London Borough of Camden Pension Fund - Fund Maturity

This paper is set out in the following sections:

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1 Background

This paper is addressed to the London Borough of Camden in its capacity as Administering Authority (in effect the trustee) to the London Borough of Camden Pension Fund ("the Fund"). The Fund is part of the Local Government Pension Scheme ("LGPS"), and its assets are held separately from the Council.

The Fund has obligations under LGPS Regulations to pay benefits to members as and when they retire, and to their dependants as and when members die, details being defined in those Regulations.

The Fund holds assets to pay those benefits, although the benefits are not affected by market movements. The assets are derived from contributions paid in by the employers (mainly the Council) and members (set by Regulations), plus investment returns achieved. In any one year, the amount of contributions received into the Fund may be more or less than the amount of benefits payable out: where they are more, the Fund is said to be "cashflow positive", otherwise it is "cashflow negative".

Whether the Fund is cashflow positive or negative is important because, in the latter case, it will need to divert investment income or (in more negative cases) disinvest assets to ensure it has sufficient cashflow to pay members' benefits.

The Administering Authority has asked us to analyse the projected position for the next 20 years, to help identify if investment action is required sooner or later on this point.

2 Recap of previous modelling results

The previous Fund Maturity report produced in November 2016 investigated when the Fund may become cashflow negative using the 31 March 2016 formal valuation membership data. The results of this analysis can be seen in the table below (which was “Table 2” in the November 2016 report).

