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2024 Interim Review Summary of Committee Workshop

Avon Pension Fund

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December 2024

A business of Marsh McLennan

Back to basics

Current financial and demographic outlook

Key funding and risk strategy considerations

2024 interim funding review outcomes

Next steps and other considerations

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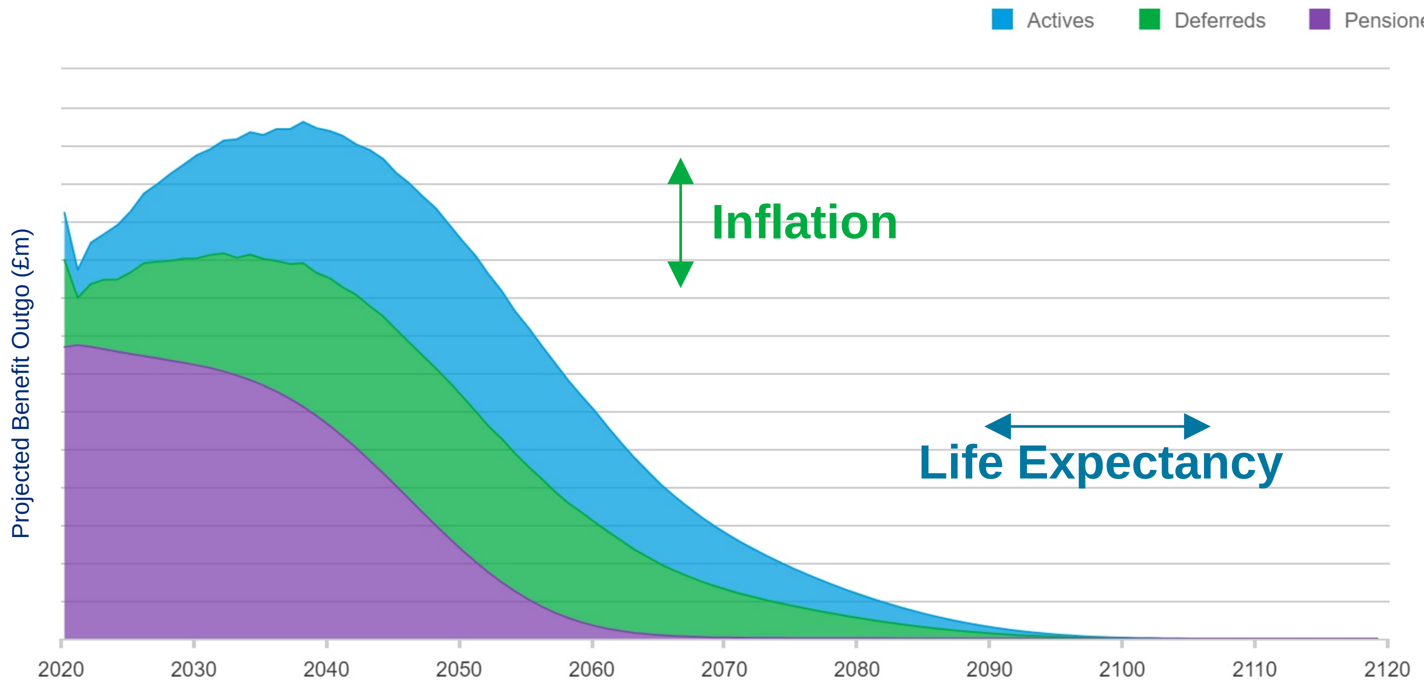
Back to basics
What is an actual valuation?

