

London Borough of Tower Hamlets Pension Fund

Pensions Committee/Board Actuarial training
September 2024

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Actuarial valuation basics

How the Fund works



Collect money
(contributions)



Invest money
(its assets)



Pay money out
(benefits)

Overriding goal of the valuation is to make sure there is enough money to pay the benefits

How do we get the sides to balance?



Employer contributions are the main tool we can control to meet the balance of cost

Why else we do a valuation?



Calculate employer contribution rates



Compliance with legislation



Analyse actual experience vs assumptions



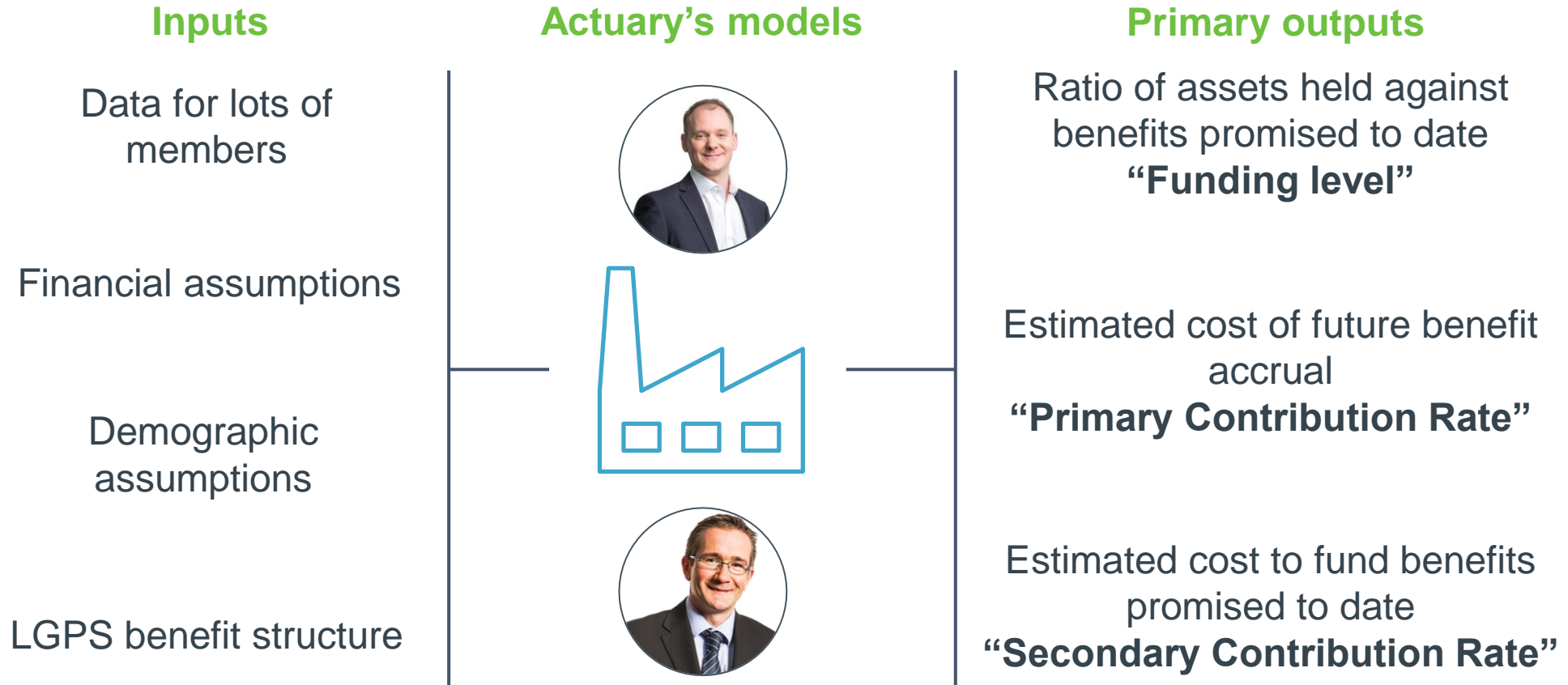
Review Funding Strategy Statement



Part of continual 'health check' on Fund solvency

The triennial valuation is a key risk management exercise for the Fund

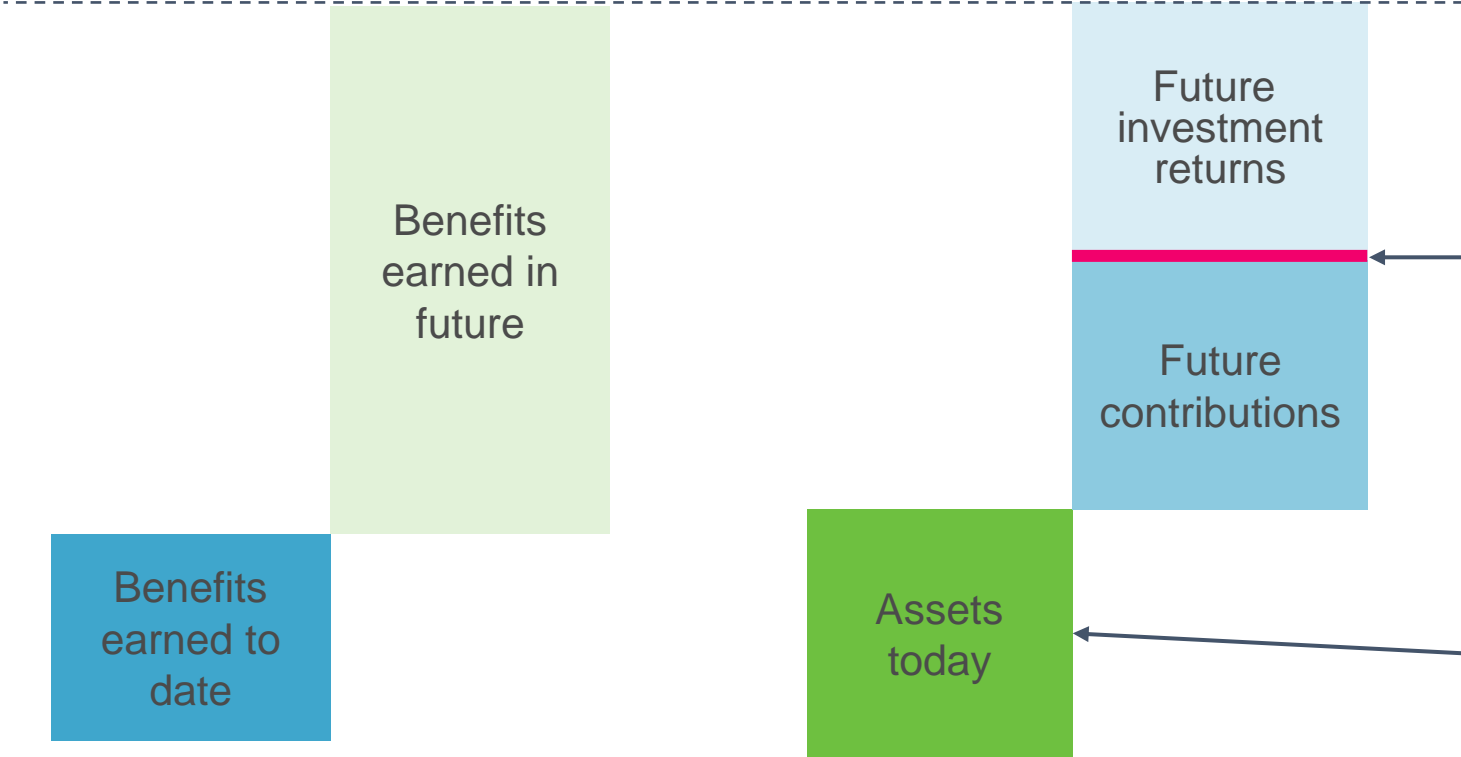
How we do the valuation



Key decision of the valuation

Liabilities

Assets

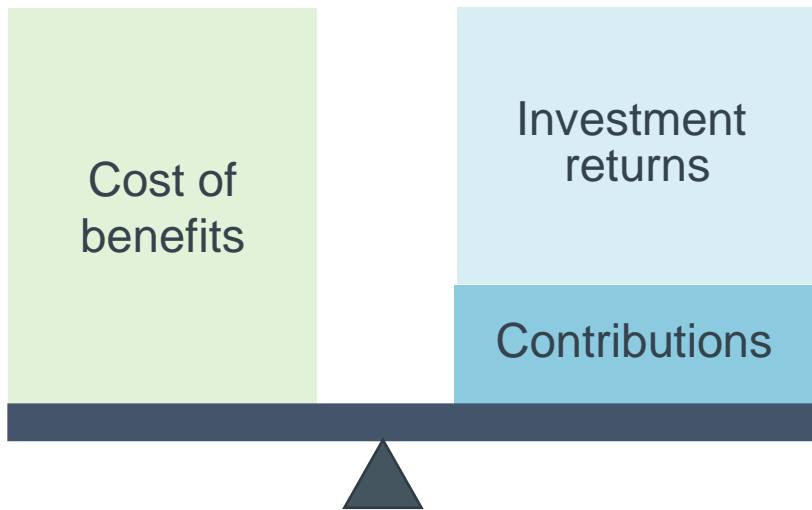


Key funding strategy decision
How much to rely on contributions vs investment returns?

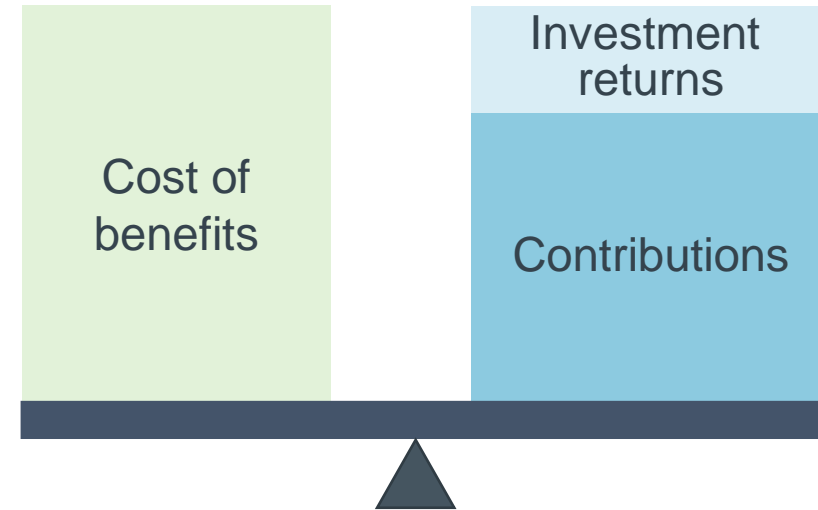
Funding level
Comparison of 'assets today' vs. 'benefits earned to date'
Balance sheet snapshot of Fund at valuation date