Chart 1

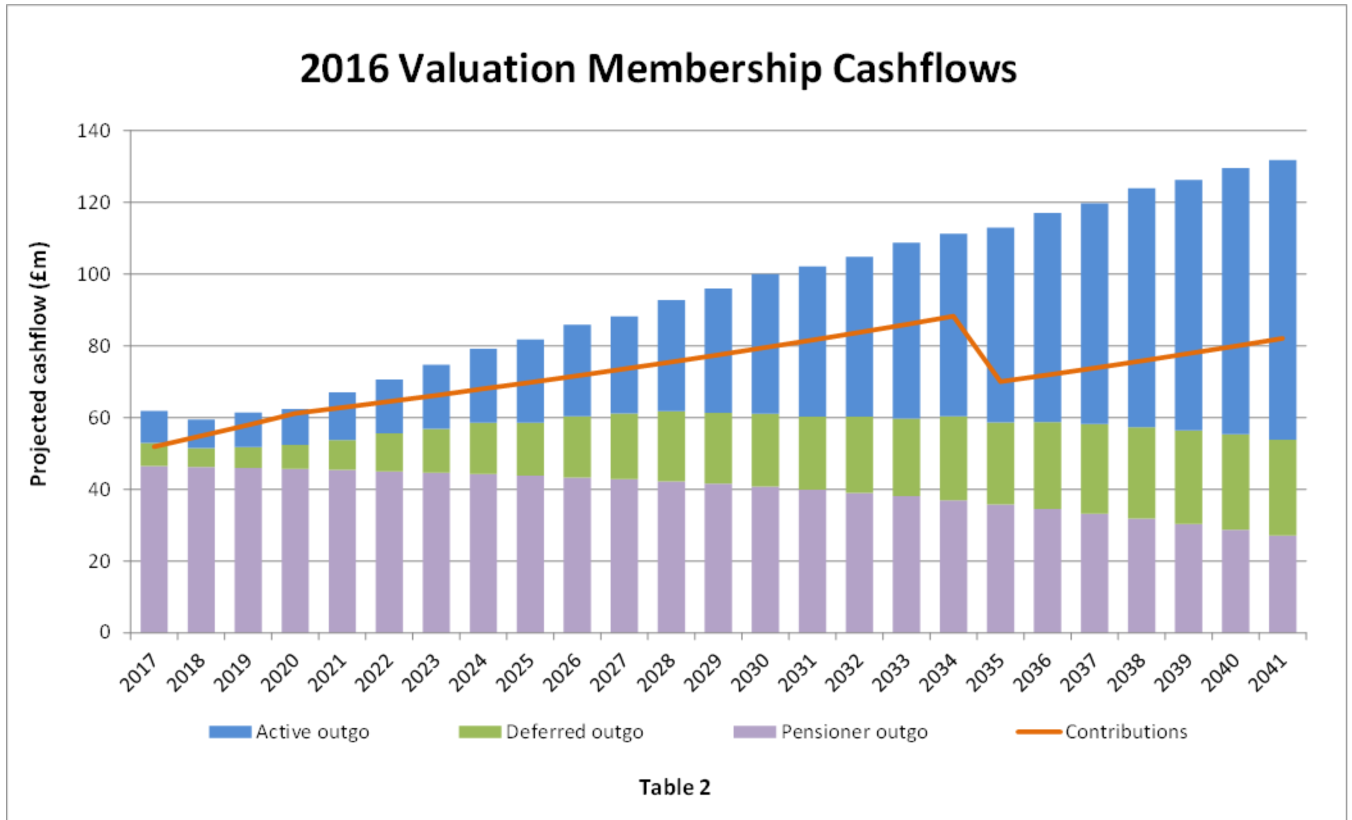


Table 2

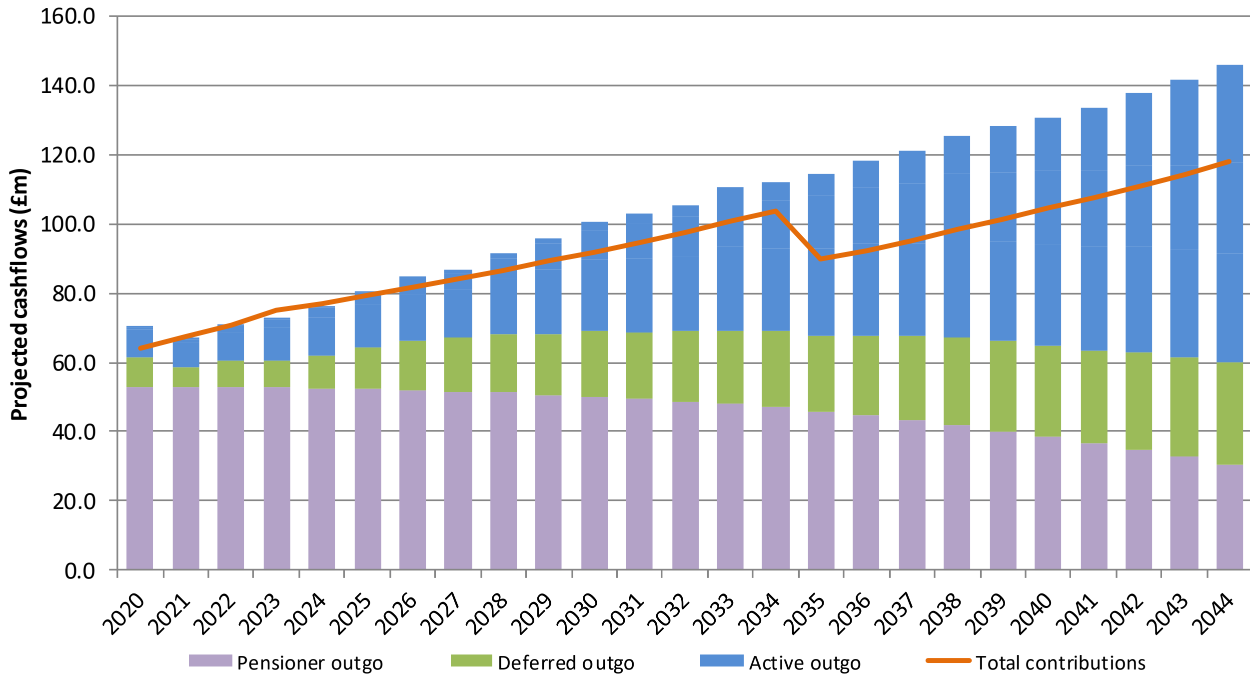
The 2016 cashflow projections showed that the Fund was expected to be slightly cashflow negative until around 2021, when the gap between contributions and benefit outgo was projected to increase considerably. The net cashflow positions in the years prior to 2020 ranged from -£1m to -£5m (ignoring the first year impact - the cashflows for the first year showed a bigger gap as we assumed that all non-retired members over pension age at the valuation date would retire immediately). In the years where the net cashflow is negative the Fund may need to use investment income to pay some of the benefit outgo.

