

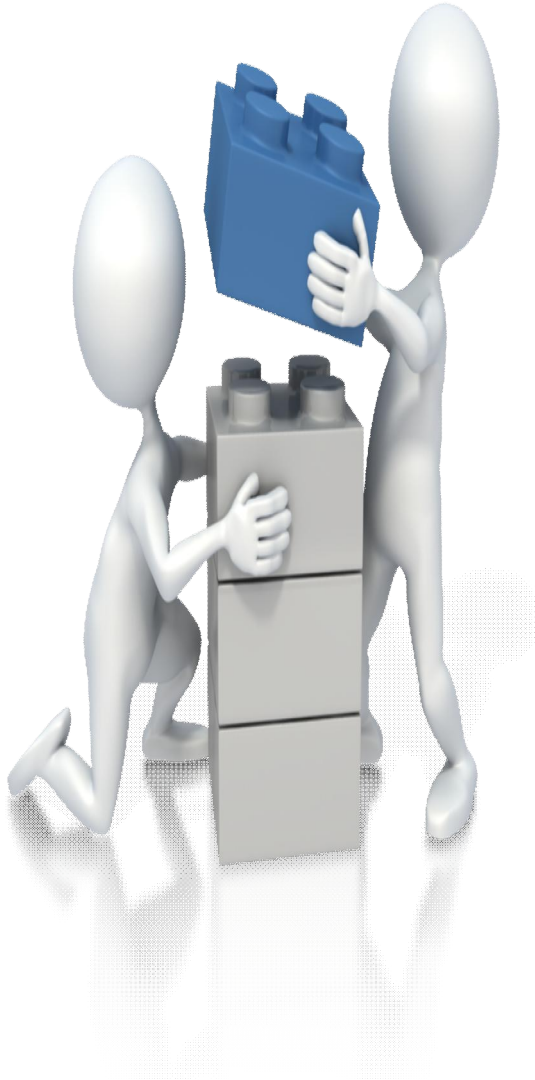
2011 EMPLOYERS CONSULTATION MEETING WEST MIDLANDS PENSION FUND

16 NOVEMBER 2011

Paul Middleman FIA

Public Sector Advisory Services Team, Liverpool