Setting strategy is a balancing act

High risk funding strategy



Low risk funding strategy



We must set employer contributions with an appropriate level of prudence (i.e. risk)

Funding update and change in environment



What's happened since 2022?

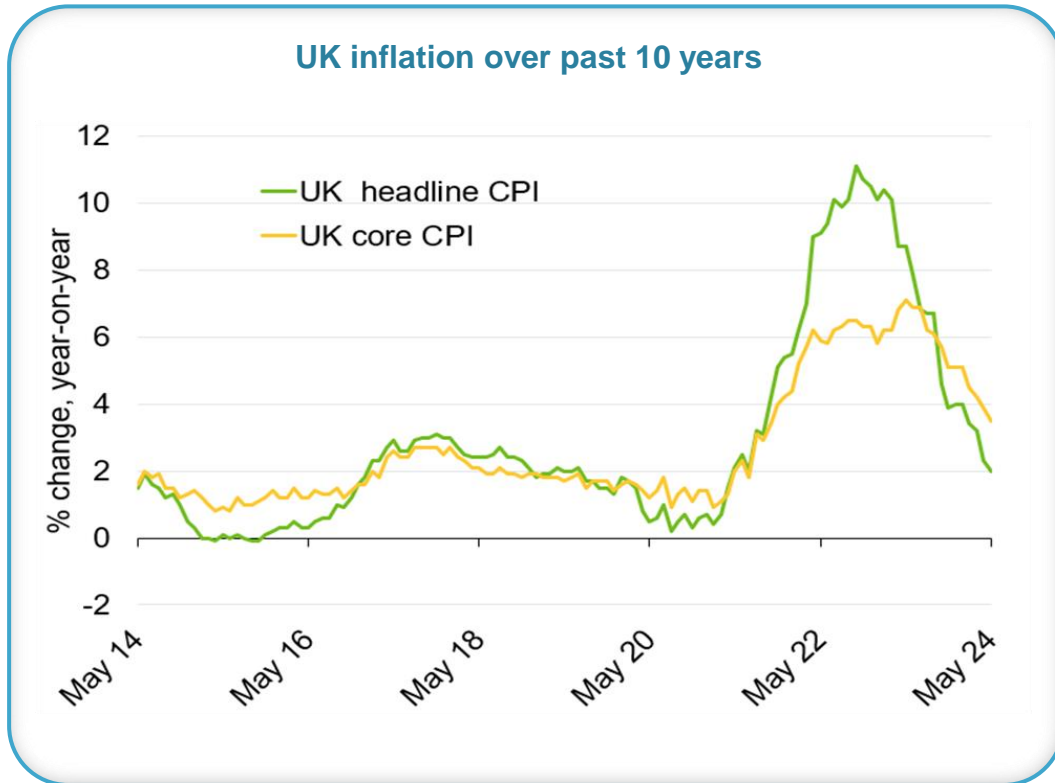


General insights

-  Funding level has improved since 2022 (was 123%)
-  Assets returns were lower than expected up to September 2023 but have since improved
-  Rising interest rates & high inflation
-  Higher expected return on the Fund's assets

The funding level has risen to 163% at 30 June 2024

High inflation



General insights



High inflation increases the cost of benefits



Pension increases of 10.1% (2023) and 6.7% (2024)