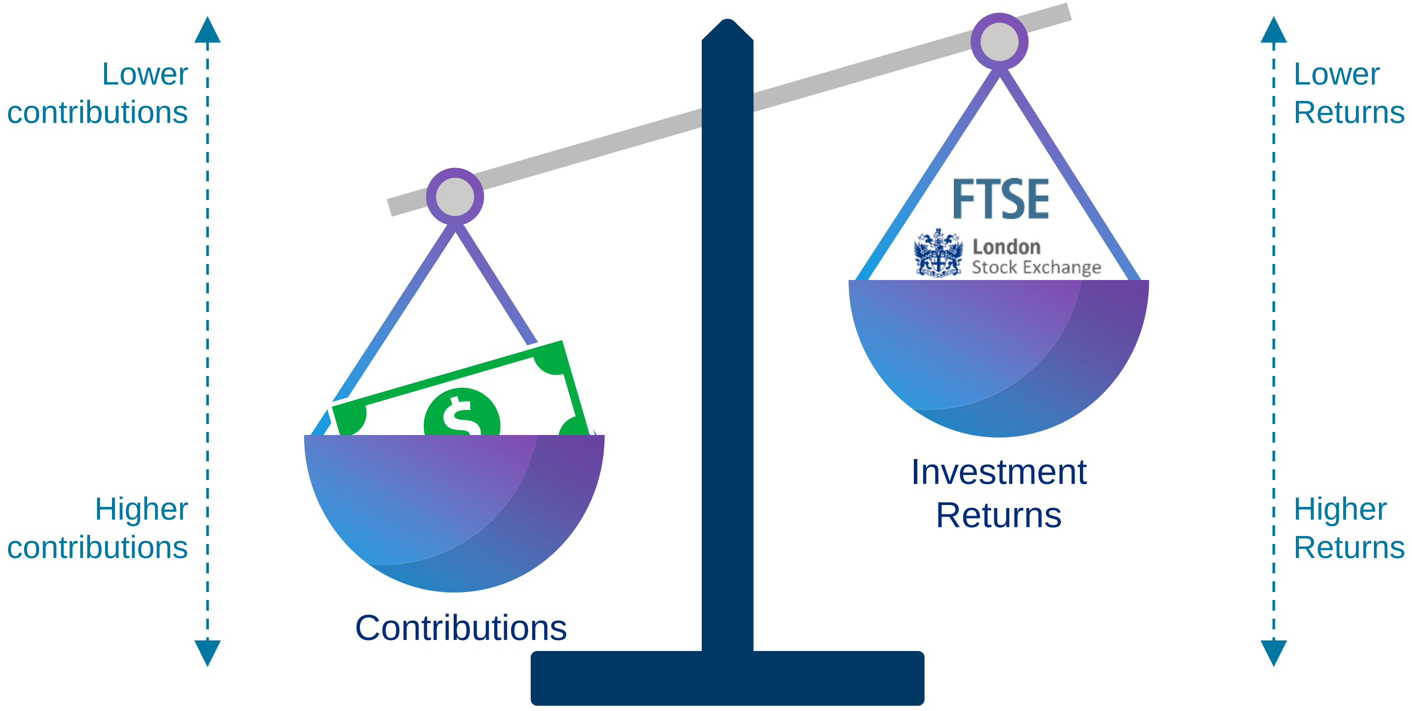
An actuarial valuation assesses the financial health of the pension fund

The primary responsibility is… → **To ensure correct member benefits are paid as they fall due**



The biggest risk is therefore… → **Running out of assets before the last member is paid**

Back to basics
Financing the Benefits



Objective is to have sufficient assets to pay benefits as and when they fall due

Back to basics
In simple terms

Secondary Contributions

Past benefits

Future benefits

Primary Contribution Rate

Has the Fund got enough assets to cover expected benefits built up to date?

How much will the Employers have to pay to for benefits earned in the future?

Depends on history of the employer, investment returns achieved and experience to date.

If the Fund assets are less than the liabilities, then there is a deficit. If the assets are greater than the liabilities, then there is a surplus.

Depends on the profile of the active membership and any benefit changes.

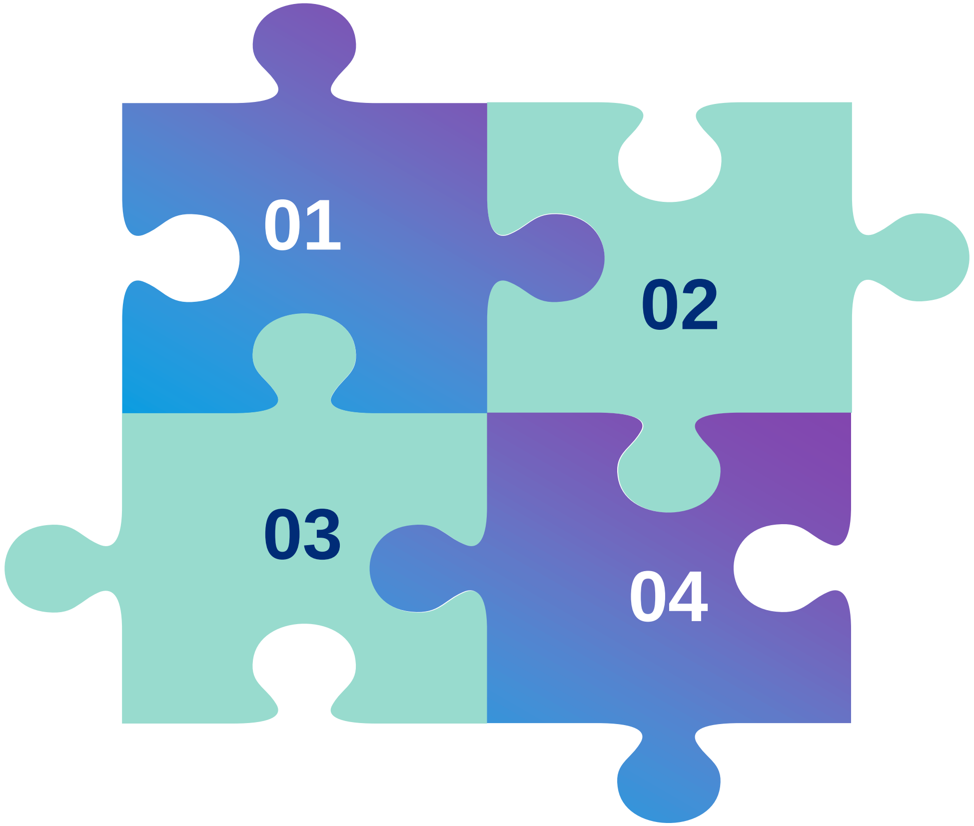
Generally, an employer with older members will have a higher contribution rate than an employer with younger members

