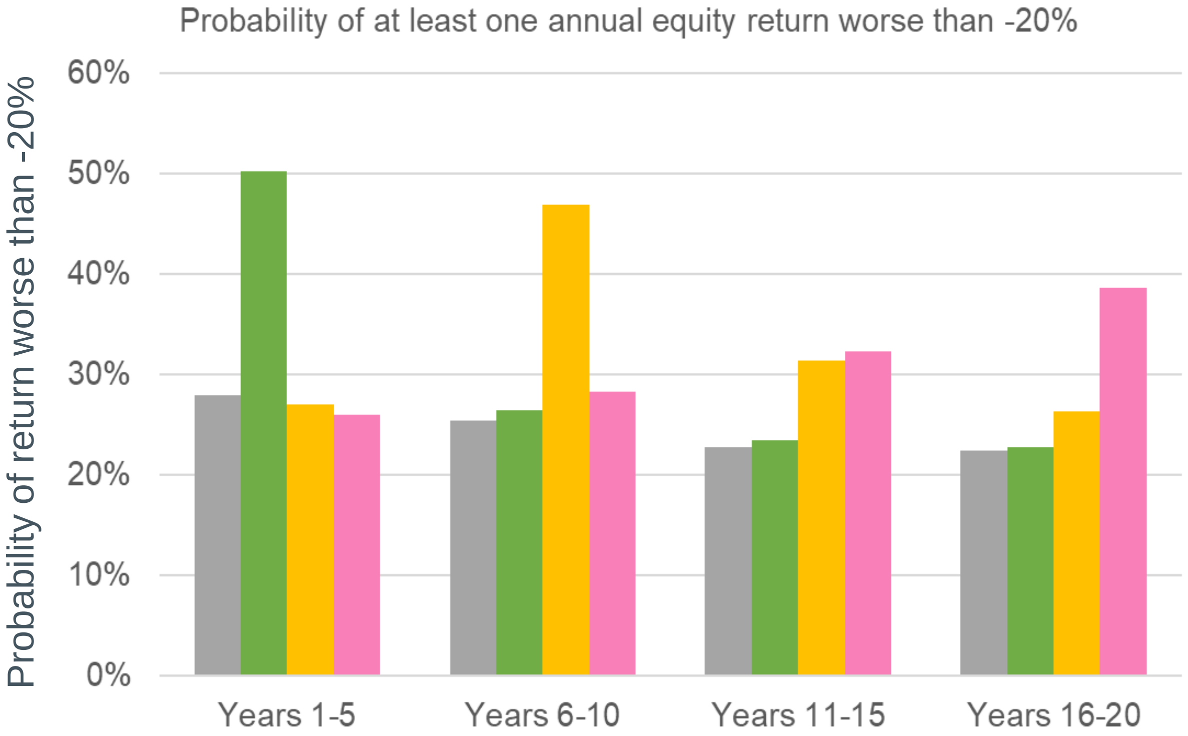
Example of scenario impact (CPI inflation)