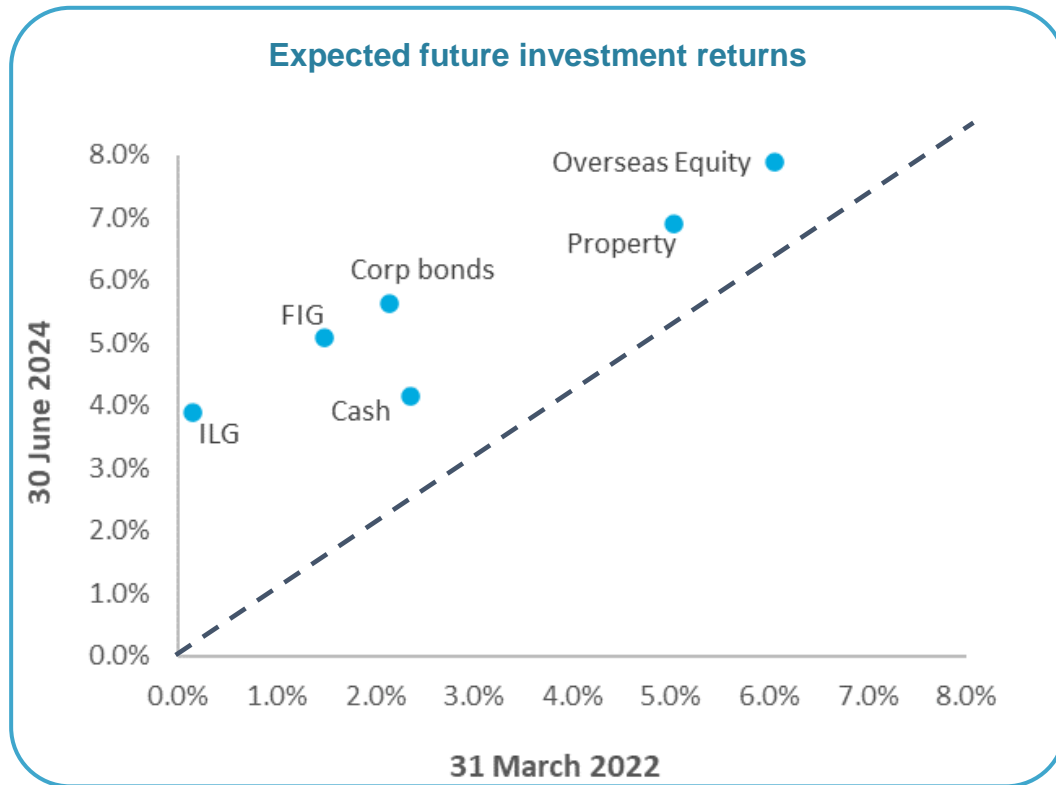
Immediate impact on Fund's net cashflow position



Future inflation remains uncertain

Monitoring inflation is important to manage long-term benefit cost and short-term cashflow risks

Investment outlook



General insights



Expected returns are higher for all asset classes



Higher returns driven by increased interest rates



Leads to a lower value placed on Fund's liabilities



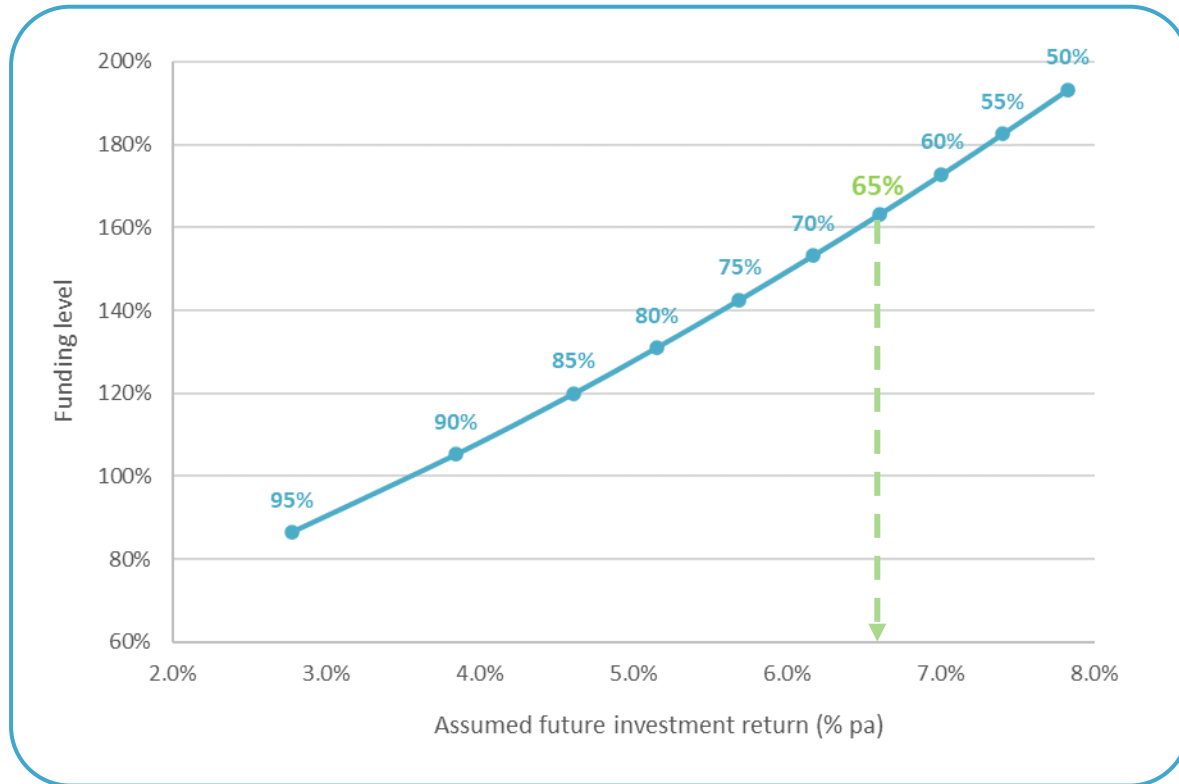
Caution required at 2025 valuation

The improvement in funding level is being driven by higher expected *future* investment returns