Calculated for the Fund, but also at employer level – each employer is responsible for their own members

Back to basics
In simple terms

Data quality & expected changes in Fund profile

The framework components i.e. investment, risk, covenant etc



Financial / demographic assumptions, calculations & analysis

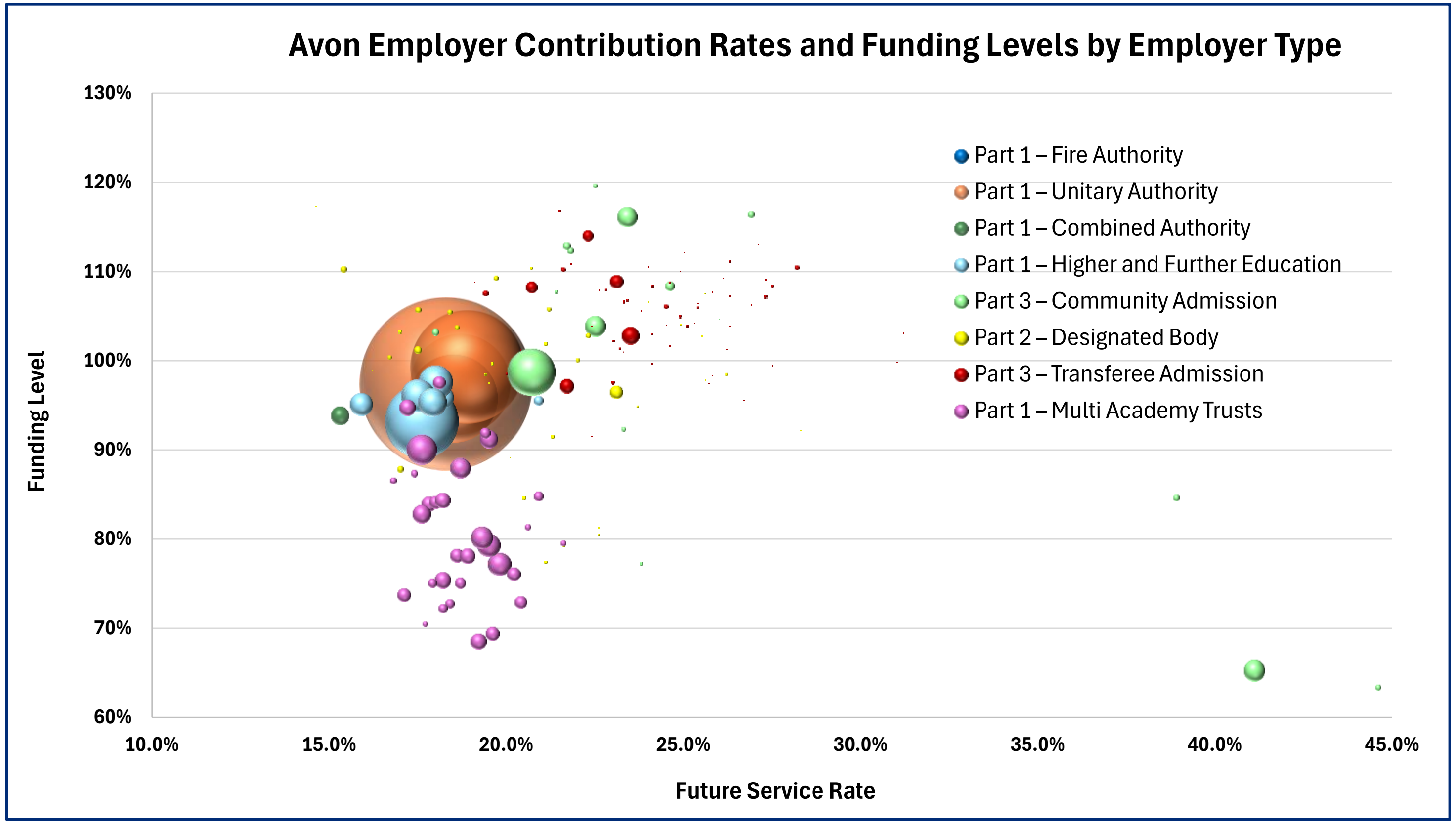
Risk management monitoring & governance

Back to basics

2022 Valuation – How do employers vary?

At a whole Fund level, the average Future Service / Primary Rate for the Fund was **18.6%** of pay and the funding level was **96%.**

Each employer is responsible for their own position and has their own contributions rates – e.g. future service rates ranging from **14.6% to 44.6% of pay** and funding levels ranged from **63% to 131%** (allowing for multi academy trusts). The graph below illustrates the range of employer funding positions and contributions by employer group. To provide an indication of relative scale, the size of the dots represents the size of the Fund liabilities for the different employer types.