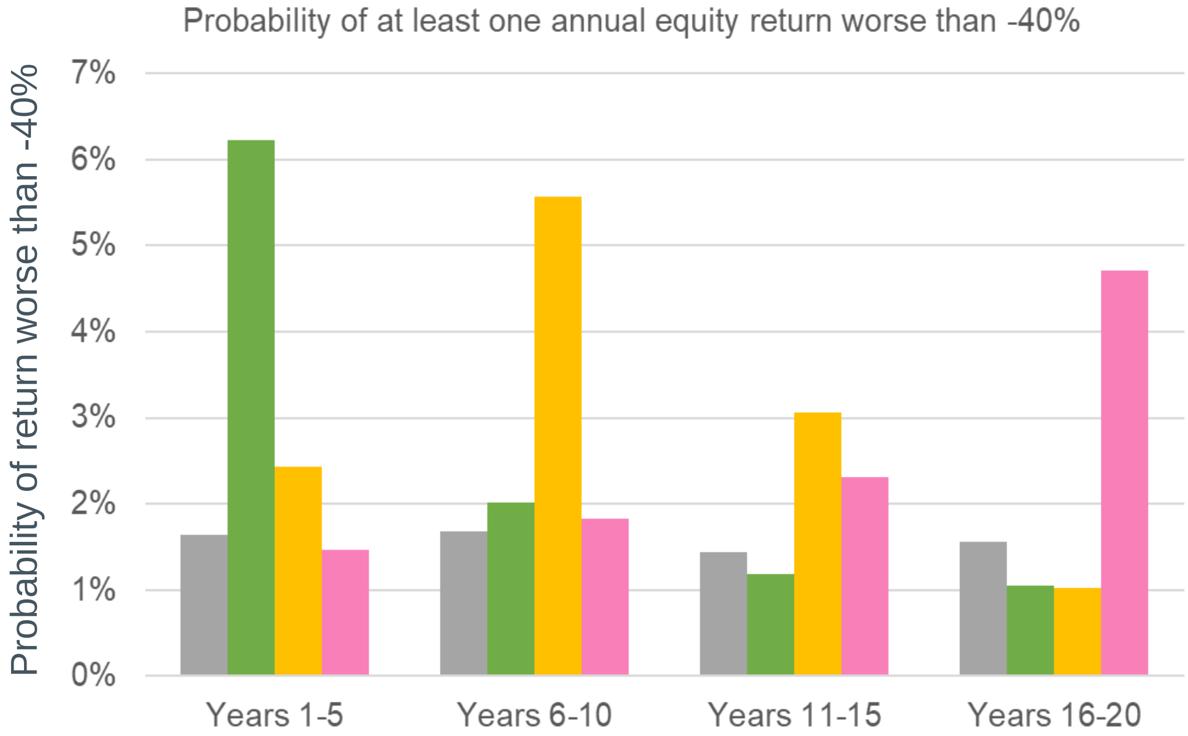


Solid black lines are the unweighted base case

Distribution of key variables widened at different periods

What extra volatility actually means



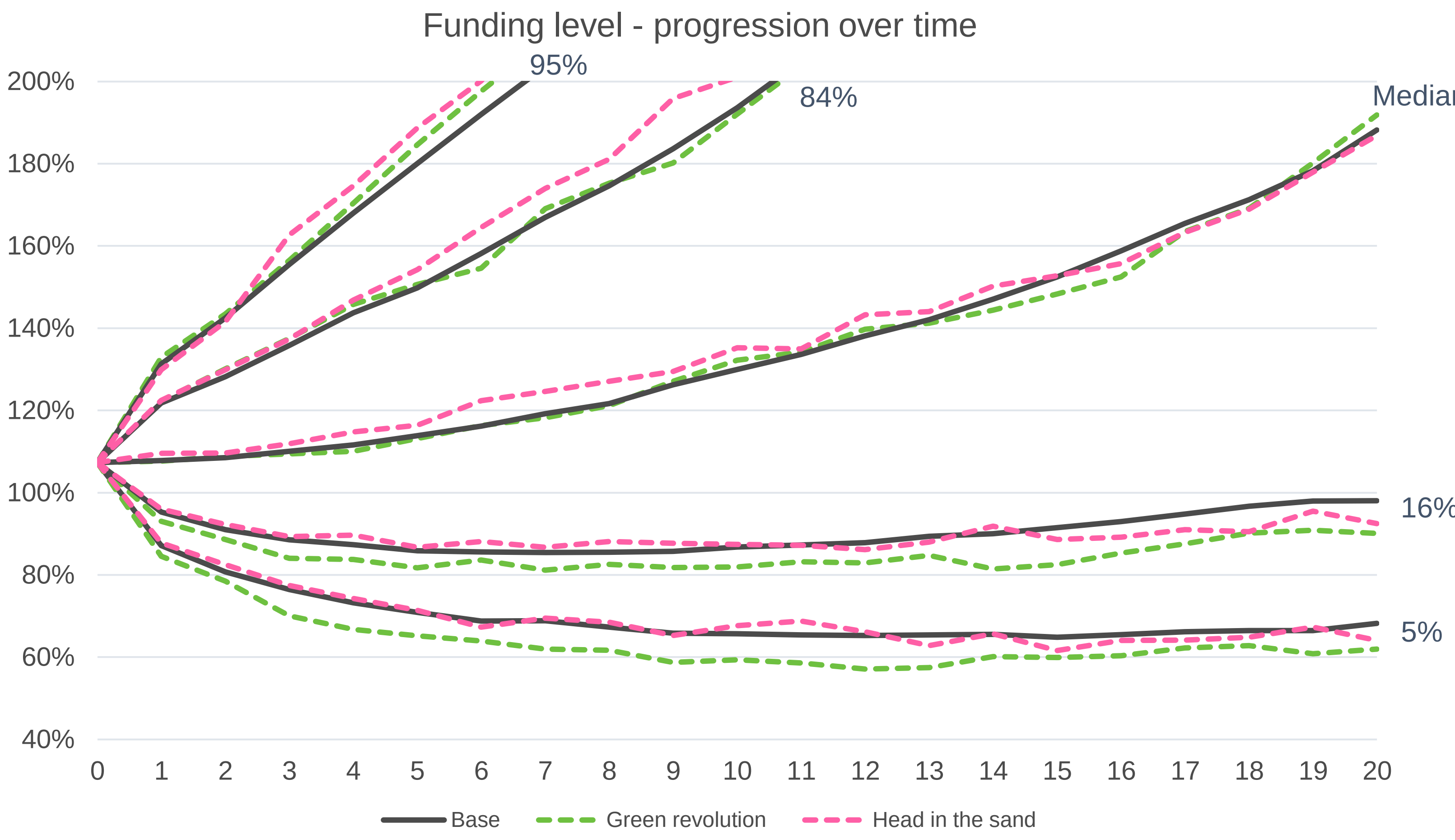


Bars from left to right: Base case (grey), Green revolution, Delayed transition, Head in the sand

Increased volatility gives a much higher chance of significant equity shocks

Results: impact on future funding outcomes

- No significant alteration to the funnel of future funding outcomes under climate change scenarios
- Funnel is slightly wider under climate change scenarios due to increased (upside and downside) volatility
- Downside risk under Green Revolution slightly higher (due to timing of impact), but not a material difference



Results for SCC based on 'Proposed' investment strategy and '+1.0% p.a. increases followed by +/-1.0%' contribution strategy. Absolute starting point of funding level should be ignored, focus of this analysis is on relative differences

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Results: summary risk metrics

- Lower likelihood of success under all three scenarios as expected given this is a stress-test. However, the reduction (from Base) is not material.
- Downside risk is increased under 'Green revolution' scenario. This will be due to compounding effect on the early period of volatility in the scenario.
- No material difference in results (bearing in mind nature of stress testing) to suggest the current funding and investment strategies are not unduly exposed to climate change risk.
- However, Fund should be aware of the sensitivity of its strategy to potential climate change risk and monitor as part of its risk management framework.

Results for SCC based on 'Proposed' investment strategy and '+1.0% p.a. increases followed by +/-1.0%' contribution strategy

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Summary

1. Employer results are generally positive
2. Updated FSS currently out for consultation with employers
3. Enhancement to cessation approach to benefit employers and the SPF
4. Funding strategy resilient to climate change risk and can be evidenced to stakeholders

Pensions Committee agenda

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Thank you