Agenda



2011 Funding Update – the Current Climate

Public Sector Pension Reforms

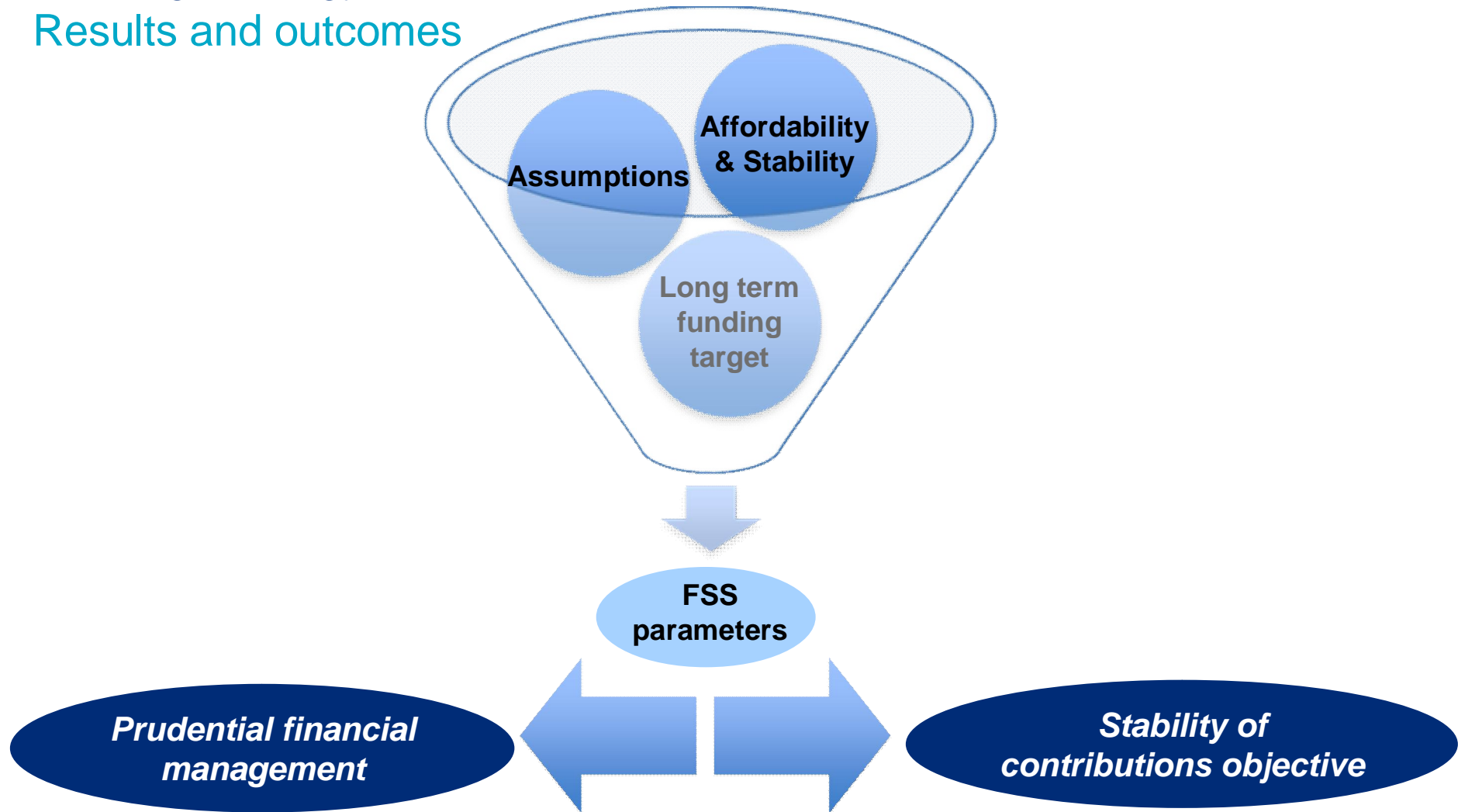
- Short term proposal
- Longer term scheme

