Division(s): N/A

PENSION FUND COMMITTEE – 11 MARCH 2016

PENSION LIABILITIES AND CASH FLOW MONITORING

Report by Chief Financial Officer

Introduction

1. The key objectives set out for the Pension Fund in both the Statement of Investment Principles and the Funding Strategy Statement are to ensure sufficient liquid resources are available to pay all pension fund liabilities as they fall due, whilst maintaining a stable and reasonable cost to all scheme employers.

2. This objective has in the past largely been met through a focus on the tri-ennial valuation and the fundamental asset allocation which have looked at meeting the long term aspects of the overall objective. There has been little focus on the short-term aspects of this objective, as the Fund as a whole has maintained a strongly cash positive position such that the contributions collected from employers and employees have comfortably exceeded the pensions in payment. The net excess of contributions has been added to the invested assets.

3. In common with many LGPS Funds across the Country, the cashflow position of the Oxfordshire Fund has become increasingly less positive over the past few years. A net inflow from contributions of £26m in 2010/11 was halved by last year, and the latest forecasts for the current financial year suggest a net inflow of just £8m.

4. Over the next year, the Oxfordshire Fund will need to consider the future cash flow projections alongside the work on the 2016 Valuation and the subsequent fundamental asset allocation review, and the development of the new sub-funds within the new pooled investment arrangements.

Current Cash Flow Projections

5. For the 2015/16 financial year, the projected cash flows from dealing with scheme members are as follows based on the first 9 months of the year:

	£000
Employer Contributions	67,374
Employee Contributions	20,290
Employer Contributions to Early Retirements	1,794
Transfers from Other Funds	4,214
Total Contributions	**93,672**
Pension Benefits	81,087
Transfers to Other Funds	4,394
Refunds	128
Total Payments	**85,609**
Net Cash Flow	**8,063**

6. Barnett Waddingham, the Fund Actuary has produced a funding model which provides forecast cash flow projections based on the results of the 2013 Valuation. The model predicted a cash flow position for 2015/16 of £8.77m and is therefore broadly in line with the latest forecasts.

7. The Barnett Waddingham model predicts cash flow for future years, allowing the user to amend the main assumptions. Keeping to the same assumptions used under the 2013 Valuation the model predicts a further reduction of £1m in net cash flow by the end of 2016/17. This reflects an increasing number of pension benefits in payment, as more reach retirement age whilst the death rate of existing pensioners reduces, and a stable or reducing workforce.

8. Reality though is likely to see a number of variations to the 2013 Valuation assumptions, particularly in light of the further reductions in public sector expenditure. Each 1% reduction in the assumed workforce would see a £1.1m reduction in the contributions receivable in 2016/17, and if these also resulted in further redundancies and early retirements, we would also see further increases in the pensions in payment.

9. Outsourcings where the new employer is admitted under a closed admission agreement where LGPS is only available to transferring staff and not subsequent replacements will also cause further reductions in contributions receivable over the medium to longer term. The scale of such proposals is currently unclear.

10. On the basis of the current information, the Oxfordshire Fund is likely to remain cash positive in 2016/17. The Barnett Waddingham model indicates the Fund will see a further fall of £3.6m in net cash flow in 2017/18, though this will be subject to the final results of the 2016 valuation and key decisions taken by the large employers within the Fund. There is therefore a real risk that cashflow will become negative in 2017/18 or soon after.

Implications of Negative Cash Flow

11. Once the Fund becomes cash negative, the Fund will need to change its current investment strategy. This does not necessarily mean an amendment to the current asset allocations, but it will require a certain level of investment income to be returned centrally to be used to meet pension liabilities rather than being re-invested by the Fund Managers. Currently the Fund is achieving annual investment income of around £25m, most of which is being re-invested by the Fund Managers (main exception is income from private equity).

12. A key element of the next stage of the work on developing our approach to investment pooling will therefore be to identify investment opportunities that will return income to the Fund, on a predictable and reliable basis. At the same time, all Funds will continue to need to identify investment opportunities that will enable the current scheme deficits to be closed over the longer term. Simply switching from the current growth assets to more defensive income generating assets carries the risk of a significant shortfall in deficit recovery and therefore significant increases in employer contributions.

13. This in turn will impact on the Valuation results and lead to a potential increase in employer contribution rates. This of course whilst initially improving cash flow again for the Pension Fund, increases the financial pressure on scheme employers, leading to further reductions in scheme membership.

14. The modelling of potential cash flow therefore cannot be seen as a straight forward task. This though does not mean that work should not continue with Barnett Waddingham to develop the current model, allowing greater flexibility to the scenarios to be tested.

15. Alongside this, work needs to be undertaken with each of the main employers to develop a better understanding of their future service levels and delivery models, to develop a better prediction of future contribution levels.

RECOMMENDATION

16. **The Committee is RECOMMENDED to:**

(a) note the current position;
(b) ask the Officers to continue to work with Barnett Waddingham and with all main scheme employers to develop a better understanding of the likely pattern of employer contributions in the forthcoming years and the potential cash flow models;, and
(c) ask the Independent Financial Adviser and Officers to bring a future paper on the alternative investment models that will deliver the new cash flow requirements of the Fund whilst as far as possible maintaining stable and affordable employer contribution levels.

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