For full details and analysis on this modelling please see the report “London Borough of Camden Pension Fund – Fund Maturity” dated November 2016.

3 Updated modelling projections

The Administering Authority has asked to update these projections using the 31 March 2019 formal valuation membership data. The results of this analysis can be seen in the table below. Using this updated membership data allows us to see how the cashflow projections have changed.

Chart 2



(NB The cashflow for the first year is more cashflow negative than normal as we assume that all non-retired members over pension age at the valuation date will retire immediately).

The updated cashflow projections show that the Fund is expected to be broadly cashflow neutral until around 2025, when the gap between contributions and benefit outgo is projected to gradually increase. The net cashflow positions in the years prior to 2025 range from -£1m to +£2m (ignoring the first year impact noted above). In the years where the net cashflow is negative the Fund may need to use investment income to pay some of the benefit outgo. See over for an analysis of projected net cash outflows each year.

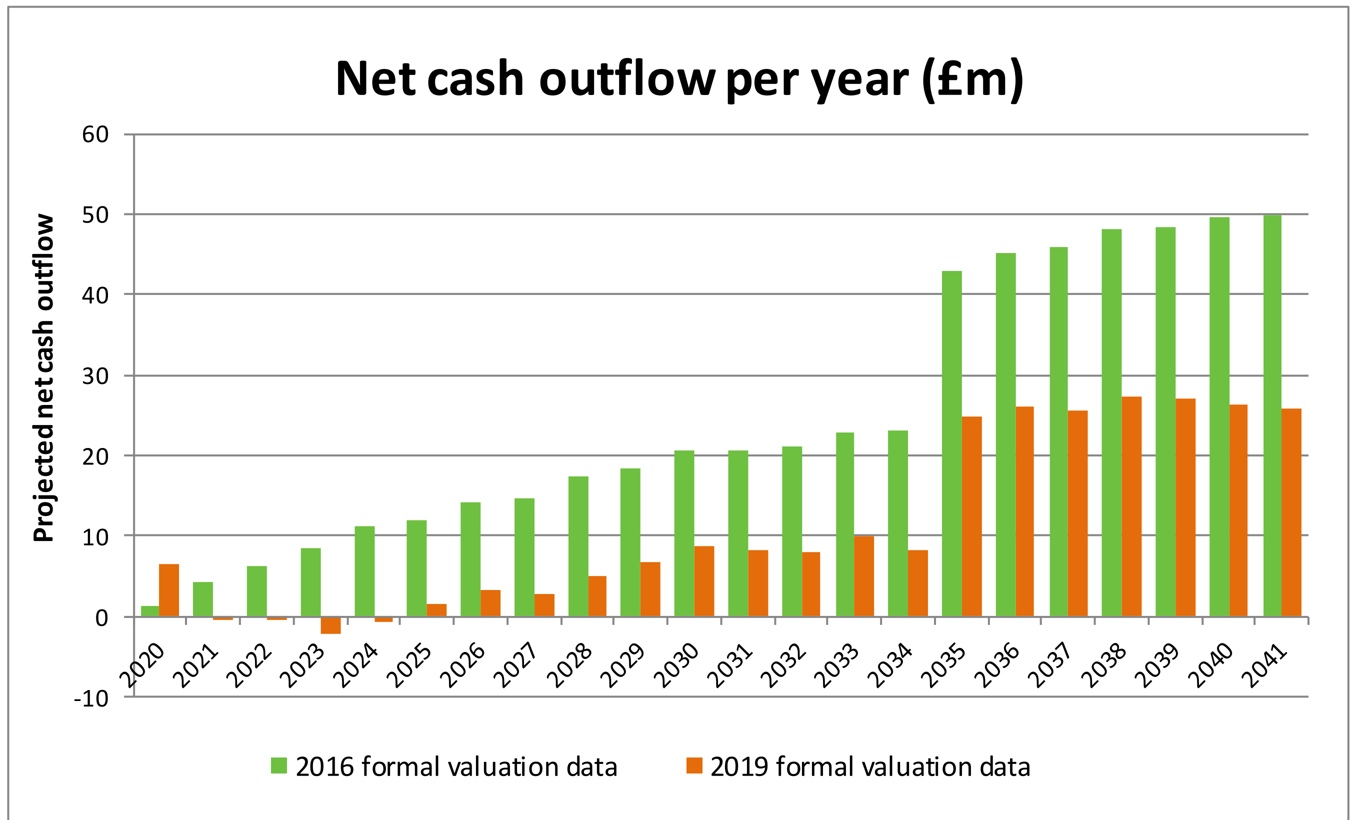
Please note, in a similar manner to previous Fund maturity reports, I have assumed the Secondary contributions (monetary amounts broadly relating to deficit repair contributions) will cease from the end of 2034. This is why there is a distinct drop in contributions in 2035. Full details of how the contribution inflows were estimated can be found in the “data summary and methodology” section below.

