Item 7

Pension Fund Investment Sub - Committee

14 September 2015

Cashflow Analysis

Recommendation

That the Pension Fund Investment sub-committee note the report.

1 Introduction

1.1 Cashflow management is an integral element of the administration of any pension scheme. The Fund has to meet its ongoing benefit payments. These may consist of monthly pension payroll, transfer value payments, retirement lump sums and death benefits.

1.2 In order to be able to meet these benefit payments, the Fund requires ready access to cash. Cash may be obtained from payments into the Fund in the form of contributions, from investment income (dividends and interest) drawn from the Fund's assets and by the sale of assets.

1.3 Board members and officers are currently concerned as to the extent to which future estimated contributions due to be received are sufficient to meet the expected benefits outgo over the 'short-term' (defined as three years).

2 Analysis of Historical Cashflows and Method for Estimating Future Cashflows

2.1 In order to estimate future benefit payments from the Fund (pensions and normal retirement lump sums), the fund actuary, Hymans Robertson, has modelled estimated future benefit payments from membership data at the date of the most recent actuarial valuation of the Fund (at 31 March 2013).

2.2 By comparing the actual Fund benefit payments (pensions and lump sums) over the two-year period from 1 April 2013 to 31 March 2015 with those expected from the 2013 valuation, reasons for any differences can be identified and used to calibrate the projected future benefit payments based on actuarial valuation data for short-term use. In the tables below, actual cashflows (A) for the period 2013-15 are compared with those expected (E) based on data at the 2013 valuation and assumptions about future pension increases and pay growth at that time.

Table 1: Comparison of actual (A) and expected (E) outgo over the last two years

	2013/14 (£m)		2014/15 £m)	
	Actual	**Expected**	**Actual**	**Expected**
Pensions	51.6	50.2	54.0	54.0
Lump Sums	11.8	13.0	12.3	14.4
Total	**63.4**	**63.2**	**66.3**	**68.4**

Table 2: Comparison of actual and expected income over the last two years

	2013/14 (£m)		2014/15 (£m)	
	Actual	**Expected**	**Actual**	**Expected**
Contributions	64.8	55.5	69.3	65.7
Investment Income	14.0	-	14.8	-
Total	**78.8**	**55.5**	**84.1**	**65.7**

2.3 The difference between the expected cashflow and actual cashflow in 2013/14 is significantly due to the cessation payment in respect of Orbit Housing.

2.4 Investment income includes dividends from stocks and shares, income from pooled investment vehicles (some of which is automatically reinvested) less the administration and investment management expenses.

2.5 The gap between the expected contributions in 2013/14 and 2014/15 is due to a combination of assumed pay growth in line with the 2013 valuation, the increase in contribution rates as a result of the 2013 valuation and changes to the contribution rates as a result of pension reforms.

2.6 Lump sums (including death grants) are lower than that expected from the 2013 valuation. This may be due to a combination of the number of retirements being less than assumed, and the amount of tax free cash taken at retirement being less than assumed.

2.7 Actual contributions received in 2013-15 have been affected by the number of early retirements. Early retirements reduce the employee membership, reduce pensionable payroll and reduce contribution income. Despite this actual contributions received over the period 2013-15 have been higher than expected. Hymans Robertson have estimated short term contribution income by applying certified contribution rates to the payroll implied from the actual contributions paid.

2.8 Future investment income is not an output from the model used to generate future liability cashflows. “Expected” future investment income is therefore not available for the table above. However, actual income is shown to highlight the magnitude of this against other cashflows.

3 Short Term Cashflow Projection

3.1 Estimates were calculated by analysing future benefit payments from 2013 valuation data with appropriate adjustments to reflect changes in membership since then, and differences between actual and expected pension increases over the period 2013-15. This method ensures projected benefit payments reflect expected pensioner deaths and new retirements from the existing workforce.

3.2 Future contributions are estimated from actual contribution income received in the year 2014/15. The estimates allow for expected long term salary increases and approximate increases to the employer contribution rates in line with the Rates and Adjustments certificate.