2011 Funding Update – the Current Climate



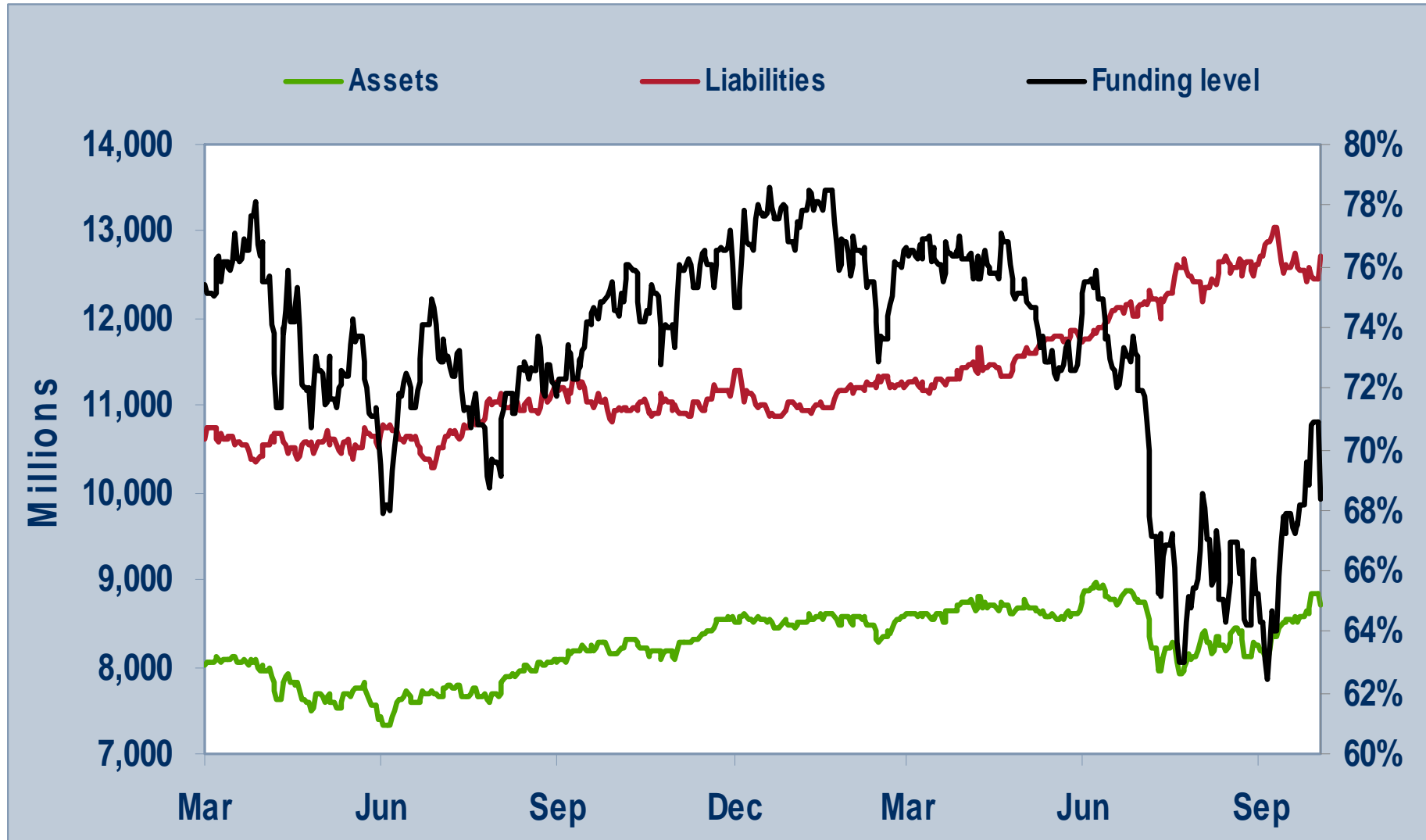
Funding Strategy

Results and outcomes



Changes in funding position since 31 March 2010

Assets, Liabilities and Funding level



Updated Funding Position as at 31 October 2011

	31 March 2010	31 October 2011
Assets	£8,008m	£8,695m (estimated)
Liabilities	£10,622m	£12,712m
Deficit	£2,614m	£4,017m
Funding level	75%	68%
Future service contribution rate	11.9%	11.9%
Past service adjustment* (% of pay p.a.)	6.2%	9.1%
Past service adjustment* (increasing lump sum p.a.)	£116m	£178m

*in line with the current funding strategy

Public Sector Pension Reforms – Short Term



Public Sector Pension Reforms – Short Term

Key areas

Financial : Do they deliver the savings?

Complexity : How do they fit into the long term reforms?
Are they easy to administer?

Impact on members : How can they be communicated and how will it affect member behaviour – opt outs?

Sustainability : Will they stand the test of time?

Public Sector Pension Reforms – Short Term Summary of current proposals – Financial Aspects

	Approach 1	Approach 2	LGG Proposals
2012/13			
Contribution increases	£180m	£95m	Up to £120m
Benefit changes	Nil	Nil	Nil
Total	£180m	£95m	Up to £120m
2013/14			
Contribution increases	£360m	£220m	Up to £360m
Benefit changes	£360m	Nil	Nil
Total	£720m	£220m	Up to £360m
2014/15 and beyond			
Contribution increases	£450m	£300m	£600m
Benefit changes	£450m	£600m	£300m
Total	£900m	£900m	£900m

Public Sector Pension Reforms – Short Term Key Questions

Do the proposals meet the policy and objectives to deliver the necessary savings in the LGPS?

Are there any consequences or aspects of the proposals that have not been fully addressed?

Is there a tariff or alternative measures which consultees think would help further minimise opt-outs from the scheme?

Are there equality issues with the current proposals and if so, to what extent and how can these be remedied?

What are the consultees views on introducing a link with State Pension Age into the LGPS?

Should any short term savings result in changes to employer rates prior to 2014 when rates from the 2013 valuation start?