During the modelling period we would expect natural membership reductions through withdrawals and retirals. To keep the membership stable we have assumed new entrants would join the Fund and replace the departing members. In modelling cash flows for new entrants we define a replacement ratio as being the proportion of pensionable salary joining each year to the salary leaving each year. We have assumed a 100% replacement ratio over the next 25 years.

Comparison between 2019 and 2016 modelling projections

We can compare these 2019 results (in this section above) with the previous 2016 cashflow projections (in section 2), in particular comparing the net outflow position (i.e. a higher figure is a greater negative for the Fund, with more money being paid out in benefits than being received via contributions). These compared figures are shown in the table below.

Chart 3



There are a number of differences between the two sets of outflows:

1. The 2019 valuation projection figures (in orange) show a less negative position when compared to the 2016 projections (in green). This reflects a greater than expected increase in salary roll than had been anticipated in 2016 along with the expected rise in the contribution rate from 2020;
2. The higher contribution income gives a less negative position when compared to the 2016 projections (and even a positive position in a few years), c.£5-12 million difference per year up until 2034;
3. The difference from 2035 onwards, using either 2016 or 2019 data, noticeably grows because we assume that deficit repair contributions would cease after 2034, leaving only contributions being paid for future service.

4. Conclusions and next steps

The conclusions that can be drawn from these latest cashflow modelling projections are:

- The Fund is expected to be broadly cashflow neutral in the short term and less cashflow negative (ignoring investment income) than when this analysis was carried out at 2016 as a result of the higher salary roll and higher contributions anticipated from 2020;
- The cashflow position will turn negative around 2025, will gradually increase in cashflow negativity until 2034 to around £10m per year, when it will quickly increase to something like £25m per year.
- The cashflow position has changed since the projections performed in the November 2016 report. This is most likely due to the changed membership profile, where significant increases in the payroll of active members and increases in anticipated contributions has delayed the onset of cashflow negativity. Nevertheless, the Fund is expected to gradually move towards a cashflow negative position with that becoming more extreme from 2034 onwards.

The next steps are for the Fund to consider:

(a) Whether further analysis is appropriate (the analysis in this paper is on a single set of assumptions; cashflow negativity may arise sooner or later than indicated, depending in particular on the numbers and profile of Fund members leaving and joining). Possible further analysis could include;

  1 the effect of different inflation rates on the contributions and benefit outgo;

  2 the effect of members living longer than expected; and

  3 allowing for known active membership changes (for example redundancy exercises), particularly at the Council.

(b) What the implications of Fund maturity will be on the investment strategy, with special consideration to:

  1 Is investment income into the Fund large enough and sufficiently stable to cover any year's cash outflow?

  2 Do investment mandates need to be altered to allow investment income to be paid to the Fund rather than reinvested?

  3 Is the current and planned future investment strategy appropriate for the maturity profile of the Fund?

(c) How the Fund will monitor the situation in the future.