Key funding risks



Key uncertainty: Investment returns



General insights



Future investment returns remain uncertain



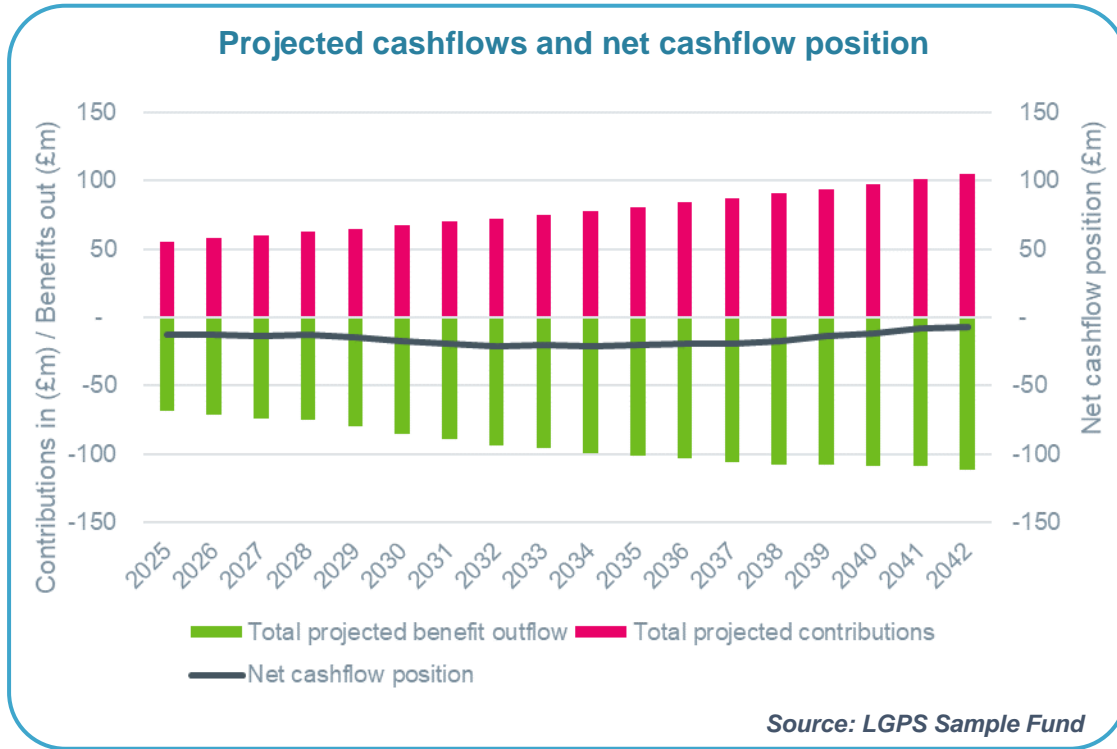
Funding position is based on 65% likelihood



Prudence levels will be reviewed at 2025 valuation

Future investment performance is uncertain during periods of increased market volatility

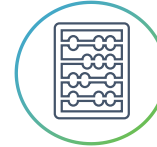
Key uncertainty: Cashflow position



General insights



Cashflow negativity becoming more likely



Sensitive to future levels of inflation



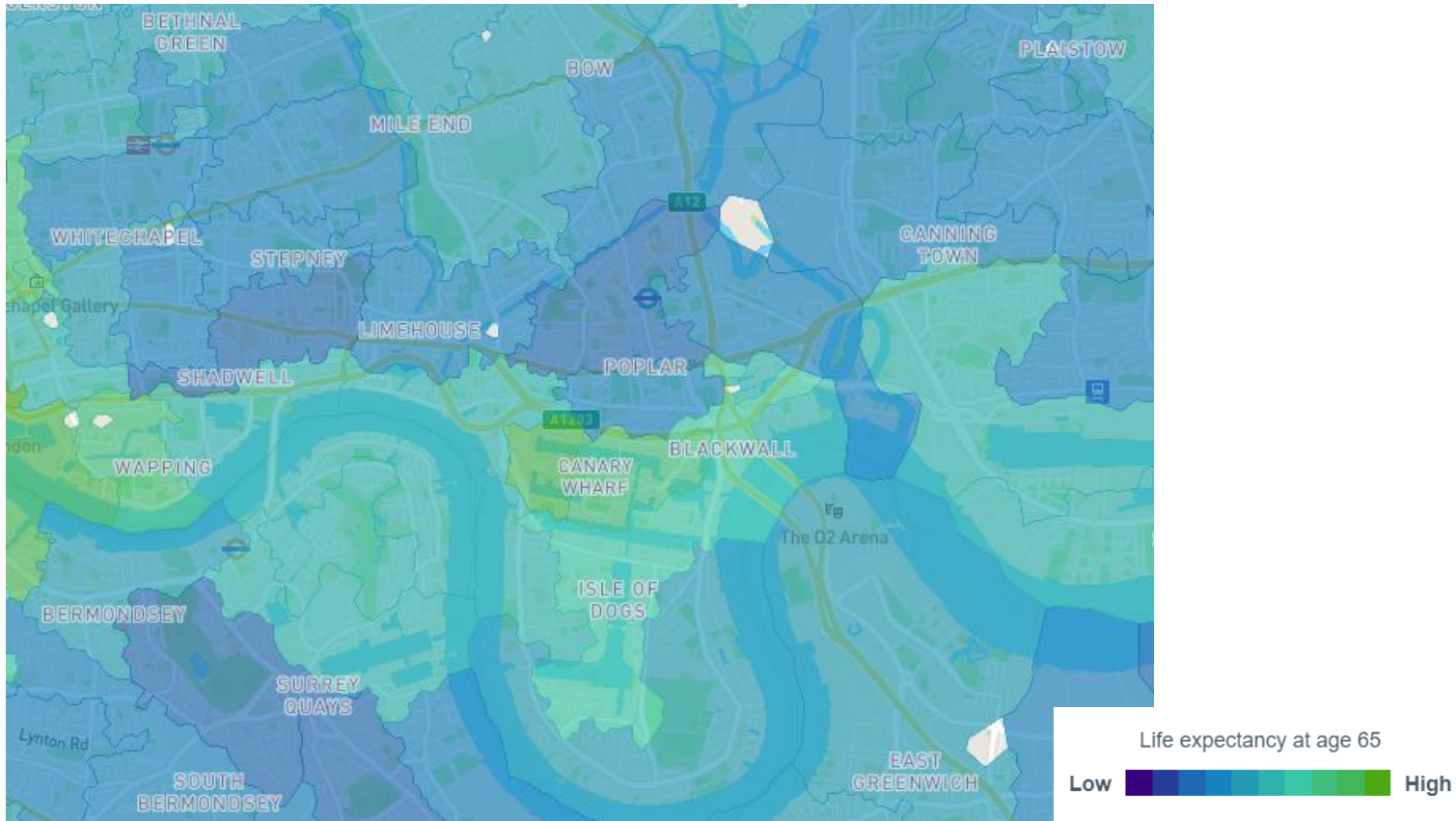
Contribution reductions would worsen the position