Public Sector Pension Reforms – Short Term Key Questions and Mercer Viewpoint

Do the proposals meet the policy and objectives to deliver the necessary savings in the LGPS?

Yes, all three sets of proposals constructed so as to ensure necessary savings are met. Some concern over LGG costings.

Are there any consequences or aspects of the proposals that have not been fully addressed?

Yes, areas of communication, administration and change management, which will affect the Fund, employers and employees

All will require considerable work to ensure a smooth transition

Public Sector Pension Reforms – Short Term Key Questions and Mercer Viewpoint

Is there a tariff or alternative measures which consultees think would help further minimise opt-outs from the scheme?

To minimise opt-outs any increase in contributions needs to be kept to a minimum and changes in benefits as simple as possible.

Are there equality issues with the current proposals and if so, to what extent and how can these be remedied?

Any proposals for reduced benefits with no compensatory change in contributions run counter to original aim of making low paid no worse off.

A reduction in contributions for low paid may offset this effect, although may mean greater increases for higher up the earnings scale.

In current format, certain proposals could lead to lower paid members opting out, in particular part-timers.

Public Sector Pension Reforms – Short Term Key Questions and Mercer Viewpoint

What are the consultees views on introducing a link with State Pension Age into the LGPS?

Adds another layer of complexity – changes in State Pension Age have just been enacted - and also interaction with current protections in LGPS

Defer any Link to 2015?

Should any short term savings result in changes to employer rates prior to 2014 when rates from the 2013 valuation start?

Difficult to support given recent market movements

Needs a regulatory change to implement any changes before 2014

Public Sector Pension Reforms

A Key Issue

Can the short and long term reforms be brought together?

Both reforms need to be considered in tandem.

Will help with the transition from the old to the new scheme.

Politically acceptable?

Public Sector Pension Reforms – Short Term Summary and Conclusion

Understand that changes are potentially fraught with difficulty and that compromises will need to be necessary

Ideally, the “short” and “long” term reforms should be considered together – would be bizarre if short-term changes to be undone

Only practical options in short-term are changing balance between member contributions, accrual rate and normal pension age

Desire to avoid administration and communication complexities reduces scope for innovation in changes proposed

As far as possible, benefit design should be kept simple

Support a short-term option which gives lowest impact on member contribution increases to minimise risk of opt-outs => Approach 2 or modified LGG Proposal

Public Sector Pension Reforms – Long Term

The background of the slide is composed of three distinct horizontal bands. The top band is a dark navy blue and contains the title text. The middle band is a medium teal color and is separated from the top band by a diagonal line that slopes upwards from left to right. The bottom band is a lighter, vibrant cyan color and is separated from the middle band by a horizontal line.

Public Sector Pension Reforms

Longer term proposals (post 2015) - Update

Based on Reference Scheme

Each Public Sector Scheme will have its own cost envelope

Longer-term reforms will allow for short-term changes to cost balance between members and employers

Scheme specific discussions until end 2011

Public Sector Pension Reforms – Long Term Cost Envelope for Public Sector Schemes announced on 2 November

Pension Scheme	Gross cost ceiling	Cost to Employees	Net Cost to Employers
NHS Pension Scheme (England and Wales)	21.9%	9.8%	12.1%
Principal Civil Service Pension Scheme	22.5%	5.6%	16.9%
Teachers Pension Scheme (England and Wales)	21.7%	9.6%	12.1%
Local Government Pension Scheme (England and Wales)	20.4%	9.5%	10.9%

- Based on underlying accrual rate of 60ths for Reference Scheme (originally 65ths)
- Excludes cost of proposed additional protections for those closer to retirement (within 10 years)
- LGPS “gross” cost will be adjusted after ST savings approach agreed

Public Sector Pension Reforms – Long Term Impact for LGPS

Likely to be 4 – 5% of pay per annum “cheaper” for employers

Expect accrual rate lower than 60ths e.g. 65ths or 70ths given contributions are not increasing by 3% of pay

Could be brought forward for one set of changes but still have to deliver £900m savings by 2014/15.