Back to basics
What affects employer funding positions and contributions?

Date employer joined the Fund

Changes in market conditions / investments likely to differ from one employer to the next depending on when they entered the Fund

Membership experience

To what extent have pension/salary increases, leavers, ill-health retirements, deaths been greater/lower than expected

Contributions Paid

Past phasing of contributions / longer recovery period / employers running off surplus will see funding positions fall compared to those paying in deficit contributions / not phasing / shorter recovery periods

Membership profile

Balance sheet for younger maturity/duration is more sensitive to changes in the underlying financial assumptions.

Also employers with older members will have a higher rate than younger members

Open / closed employer

The contribution rate for open employers will generally be lower than closed employers

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Current financial and demographic outlook
Valuation assumptions

Investment Return "Discount Rate"

Consider based on current approach and Mercer capital market assumptions and how this may develop

Inflation / Pension increases

Reviewed based on the latest data – see separate paper for technical derivation

Life Expectancy

Consider latest trend evidence based on CMP model projections published in May 2024 (CMI 2023 model). Full review to be undertaken for the valuation.

Other assumptions

Will cover pay growth, ill health incidence etc. and are usually much less impactful financially. Considered in conjunction with employers and as part of valuation process.

Expected Return and inflation – “The Discount Rate”

There have been significant changes in economic outlook, inflation expectations and further developments in the Fund’s investment strategy. When considering the discount rate there are a number of factors which we need to consider to arrive at an appropriate assumption which are summarised as follows:

1. **Market outlook and “model” expected returns:** Overall the best estimate expected “model” returns have increased from 5.6% p.a. (CPI+2.5%) to 8.1% p.a. This has been predominately driven by the change in the prevailing average gilt yield (over the yield curve) which has increased from 1.7% p.a. to 4.4% p.a. over the period. Whilst model expected returns are important, they should only support the decision on an appropriate discount rate which needs to take into account other factors including market risks. Please see the appendix for return assumptions for the main asset classes modelled.

2. **Inflation expectations:** On a consistent basis, between March 2022 and August 2024 expectations of long-term CPI inflation have reduced by c0.6% p.a. from 3.1% p.a. to 2.5% p.a. (over the yield curve). The current short term inflation rate has fallen significantly (annual CPI rate at September 2024 was 1.7% which will determine the 2025 pension increase, which compares to the September 2022 CPI of 10.1%).

3. **Fund risk management framework:** This increases the acceptable discount rate given the ability to remove margins due to higher certainty of returns due to the risk controls in place.

4. **Climate Change**: When considering the discount rate we need to allow for risks which are difficult to model. In terms of climate change risk, we need to retain sufficient prudence in our assumptions but we will also illustrate some potential tail risk outcomes over different time periods under different scenarios. This will be done as part of the 2025 valuation.

5. **Employer contribution sustainability:** Maintaining current contributions or limiting any reductions would provide better stability at future valuations in the event expected returns fall (e.g. if interest rates fall more than expected) or inflation increases. A balance must be struck between current budget pressures and future sustainability of contributions – intergeneration equity is a requirement of any funding plan. This means that the discount rates will be set to ensure the sustainability criteria is achieved. This can be applied in different ways e.g. smoothing and/or requiring higher certainty of model outcomes.

Current financial and demographic outlook
Life Expectancy

In order to feed into the 2024 interim review, we have reviewed the life expectancy assumptions for the Fund. At this stage, based on our analysis, we propose to update the life expectancy tables and associated weightings. We have produced a separate report which details the changes.

The updated tables have the following impact on life expectancies:

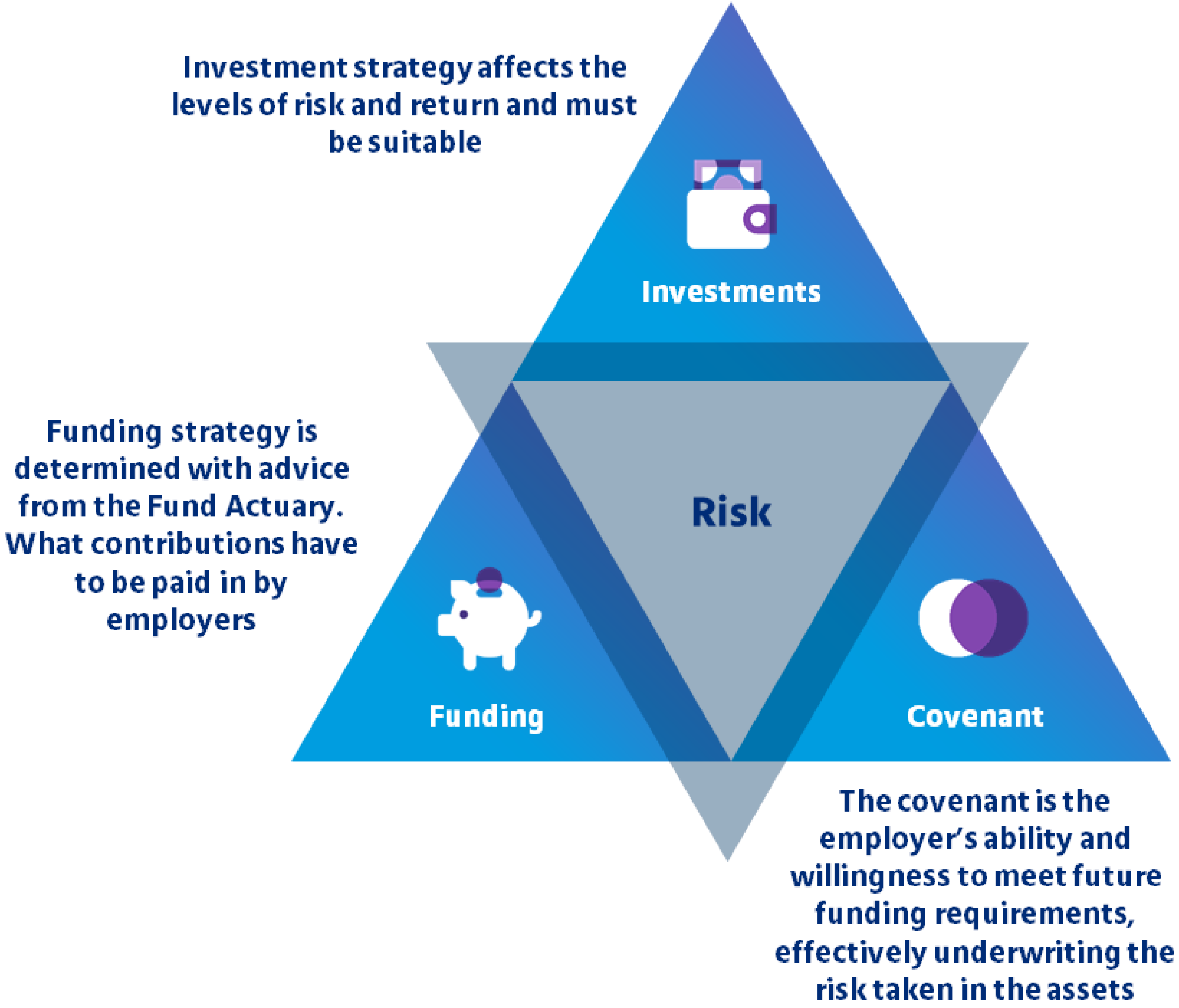
	Impact of allowing for the updated tables on life expectancies	
	Males	**Females**
Actives	Reduce by 0.5 years	Reduce by 0.2 years
Deferreds	Reduce by 0.4 years	Reduce by 0.1 years
Pensioners	Reduce by 0.4 years	Reduce by 0.2 years

As an example, for a male active member, the life expectancy would reduce from 89.1 years to 88.6 years.

The impact of moving to these tables would be to reduce past service liabilities by c1.6% and reduce the primary contribution rate by c0.3% of pay. However, the impact by employer would vary based on their own membership profile.

We would expect the updated tables and weightings to have a similar impact on termination liabilities.

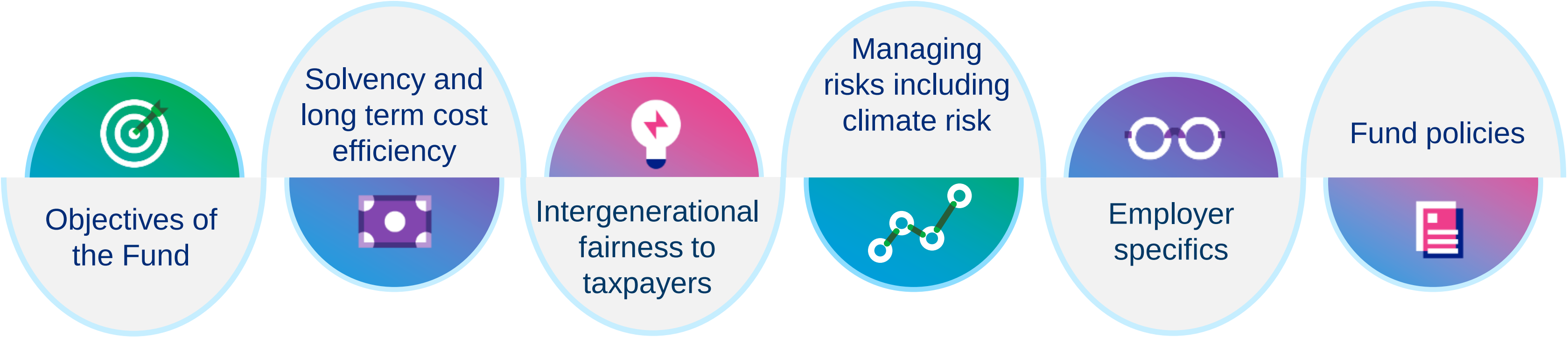
Key funding and risk strategy considerations
FSS – An integrated strategy not a snapshot…



