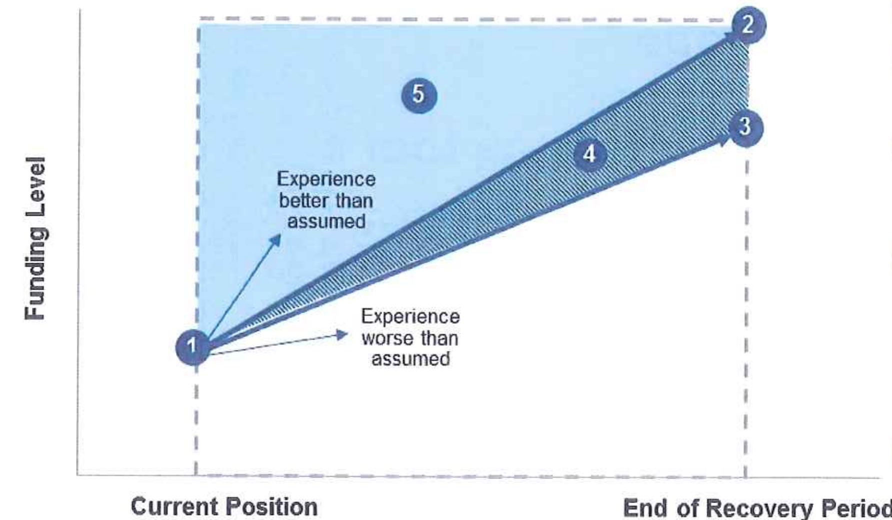
# DEFICIT AND RISK MANAGEMENT FOR THE FUND
# WHAT IS IN THE TOOLKIT?

## What can we use to control contributions and risk?

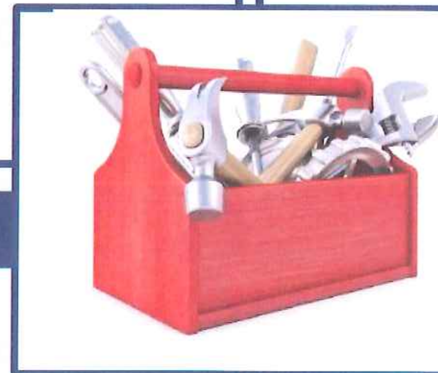
- **Adjusting assumptions, deficit recovery period, phasing etc.**
- **Maximising employer input when affordable**
- **Bespoke liability management e.g. trivial commutation**
- **Maximising returns and efficient reduction of risk – balance of risk hedging vs return seeking strategy**
- **Control deficit & contribution outcomes – Whole Fund and by employer/employer group**

## Put a plan in place and be opportunistic



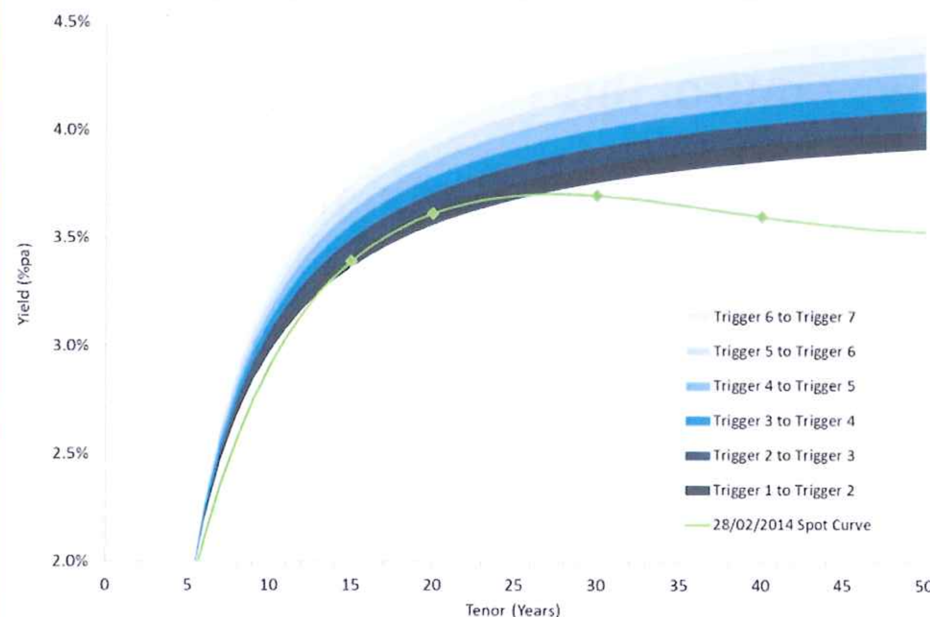

1. Current funding level
2. Potential Target – 100% funded on termination basis?
3. Valuation Target – 100% funded on Valuation basis.
4. Gap can potentially be made up by difference between 'prudent' Valuation assumptions and 'best estimate' returns. Reduce risk or maintain contributions?
5. Zone for reducing risk (and contributions?)