Closer to cost share ratio of 1:1 for LGPS (employer : employee)

Public Sector Pension Reforms

What is being said?

DCLG:

- “Achieving £900m by 2014/15 unavoidable”
- “Door is open for alternatives”
- “Generous, among the very best available”
- “Fair, career average is fairer for most”
- “Flexible, occupational relevance very important”

GMB Union:

- “Sustainable LGPS reform is bespoke and affordable, valuable, stable”
- “Current proposals fall short of this test”
- “Better would be a single change to benefits/contributions around the 2013 valuation - based on a lower cost shared 2:1”

....and Finally

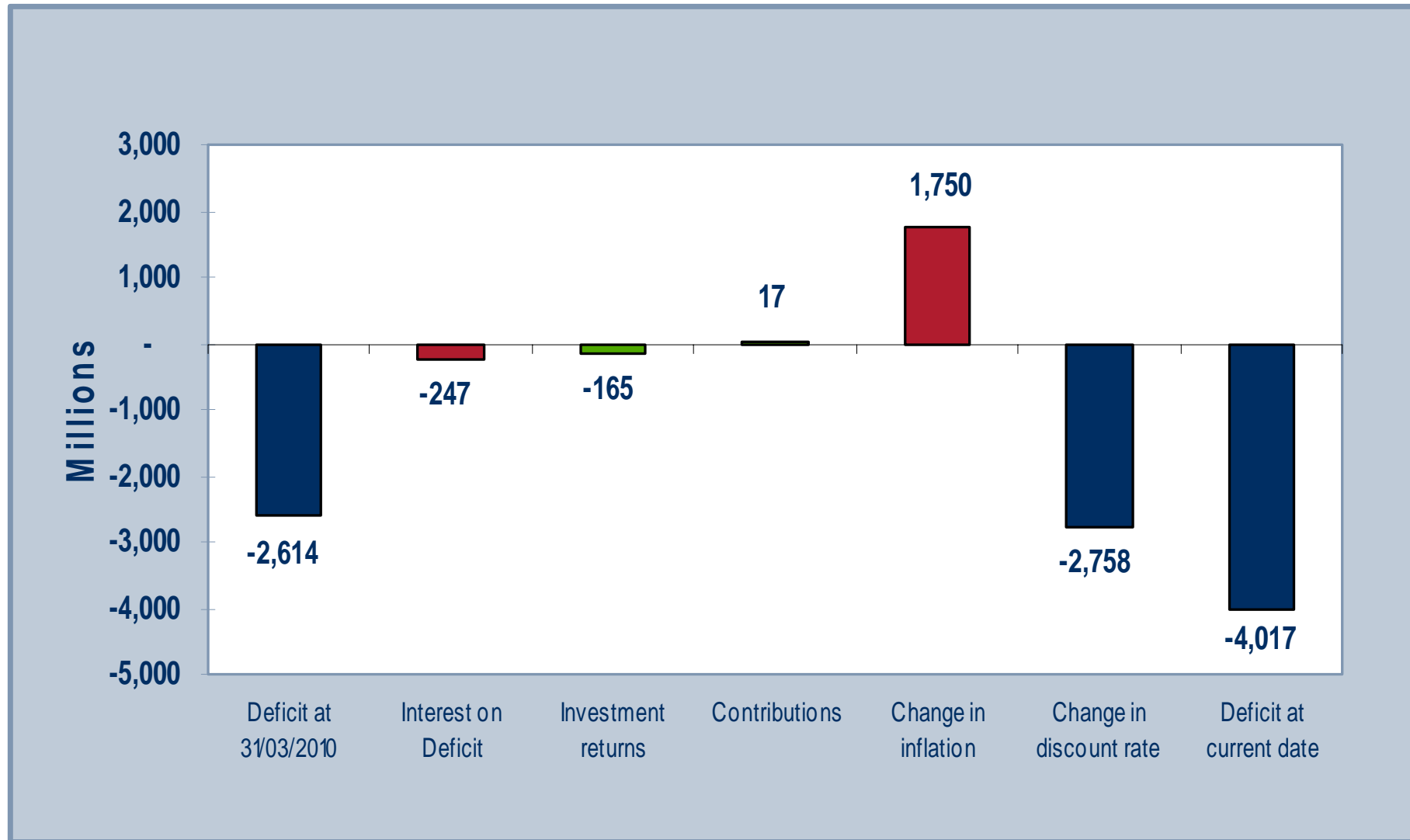


Appendix 1 – Funding

The background of the slide is composed of three distinct horizontal color bands. The top band is a dark navy blue, the middle band is a medium teal, and the bottom band is a bright cyan. The boundary between the top and middle bands is a diagonal line that slopes upwards from left to right. The bottom band is a solid, horizontal rectangle.

2011 Funding Update

Analysis of change in funding position since valuation date (to 31 October)



Past service assumptions – nominal values

Market-related assumptions

	31 March 2010	31 October 2011
Discount rate pre retirement	6.5% p.a.	5.4% p.a.
Discount rate post retirement	5.5% p.a.	4.4% p.a.