Cashflow monitoring to be carried out more frequently

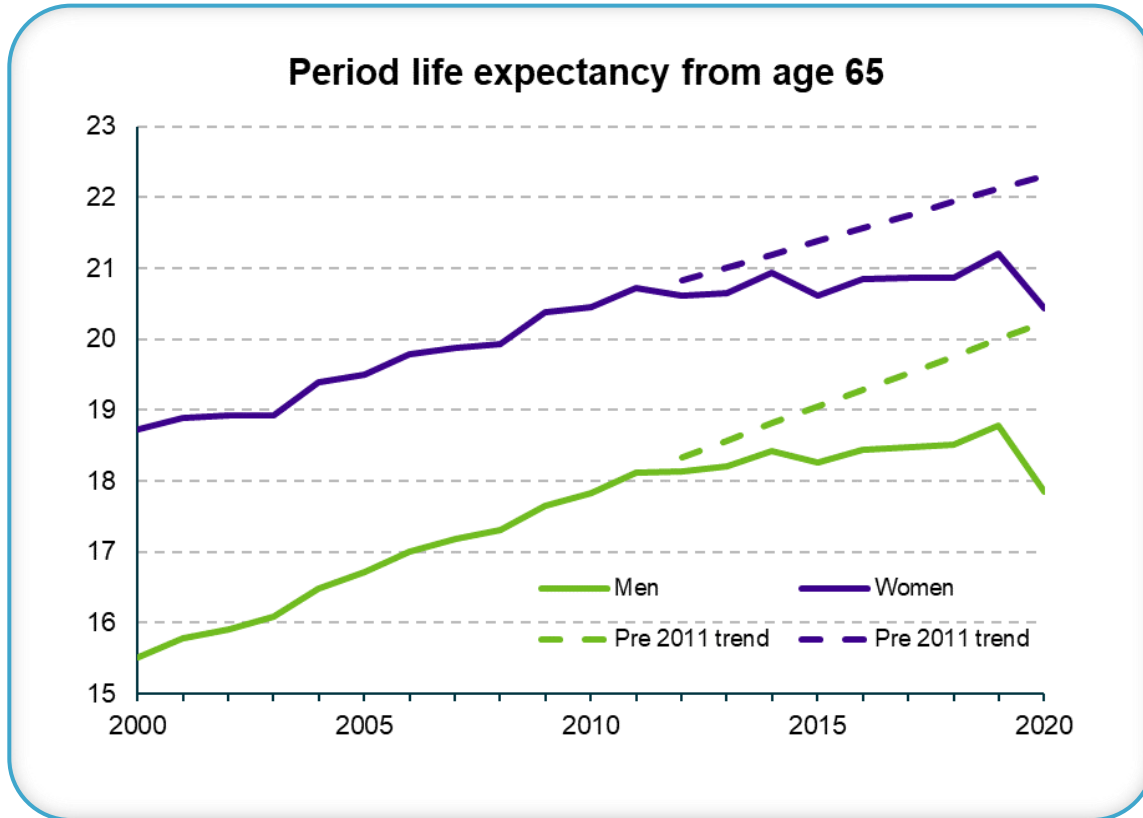
Focus on cashflow is increasing due to inflation and potential impact of contribution reductions