THE FUNDING PLAN COMES DOWN TO MANAGING RISK IN THE SHORT AND LONG TERM

- Agree a plan to balance risk versus long term affordability
- What level of risk is acceptable?
- What is the ultimate objective?

Key funding and risk strategy considerations
FSS – Main Areas



Updated guidance on preparing a Funding Strategy Statement is being finalised and will be issued centrally prior to 2025 valuation exercise

- Back to basics
- Current financial and demographic outlook
- Key funding and risk strategy considerations
- **2024 interim funding review outcomes**
- Next steps and other considerations

2024 interim funding review outcomes
Key Parameters used

A summary of the interim review key parameters used are set out below (as per previous slides):

1. **Discount Rates – Past service discount rates** consistent with the current monitoring updates which was based on CPI+2.75% p.a. (equivalent to 5.25% p.a. at 31 August). This will be developed further over the coming months and will be factored into the funding strategy discussions for the 2025 valuation.

   This was considered for **future service** on a smoothed basis which was based on CPI+2% (equivalent to 4.5% p.a. at 31 August) also to aid in contribution stability and intergenerational equity.

   This is a key parameter which needs to be considered carefully in the context of **contribution sustainability**.

1. **UK Inflation / Pension increases –** We have maintained the same approach as at the 2022 valuation after considering market expectations and BoE data. This will be reviewed as part of the 2025 valuation based on the updated outlook and economic/fiscal outlook. The average inflation assumption at 31st August 2024 was 2.5% p.a.

2. **Life expectancy** – Allowance for latest trends to be incorporated based on CMI 2023 projection models. A full analysis based on the Fund's individual data and experience is being undertaken as part of the 2025 valuation.

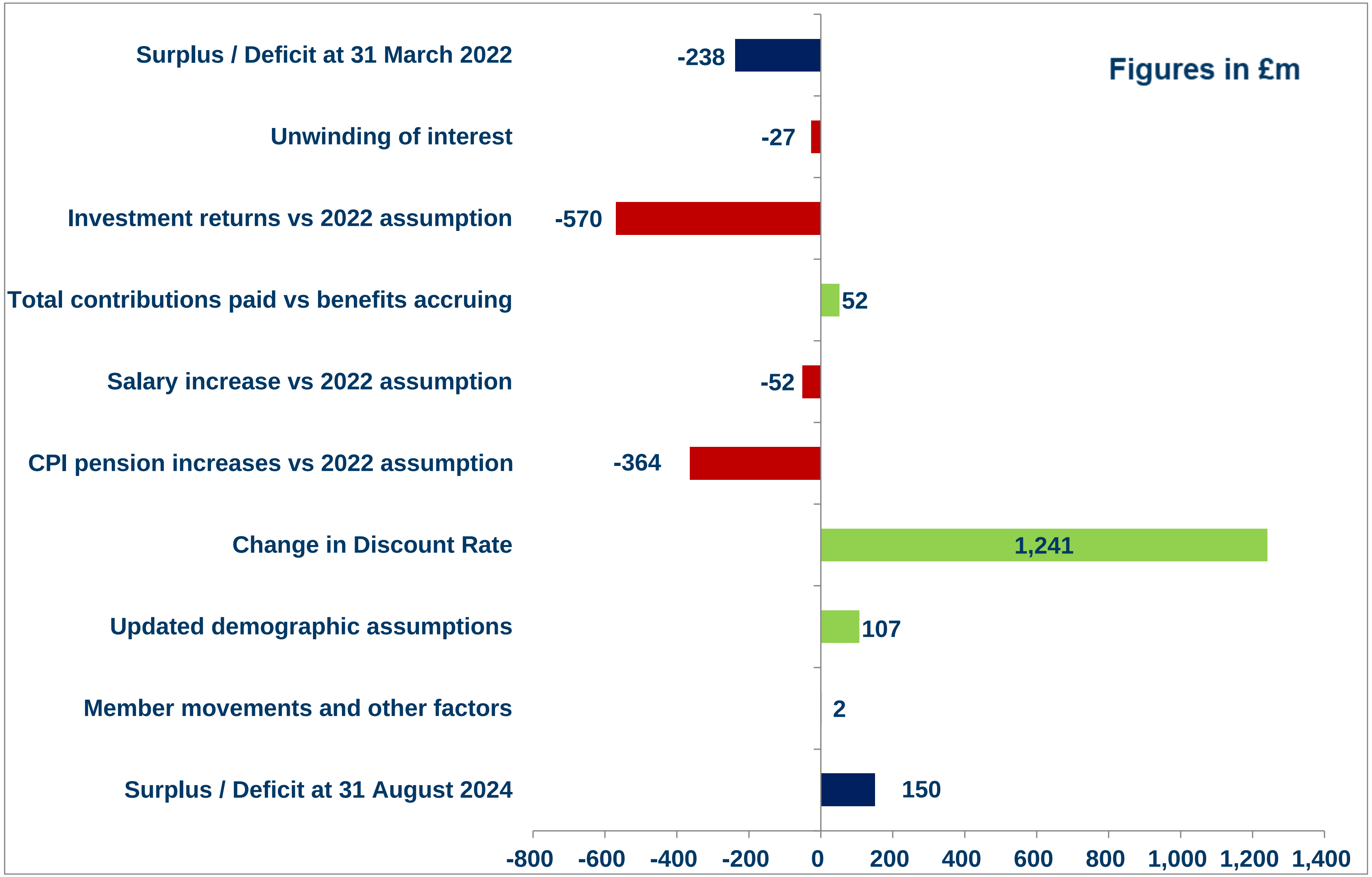
3. **Data used -** We have performed full calculations based on the data as at 31 March 2024 but rolled forward the results to 31 August 2024.