Salary increases	4.75% p.a.	4.05% p.a.
CPI Pension increases	3.0% p.a.	2.3% p.a.
Mortality	Based on SAPS P and D CMI [1%] improvement projections	Based on SAPS P and D CMI [1%] improvement projections

Future service assumptions – nominal values

Smoothed assumptions

	31 March 2010	31 October 2011
Discount rate	6.75% p.a.	6.75% p.a.
Salary increases	4.5% p.a.	4.5% p.a.
CPI Pension increases	3.0% p.a.	3.0% p.a.
Mortality	Based on SAPS P and D CMI [1%] improvement projections	Based on SAPS P and D CMI [1%] improvement projections

Appendix 2 – Pension Reforms

The background of the slide is composed of three distinct horizontal bands. The top band is a dark navy blue, containing the title text. The middle band is a medium teal color, and the bottom band is a lighter, vibrant cyan color. The bands are separated by thin white lines.

Public Sector Pension Reforms

Potential shorter term changes from April 2012 – Options 1 and 2

OPTION 1

Stepped Increases in employee contributions from April 2012 (protections for lower paid)



**£450m Saving by 2014/15
(1.5% of payroll)**

Benefit Accrual of 1/64ths in 2013/14 and 1/65ths in 2014/15



**£450m Saving by 2014/15
(1.5% of payroll)**

OPTION 2

Stepped Increases in employee contributions from April 2012 (protections for lower paid)