Table 3: Estimated Cashflows for period 1 April 2015 to 31 March 2018

	2015/16	2016/17	2017/18
Pensions	-55.5	-58.0	-60.8
Lump Sums	-11.1	-11.8	-14.2
Contributions	73.5	78.4	82.3
Net Cashflow	**6.9**	**8.6**	**7.3**

3.3 It can be seen from the above table that the Fund is cashflow positive. The net cashflow is expected to remain broadly the same over the 3 year period (on central assumptions). No allowance for early retirements has been made in this projection; the lump sums are estimates of lump sums expected as a result of normal retirements.

3.4 However, if there were to be increased levels of early retirements and/or redundancies above those observed, there would most likely be increased lump sum outgo, increased regular pensions in payment and reduced regular contribution income (although there may be a short term increase in income from any strain payments for early retirements). The net effect of increased redundancies and/or early retirements would worsen the cashflow position.

4 Sensitivity of Results to Future Salary Freezes

4.1 The public sector pay freeze has been extended following the Chancellor's 2015 Summer Budget. The pay rises for public sector workers will be capped at an average of 1% p.a. for the next 4 years. The table below shows the likely impact that the pay freeze could have on the contributions being paid into the Fund.

4.2 Taken in isolation, this reduction in the expected rate of pay growth will result in a lower value of past service benefits compared to that expected at the 2013 valuation (which will affect benefit payments in the longer term). However, in the short term this will also reduce the contribution income expected to be received by the Fund where employers are paying a percentage of payroll. The contributions towards the deficit will not be affected

by the salary freeze for employers who are paying monetary deficit repayment amounts.

Table 4: Estimated Cashflows for Period 1 April 2015 to 31 March 2018 Allowing for Salary Freeze

	2015/16	2016/17	2017/18
Pensions	-55.5	-58.0	-60.8
Lump Sums	-11.1	-11.8	-14.2
Contributions	71.5	74.3	75.8
Net Cashflow	**4.9**	**4.5**	**0.9**

4.3 The impact of the salary freeze causes the net cashflow to gradually decrease but contribution income is still sufficient to cover the benefit outgo in the short-term. However, if a shortfall was to arise, there could be income available to cover the cash outflow provided that the investment income is relatively stable and in line with levels experienced in 2013/14 and 2014/15.

5 Investment Income

5.1 The projections suggest that the Fund will be cashflow positive over the next 3 years. However, income and expenditure levels are very similar and, consideration should be given to reinvestment of the contribution and investment income generated by the Fund's assets. At present, we understand that income is received from some of the Fund's investment managers, whilst the income from other managers is reinvested within the respective portfolios. It should be possible to estimate the level of investment income available to be reinvested into the Fund's assets across all of the investments (the accuracy of these estimates will vary depending on asset class).

5.2 Reinvesting income may ultimately create an imbalance in the overall cash availability which must also be managed. We therefore recommend that the overall cash availability is monitored closely. Eventually, assets may need to be sold on a regular basis in order to fund outgoings, should these increase in the longer term, though we expect this point to be some time away. At that point, account will need to be taken of the underlying liquidity of each of the Fund's investments (and therefore how readily available cash actually is) alongside the administrative complexity of instructing frequent investments/disinvestments.

6 Actions Required

6.1 The existing arrangements to draw income from particular fund managers is sufficient to cover the projected cashflow needs of the fund, however Hymans Robertson have made the following points for officers use in their management of fund cash:

- The cash balance maintained is not so large as to reduce the potential for future investment returns.

- The cash balance maintained is not so small so as to create a risk that the balance will be easily exhausted, and thus disinvestments will be required either frequently or at short notice.
- Additional assets are invested in the most efficient manner possible.

6.2 Regular monitoring of short term cashflows, based on whole fund membership data is recommended.

Background Papers

Hymans Robertson Cashflow Management paper

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