5 Data summary and methodology

2019 valuation membership details for Fund (Table 1)

Summary of 2019 formal valuation membership	Number	Average Age	Actual Pay / (£000)	Average Pay (£)
Actives	5,412	53.3	164,844	30,459
Deferred Pensioners	9,393	52.7	24,911	2,652
Pensioners	7,216	68.2	52,924	7,334

Total membership = 22,021

* Average age is liability weighted

2016 valuation membership details for Fund (Table 2)

Summary of 2016 formal valuation membership	Number	Average Age	Actual Pay / (£000)	Average Pay (£)
Actives	5,101	52.2	149,636	29,335
Deferred Pensioners	8,493	51.7	22,621	2,663
Pensioners	6,665	67.3	46,007	6,903

Total membership = 20,259

* Average age is liability weighted

Benefit outgo

The membership data used for our projections is from the provisional results of the 2019 valuation of the Fund. Therefore, any changes in the membership profile, (e.g. leavers and retirements), or data, (e.g. salaries), since 31 March 2019 have not been taken into account.

The annual cash flows are shown for each year following 31 March 2019, i.e. Fund years (so the year 1 cash flows are payable during the period 1 April 2019 to 31 March 2020). The cash flows are assumed to be paid midway through their respective period.

We have shown cash flows separately for active members (current employees), deferred pensioners (former employees who have not yet retired) and pensioners (currently receiving a pension from the Fund) at the valuation date.

Cash flows for new entrants into the Fund have been estimated assuming all leavers and retirements are replaced by new employees (across a spread of ages, 37 on average), i.e. there is no assumed increase or reduction in the active membership of the Fund in future years.

Contribution income

We have included estimates of contribution income based on the 2019 formal actuarial valuation:

- payment in all years, by employers, of Primary rate (i.e. the cost of active members continuing to build up new pension each year) estimated as 28.3% of pensionable payroll in each year;
- plus payment until 2034 (the Council's deficit recovery time horizon) of Secondary Contributions of an additional 3.7% of pensionable payroll;
- plus employee contributions in all years at an average rate of 7.0% of pensionable payroll;
- less administrative expenses, 0.6% of pensionable payroll.

Investment income

We have not included investment income in our calculation of net cashflows.

Assumptions

The financial and demographic assumptions used to project the benefit outgo from the Fund are those underlying the draft results of the 2019 actuarial valuation (details shown in preliminary results report, to be confirmed in the full formal report due by 31 March 2020). Contribution income figures have also been produced on that single set of assumptions (in particular the assumed payroll growth).

6 Reliances, limitations & professional notes

These figures have been produced for illustration purposes only at this stage.

The cash flow projections are based on a single set of deterministic assumptions, which are highly unlikely to be borne out exactly in practice. The extent of the deviations from the assumptions underpinning the cash flow projections depends on uncertain economic events as well as other factors that are not known in advance such as members' decisions, variations in mortality rates, retirement rates and withdrawal rates, fluctuations and rates of salary increase, changes in the regulatory environment and possible changes in retirement benefits. These other uncertainties are often not related to any particular investment and economic eventualities.

Two of the important uncertainties are the rate of pension increases, the vast majority of which increase at the annual increase in consumer prices inflation, and the extent of any commutation of pension benefits into lump sums at retirement. The cash flows provided assume that retiring members will opt to take 50% of the maximum permissible amount of tax-free cash (equivalent to 75% in the new post-April 2008 and 2014 schemes).

In summary, it should be noted that there is significant uncertainty in the cash flows, which are largely unrelated to investment conditions. However we are comfortable that these are suitable for long term planning purposes, and would recommend this position is updated at each formal valuation.

This paper is being made available publicly as part of the Fund's Pension Committee meeting pack for 28 November 2019.

This paper is not formally addressed to, or intended to be taken as advice by, any other party such as Fund employers, members of the Fund, or Council tax-payers. The purpose of this paper is to identify to the Fund when and by how much it is expected to become "cashflow negative" in future years. Hymans Robertson does not accept responsibility for, nor can be held liable for, this paper being used by any other party than the Administering Authority or for any other purpose.

The following Technical Actuarial Standards (produced by the Financial Reporting Council) are applicable in relation to this report:

- TAS 100 – Principles for Technical Actuarial Work;
- TAS 300 – Pensions.

This report complies proportionately with each of the above Standards where material.

Barry Dodds FFA
25 October 2019
For and on behalf of Hymans Robertson LLP