**£300m Saving by 2014/15
(1% of payroll)**

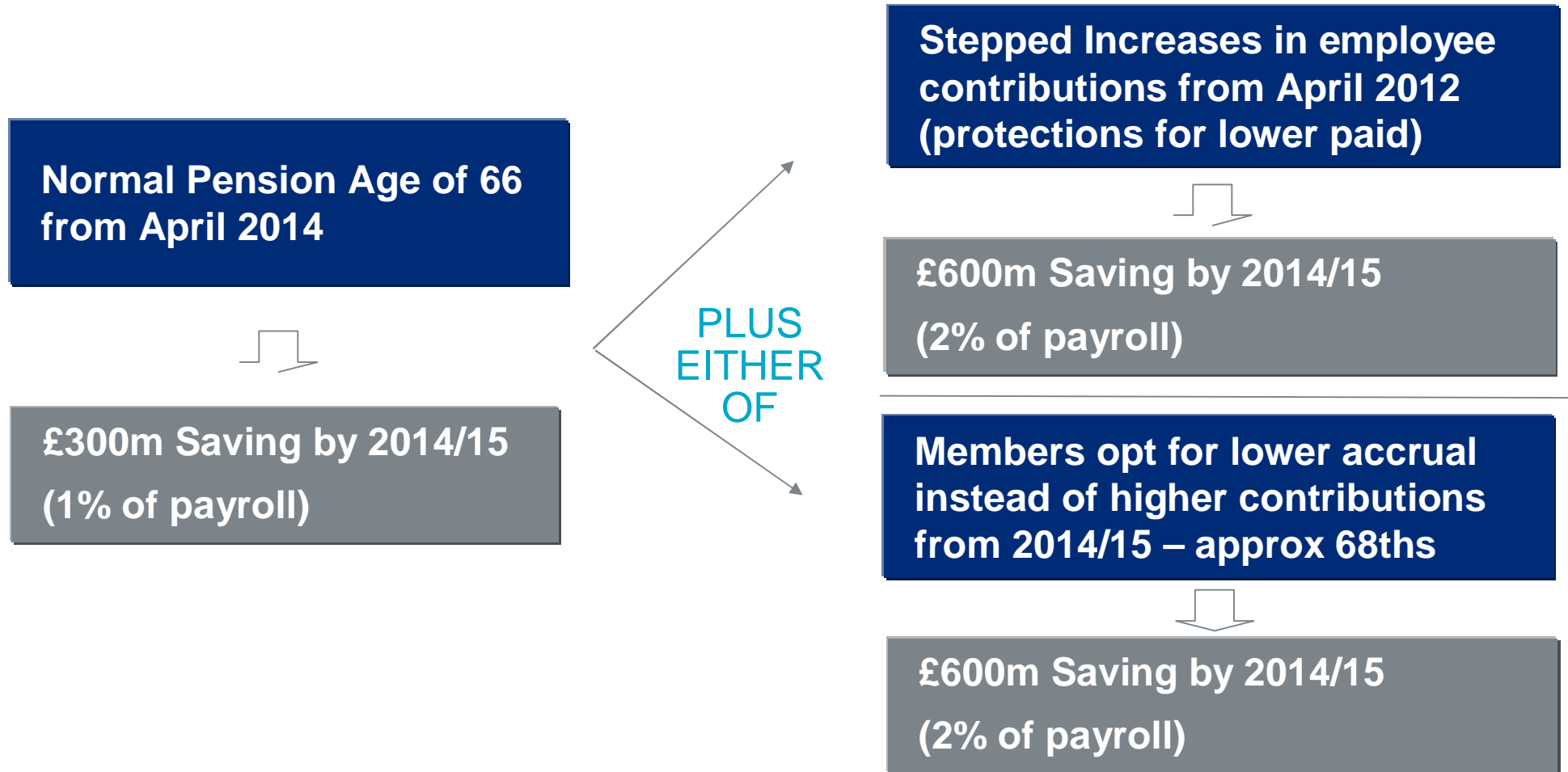
Benefit Accrual of 1/67ths in 2014/15



**£600m Saving by 2014/15
(2% of payroll)**

Public Sector Pension Reforms

Potential shorter term changes from April 2012 – Alternative LGG Proposals



Public Sector Pension Reforms

Longer term proposals (post 2015) – Benefit Changes

Some of the main benefit recommendations from the Hutton Report

- Retain Defined Benefit
- CARE to replace Final Salary (*for future service*)
- Link to final salary maintained for benefits accrued in the existing schemes
- NRA to be linked to SPA (*for future service only*)
- Retain ‘tiered’ contributions i.e. dependent on salary

Public Sector Pension Reforms

Changing from Final Salary to CARE (for future service)

- Final Salary

$$\text{Pension} = \text{accrual rate} \times \text{service} \times \text{final salary}$$

- Career Average Revalued Earnings (CARE)

$$\text{Pension} = \text{accrual rate} \times \text{service} \times \text{career average salary}$$