Key uncertainty: Life expectancy



Socio-economic factors can make a big difference to longevity

Recent longevity trends



General insights



Improvements slowing down



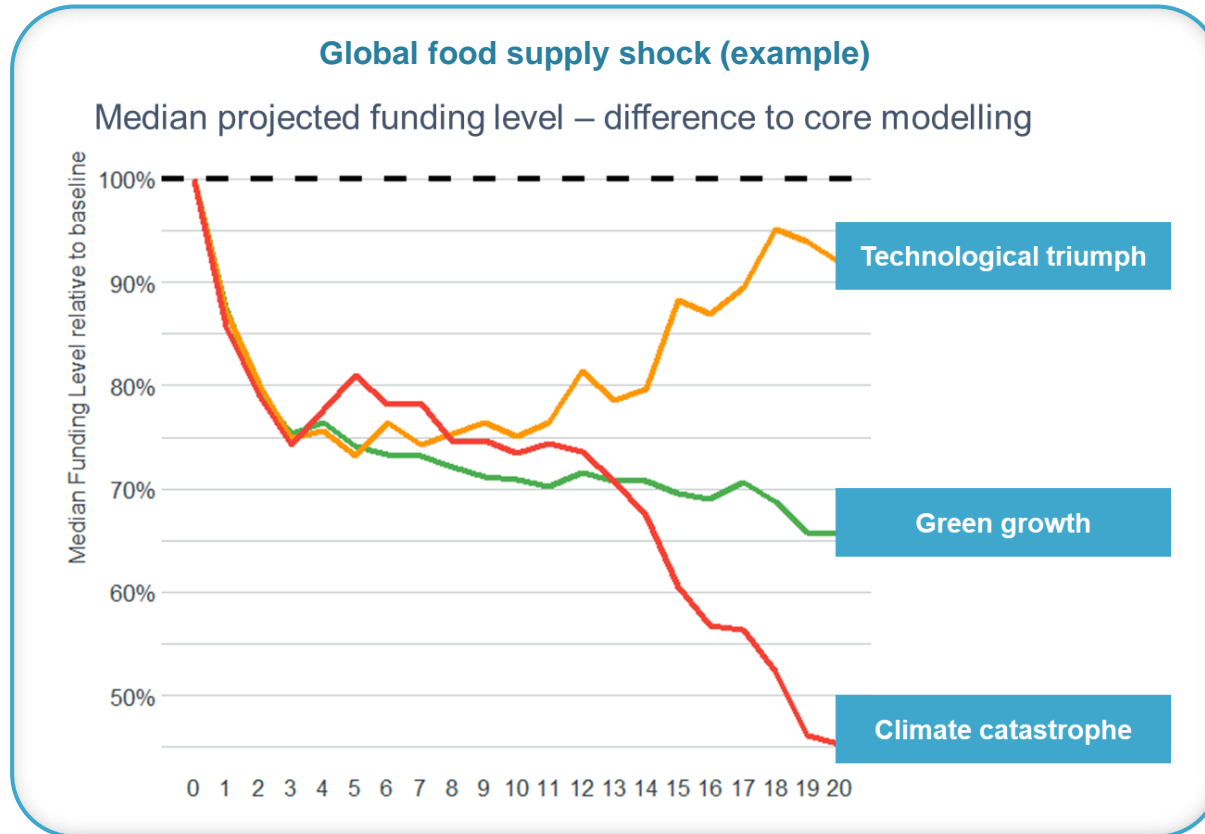
Long term impact of the pandemic uncertain



LGPS 'bucking the trend' on excess deaths

Monitoring longevity trends is key to setting life expectancy assumptions

Key uncertainty: Climate risk



General insights



Climate damages could be extreme



Sectors have strong correlations under stress



Events can cascade through supply chains



The low-carbon transition may be sudden

Factor in extreme risks when exploring strategy at 2025 valuation

A challenging environment?



