Item 7

Pension Fund Investment Sub-Committee

15 June 2015

Employer Asset Tracking

Recommendation

That the Pension Fund Investment Sub-committee is asked to approve the adoption of an employer asset tracking model by the fund.

Note: The information in **Appendix A** is not for publication because as it contains information classified as exempt under Schedule 12A of the Local Government Act in that it contains information relating to the business or financial affairs of any particular person (including the Authority holding the information).

1. Purpose of the Report

1.1 At the sub-committee meeting on 16 February 2015 a proposal was presented by the fund actuary that looked at the direct apportionment of fund assets amongst individual employers in order to best assess an accurate surplus/deficit per employer. This approach is known as “employer asset tracking” and works by allocating cash flows and investment returns to employers in a similar way that units in pooled funds are allocated to various investors.

1.2 The method currently adopted by the fund is known as the “analysis of surplus” whereby the actuary predicts cash flows that are expected to be paid out by the fund on behalf of each employer and when these outflows are likely to take place. These assumptions are then, at the next actuarial valuation, compared to what was actually paid out, and these results form the basis for the analysis of surplus/deficit.

1.3 The current method as highlighted in 1.2, whilst fit for purpose, can be bettered by an employer asset tracking method. This is because there are a growing number of complexities that the fund is exposed to including a greater and more diverse employer base, more technical benefit calculations, and the fact that assets are only re-distributed every three years to employers at each actuarial valuation.

1.4 Sub-Committee members agreed in principal to a revised method but asked for further research. Officers have undertaken further work around employer asset tracking including an alternative provider and the indirect benefits from the system if implemented.

2. In-house

2.1 As discussed at the February meeting the analysis of surplus method is showing limitations due to the greater number of employers, the varying nature of employer groups, and the greater degree of scrutiny around Local Government Pension (LGPS) schemes, particularly with the Funds Local Pension Board now in existence which will look at scheme governance. There is a need for a system that gives a granulated depiction of an employer's share of assets when the actuary calculates the various figures needed for each employer's financial statements, employer cessation figures, and most importantly when undertaking an actuarial valuation.

2.2 Whilst the fund has qualified accounting staff we do not hold any in-house actuarial resource and to hold such a resource internally would not be cost effective. Nevertheless, even if the fund did have an internal actuary the underlying assumptions used in work carried out would still need to be undertaken by a third party to ensure total independence and impartiality.

3. Alternative Provider

3.1 Because the issue of asset tracking is so integrated in the Fund's actuarial service provision it is difficult to source an alternative provider without looking at a full tender process. However officers visited KPMG who have a system that can track fund assets and liabilities to give a funding level. The system is called FUSION and is being looked at by some LGPS funds. We are not aware of any other stand-alone products that provide this service.

3.2 The system is a robust tool giving users a snapshot funding position which can use daily pricing for up to date accuracy. There is also the ability to customise assumptions to look at projections in the future and the implications on assets and liabilities given varying conditions.

3.3 However the FUSION system cannot be utilised at an individual employer level. There is an option to segregate the employer base into rough risk groups but not to an individual level. This means it could not be an alternative to HEAT as there would still need to be an actuarial method to calculate employer assets on an individual basis.

3.4 Whilst not "best-fit" in this instance, the FUSION system may be useful for the Local Pension Board in their future discussions around funding levels, liability profiles and risk. The costs though are broadly in line with HEAT and would need to be proposed and voted on by the Board.

4.0 Fund Actuary

4.1 The 2016 Actuarial Valuation will be underway in the near future, and a considerable amount of lead time is needed to make the transition to the

HEAT system. Therefore if unitisation of assets is to be in place for the process we would need to use our current actuarial relationship with Hymans Robertson.

4.2 There is likely to be a considerable level of scrutiny amongst employers, auditors and the Local Pension Board on the revised contribution rates and overall funding level at the 2016 valuation. The HEAT system will provide an additional layer of transparency in that the output will be employer specific and there will be clear evidence that no cross subsidy has taken place. This will assist us in the event of mergers and cessations amongst employers. Members of the committee will be aware that there have been reports at prior meetings where employers have faced financial difficulty or insolvency. Therefore with the adoption of an employer tracker system there would be more detailed and current information that is employer specific will be available for discussion at committee level.

4.3 Combined with the COMPASS employer contribution rate stabilisation mechanism in place, the HEAT system will ensure whilst the fund is making efforts to remain affordable and prudent. Also that the Fund has recognised that assets are better assessed in isolation when setting employer contribution rates. Particularly with the fund employers an asset tracking solution increases the degree of engagement from the underlying employers and through regular monitoring can allow better planning in certain events.

5.0 Further benefits

5.1 The costs of HEAT, if implemented will be partially off-set by a reduced cost in most other work that Hymans Robertson provide for the fund. The Actuarial Valuation data collection will be a less cumbersome process due to current information being held by the actuary. It has also been estimated that the cost of the next valuation will be around 20% less in terms of fees.

5.2 The cost to fund employers would be reduced. Accounting returns and cessation figures will be discounted by £100/£250 respectively.

5.3 The total amount recharged to employers for accounting and cessation work for the last two financial years totalled around £170k.

6.0 Implications for the Administration Team

6.1 The introduction of an employer asset tracking process will add an increased level of administration for the pension administration team to deliver. The more precise method of analysing the funding position for employers will require the calculation of transfer values between employers within the Warwickshire Pension Fund. Currently assets and liabilities for such internal transfers are pro-rated by the Actuary at the time of the triennial valuation.

6.2 The additional process will involve such internal transfers being calculated on (what is known as) inter-fund transfer basis which is the process applied to transfers between LGPS pension funds. This entails the calculation of a cash equivalent value in respect of the pension rights in accordance with guidance issued by the Government Actuary's Department. Over a two year period (April 2013 to March 2015) the team processed 261 inter-fund transfers.

6.3 Ignoring transfers from WCC to academies (where the Actuary calculates the opening position and allocates funds for the new employer at commencement), the administration team has identified that had HEAT been in place since April 2013, a further 122 transfers would have had to be calculated; an increase of 47%.

Background Papers

None

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