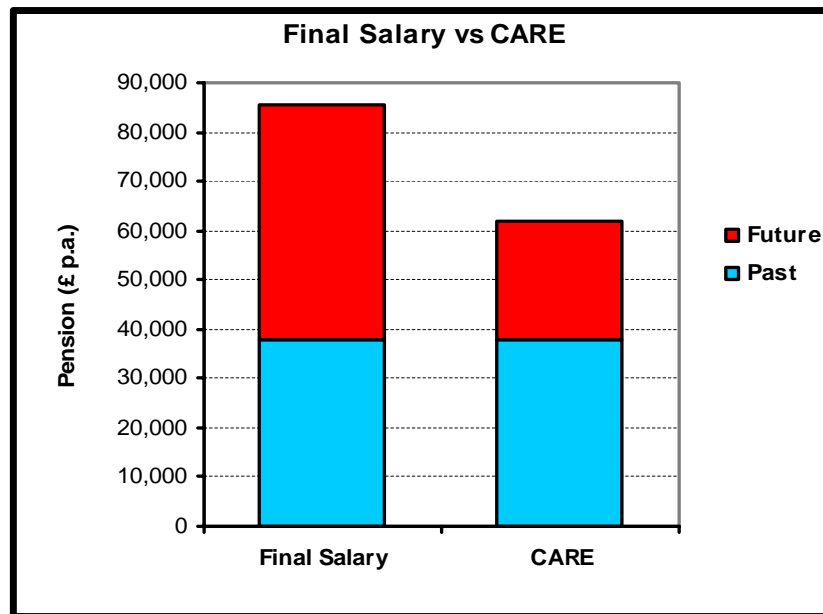
Career average salary indexed in line National Average Earnings (LGPS)

- Under both structures Employers normally meet 'Balance of Cost' above member contributions

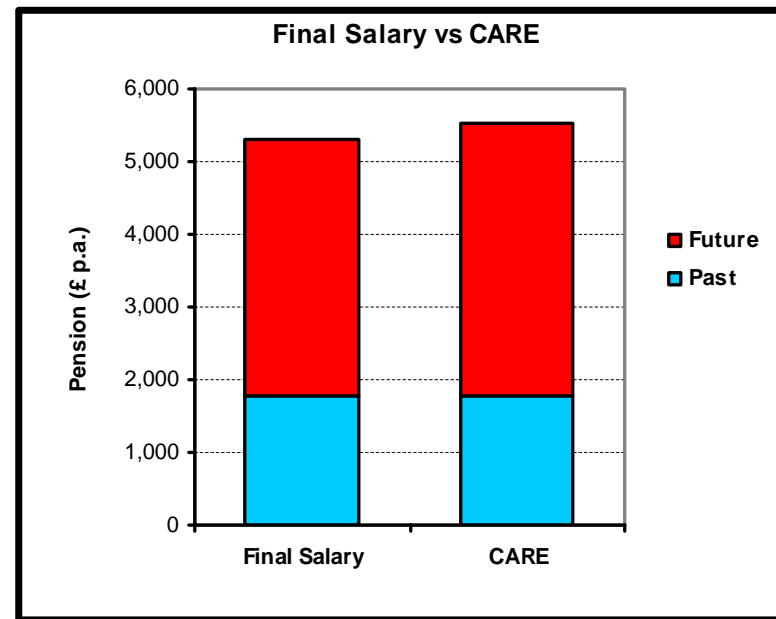
Public Sector Pension Reforms

“Winners” & “Losers” of CARE Scheme?

High Flyer = “Loser”?



Low Progression = “Winner”?



Low progression members could be better off because of level of revaluation.

High flyers might lose out.

Overall impact depends on accrual rate.

Actuarial advice

This presentation has been prepared for the purpose of providing an update to the Administering Authority of the West Midlands Pension Fund in relation to the Local Government Pension Scheme. We do not accept liability to any third party in respect of this information; nor do we accept liability if this presentation is used for any purpose other than that stated. Also, we have relied on the accuracy of the data provided. Whilst reasonableness checks on the data provided have been carried out, they do not guarantee the completeness or accuracy of the data. Consequently we do not accept any liability in respect of our advice where we have relied on data which is incomplete or inaccurate.

This presentation contains confidential and proprietary information of Mercer Limited (“Mercer”) and is intended for the use of Mercer and our clients. The report may not be modified, sold, or otherwise provided, in whole or in part, to any other person or entity without Mercer’s written permission. This presentation should be considered in conjunction with the formal report on the 2010 actuarial valuation.



Mercer Limited is authorised and regulated by the Financial Services Authority

Registered in England No. 984275 Registered Office: 1 Tower Place West, Tower Place, London EC3R 5BU