Market risk

- High inflation
- Interest rates
- Market volatility



Cashflow risk

- High inflation
- Reduced contributions
- Liquidity risks



Longevity risk

- Increased deaths
- Longevity trends
- Future improvements



Climate risk

- Inflation
- Investment returns
- Longevity



Covenant risk

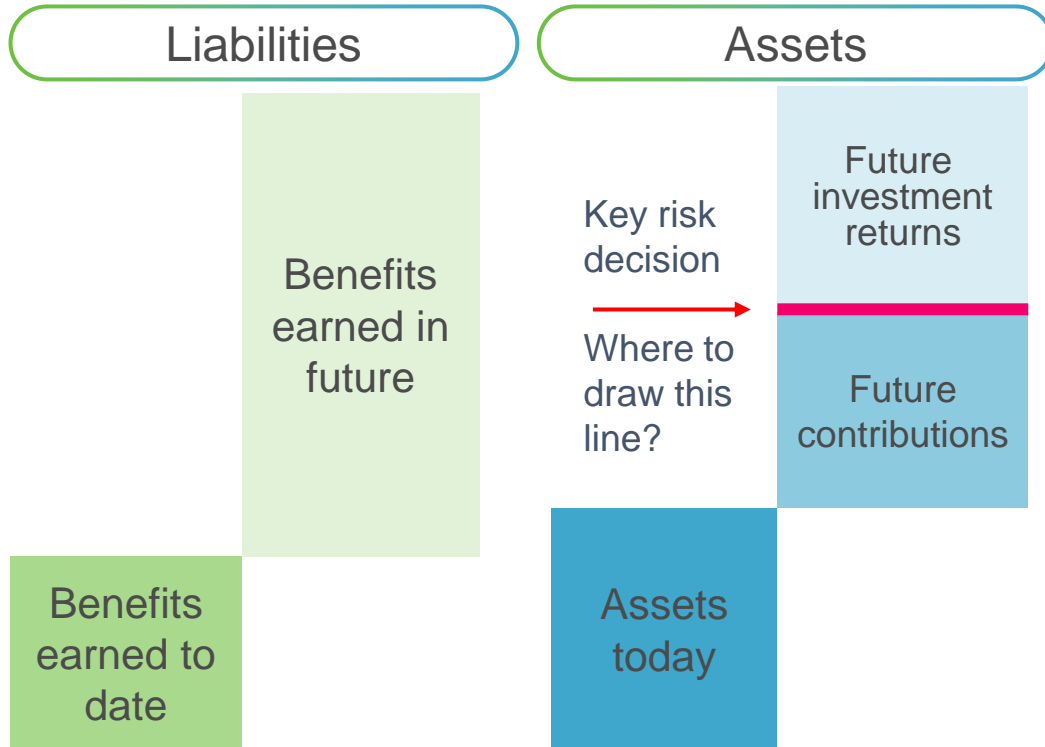
- Economic environment
- Demographic changes
- Regulatory environment

New economic cycle? What are the key risks to future funding...

2025 valuation



Surplus – what now?



General insights



Funding level is 'past service' only



Majority of benefits yet to be earned



Balance future contributions vs investment risk

Setting contributions requires careful management

Surplus – what are the options?



1. Reduce employer contributions



2. Change investment strategy



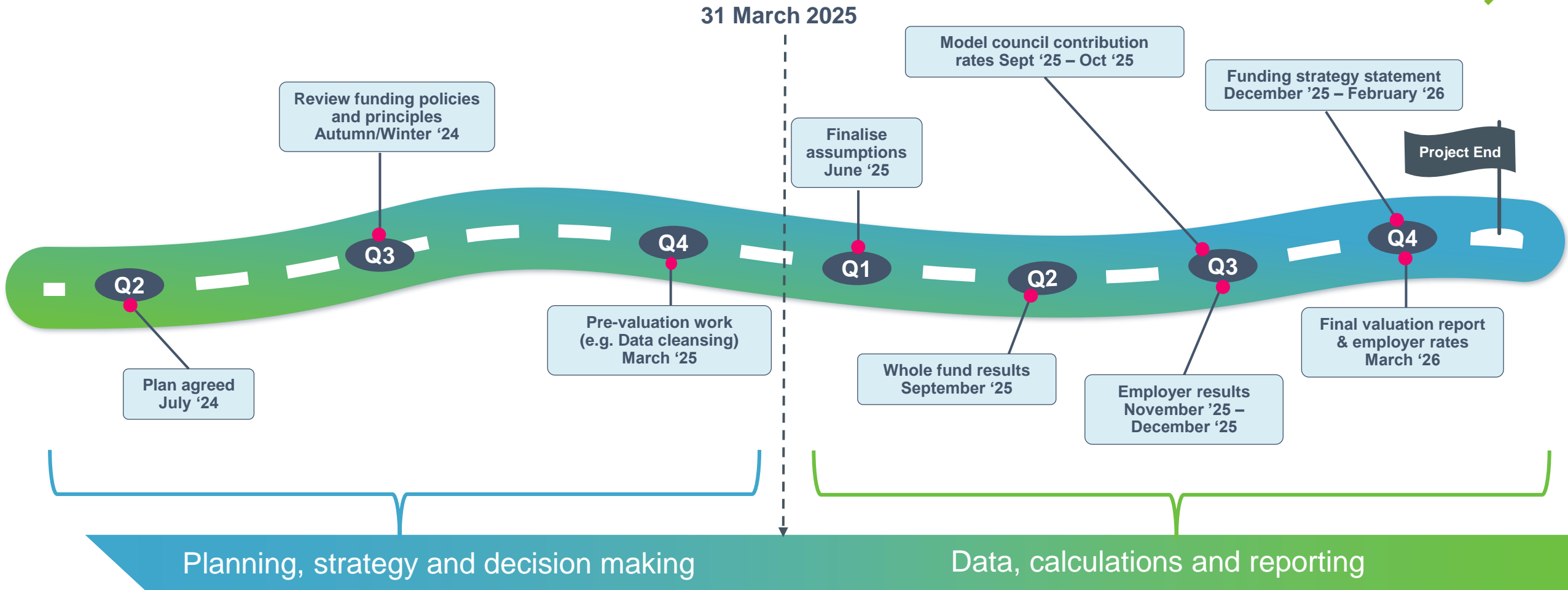
3. Increase prudence levels



4. Retain the surplus

Seek to balance employer affordability with long term sustainability

2025 valuation – key dates



Thank you

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