4. **Employers -** we have also shown estimated contribution outcomes for the major employers in this paper based on market conditions and returns to 31 August 2024 (estimated where appropriate). We have also shown the scenario, for the whole Fund, where surplus is retained and the resultant impact on contributions.

2024 interim funding review outcomes
Whole Fund update at 31 August 2024

	31 March 2022 Actuarial Valuation	31 August 2024		
		Updated Past Service Discount Rate only	Future Service Discount Rate Sensitivity	Retain Full Surplus
Past Service Discount Rate	CPI+1.50%	CPI+2.75%	CPI+2.75%	CPI+2.75%
Future Service Discount Rate	CPI+2.00%	CPI+2.00%	CPI+2.25%	CPI+2.25%
Assets (£m)	5,822	5,967	5,967	5,967
Liabilities (£m)	6,060	5,816	5,816	5,816
Surplus/(deficit) (£m)	(238)	150	150	150
Funding level	96%	103%	103%	103%
Recovery period	12 years	12 years	12 years	12 years
Projected 2024/25 Pensionable Pay (£m)	866	866	866	866
Deficit / (Surplus) contributions (% of pay)	2.7%	-1.6%	-1.6%	0.0%
Future Service Rate (% of pay)	18.6%	18.1%	16.7%	16.7%
Total Contribution Rate (% of pay)	21.3%	16.5%	15.1%	16.7%
Short Term Pay	Varies by employer	None		
Life expectancy assumptions	2022 valuation	Updated for latest trends		

2024 interim funding review outcomes
Whole Fund - Reconciliation of funding position



2024 interim funding review outcomes
Potential impact of investment market changes and return outlook

Currently we are estimating the Fund to be in surplus, however this can reverse quickly due to movements in investment markets as well as the impact of return and inflation outlook. We have illustrated two simplified scenarios below showing the impact of a one off 10% reduction in the value of growth assets and also a reduction in the expected return (above inflation) by 0.25% p.a.

Scenario	Funding Level	Future Service Rate (% of pay)
Illustrative Baseline – Updated discount rates	103%	16.7%
Scenario 1 – Growth Assets fall by 10%	98%	16.7%
Scenario 2 – Expected return (above inflation) falls by 0.25% p.a. due to unexpected interest rate fall	99%	18.1%

An increase in growth assets or increase in expected returns would have broadly the opposite effect.

2024 interim funding review outcomes
Factors affecting individual employer results

At the total Fund level you could expect the overall theoretical contribution requirements to reduce (the level will depend on the level of stability required). This pattern will be similar for most employers unless their profile is materially different and/or depending when they entered the Fund. For employers, variance will be seen versus the whole Fund as well as when comparing similar sub-groups of employers for the main reasons summarised below:

- The 2022 valuation funding position
- The liability maturity profile versus the whole Fund especially given the relatively large changes in discount rate (above inflation) from 2022.
- The impact of the life expectancy assumption change due to the liability profile (but not as much as the discount rate impact).
- The contributions that have been paid including if the employer prepaid any deficit and future service contributions
- Changes in membership profile since 2022 (e.g. leavers, new joiners, retirements etc)
- The pay growth that has been granted (versus assumptions) and the expected pay growth going forward

The most significant factors are usually the first four whereas the last two factors usually have a bigger impact on smaller employers.