The approach can be applied at a Fund level or for individual employers



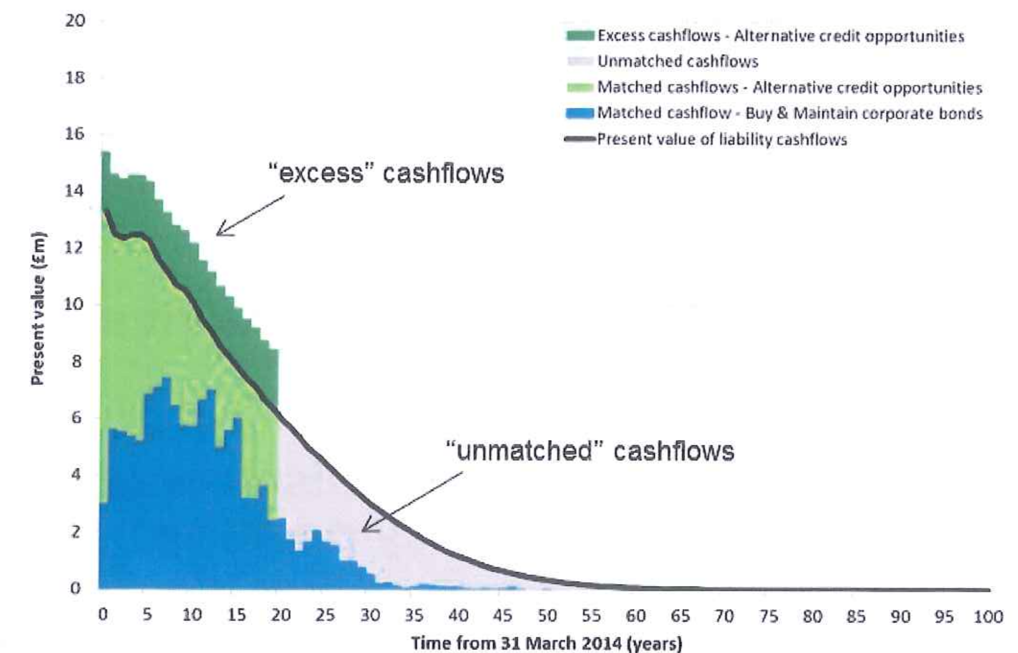
## More "efficient" liability matching

### Example LGPS interest rate triggers




- ✓ Take a long term view
- ✓ Have a plan
- ✓ Capture gains as they happen
- ✓ Be more opportunistic
- ✓ More stable deficit and contributions as a result

## Cashflow matching – very stable target contributions




Discount Rate mainly driven by asset income yield

# FUNDING APPROACH
# HOW DO WE DECIDE?

## BACK TO BASICS

- Approach determines pace of funding and long term target asset coverage
- Valuation is a critical governance tool
- Investment and risk management strategy must *drive* funding approach
- Integrated approach: investment, funding & covenant
- No funding philosophy/approach is correct just different!

## OBJECTIVES DRIVEN

- Changing sector size and service delivery models
- LA budget size and tolerance to cost volatility
- Investment strategy now vs. longer term target strategy?
- Best estimate vs. prudence
- Transparency, decision making and practicality
- Solvency (deficit) vs affordability (contributions)?

## DIFFERENT APPROACHES

- Gilts+ vs Inflation+ vs Economic models
- Main difference is in discount rate/expected return derivation and level of prudence
- Differing levels of subjectivity in derivation of expected return
- *All* LGPS actuarial firms stabilise contributions but some also smooth solvency position
- Does the approach support good decision making?

## 2016 OUTCOMES & APPROACH – KEY QUESTIONS

- Can employers tolerate volatility in funding?
- If not, how do we control this?
- What is the philosophy on risk hedging?
- Reduce level of prudence?
- How do we deal with diversity of employers and different maturity/covenant profiles?
- The funding approach and assumptions should be the Governance "wrapper" around these issues