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2025 Valuation Timeline

✖ Committee meetings

January/February 2025
- **Megan** / **Julia** to refine 2025 plan
- **Mercer** perform demographic assumptions review.

March 2025
- **Mercer** complete demographic analysis
- **Mercer** issue data requests to the Fund

April 2025
- **Fund** provide some initial (non-member) data to Mercer
- **Mercer** start drafting the updated FSS including policy considerations
- **Mercer** do preliminary funding results

May 2025
- **Mercer** to do discount rate analysis and deliver assumptions advice
- **Meetings** to discuss preliminary results, FSS and assumptions with the Fund, UAs and HE/FE
- **Fund** review the draft FSS and provide comments

June 2025
- Initial presentation to **Committee** on FSS principles
- **Fund** consider employer covenant
- **Dave** to provide 3 year cashflows
- **Julia** to provide Schedule 2 and other employer data

July 2025
- **Amanda** to provide valuation UDEs to Mercer early July
- **Mercer** to raise initial data queries once ready
- **FSS consultation** with employers

August 2025
- **Mercer** raise any further emerging data queries with **Amanda**
- **Mercer** process results for Whole Fund and Major Employers
- **FSS consultation** with employers closes

September 2025
- **Meeting** to discuss initial results with the Fund
- **Committee** presentation of initial results and draft FSS / policies and finalisation of FSS
- **Mercer** processes results for all remaining employers

October 2025
- **Mercer** complete data quality review
- **Mercer** collate Section 13 data for GAD
- **Mercer** provide employer results database including results schedules

November 2025
- **Employer meeting** to discuss initial results (if needed)
- **Investment forum** / other employer meetings
- **Julia** / **Amanda** to consider any bespoke employer / data issues emerging whilst going though employer results
- **Fund** issues employer results

December/January 2026
- **Fund** continues to engage with employers and raise any queries with Mercer
- **Fund** collates Employer responses
- **Mercer** to perform sweep up exercise for employers who joined since 31 March 2025

February/March 2026
- Employer contribution rates finalised
- **Mercer** to collate databases and combine into one final database of employer results
- **Fund** to consider self service options
- **Mercer** to finalise FSS and other policy documentation
- **Mercer** to prepare formal report documentation for review by the **Fund** and final sign off

Appendix

Key Nominal Financial Assumptions

Assumptions	31 March 2022	31 August 2024
Discount Rate	4.60% p.a. (past) 5.10% p.a. (future)	5.25% p.a. (past) 4.75% p.a. (future)*
Long Term Salary Growth	4.60% p.a.	4.00% p.a.
Pension Increases	3.10% p.a.	2.50% p.a.

*assuming CPI+2.25% p.a.

Whole Fund Results
Membership Data

	31 March 2022	31 March 2024
Active members		
Number	38,803	40,352
Total Pensionable Salaries (£000s p.a.)	724,413	865,930
Average Pensionable Salary (£ p.a.)	18,669	21,459
Average age (weighted by pension)	50.8	50.9
Deferred pensioners (including undecideds)		
Number	53,321	58,770
Total revalued deferred pensions (£000s p.a.)	72,574	91,551
Average deferred pension (£ p.a.)	1,361	1,558
Average age (weighted by pension)	50.3	50.4
Current Pensioners and Dependants		
Number	36,844	39,561
Total pensions payable (£000s p.a.)	169,795	206,109
Average Pension	4,608	5,210
Average age (weighted by pension)	72.5	72.9

Important notices

- We have prepared this report for the Administering Authority for the purpose of assisting the Fund with planning ahead for the 2025 valuation of the Fund.
- This report, and the work done in its preparation, is compliant with Technical Actuarial Standard 100 General Actuarial Standards (TAS 100 v2) and Technical Actuarial Standard 300 Pensions (TAS 300 v2), which are issued by the Financial Reporting Council.
- This report should be read in conjunction with our report on the actuarial valuation of the Fund as at 31 March 2022.
- Unless otherwise stated, we have relied on cashflow information, investment returns, draft accounts and 2024 member data provided by the Fund plus other data supplied to us in preparing the report, without independent verification. We will not be responsible for any inaccuracy in the advice that is a result of any incorrect information provided to us.
- Mercer does not accept any liability or responsibility to any third party in respect of this report.
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- We are not lawyers, tax specialists or accountants. We are unable to give legal/tax/accountancy advice. If you think such advice is appropriate, you are responsible for obtaining your own professional advice.
- This summary report is correct at December 2024. It will not be updated unless requested.

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