Church Workers Pension Fund (CWPF)

Actuarial valuation at 31 December 2019

Valuation update

THE CHURCH OF ENGLAND PENSIONS BOARD

Introduction

Many of you will know we are required by legislation to run a full and independent check on the financial health of the Defined Benefit Section (DBS) of CWPF every 3 years, called a valuation.

The next valuation is due as at 31 December 2019 and work is already underway. With the help of our actuarial advisers, LCP, we have put together this note to give you an early indication of the process and key considerations.

The valuation helps us identify two key figures for each employer;

1. Whether they have a deficit
2. The contributions required to fund future pensions being earned

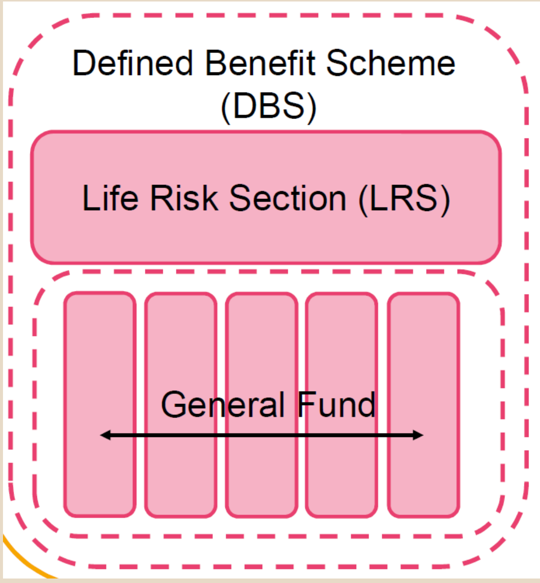
This is the first of a series of communications to keep you informed as we move through the process during 2020 and into 2021.

Peter Dickinson
Pensions Manager
On behalf of the Church of England Pensions Board
March 2020

Section 1
Reminder of how CWPF works

The Defined Benefit Scheme is split into two key sections:

1. General Fund – this is made up of all the individual employer sections, and,
2. Life Risk Section – this is a pooled section which pays pensions to retired members and death benefits when members die.



The valuation looks at both sections to see if we have enough money (assets) to cover the expected cost of providing everyone's pension when it is due (liabilities).

Life Risk Section (LRS)

The first step of the valuation is to calculate the funding position of the LRS. At the point a member retires, we transfer assets from the employer's section (held in the General Fund) into the LRS to cover the expected cost of paying the pension and associated death benefits.

The amount we transfer might not always be enough. We do not know how long pensioners are going to live, how much their pension will increase with inflation each year or how the LRS's assets will perform. Because of this, the LRS sometimes falls into deficit. If this happens we transfer assets from employer's General Funds to cover this via a levy. The levy is proportional to the original pensioner liability of each employer, but ignores the actual mortality experience since retirement, since this is a risk shared by all employers.

General Fund

The General Fund is made up of 79 employers, and each employer is responsible for its own section. This covers current and former employees who have not yet retired. Once we have reviewed the LRS, we run a valuation for each employer section within the General Fund. This measures two things:

1. does each employer section have enough assets to cover the benefits already earned, so is there a surplus or deficit, and,
2. if the section still has members accruing benefits, what contribution rate is needed to cover this.

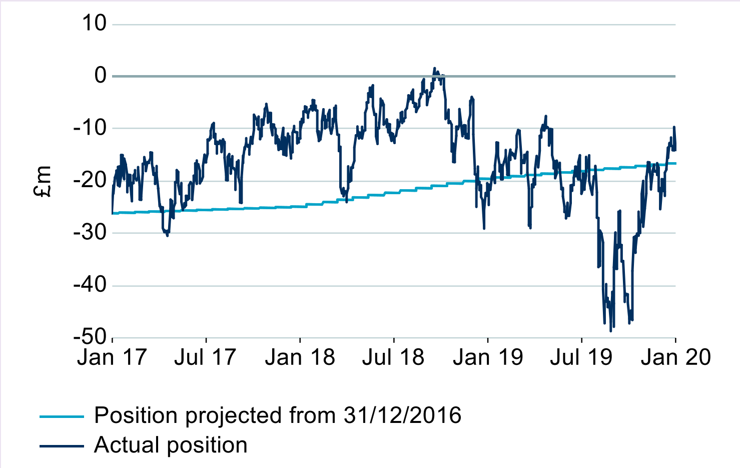
We then provide your individual employer results. If there is a deficit we will propose a "recovery period" – i.e. the length of time the deficit is paid over. We will use our assessment of your "covenant" as part of our considerations. We aim to set a standard recovery plan which we believe the majority of employers can afford, allowing those who wish to fund more quickly to do so. Being sensitive where affordability is constrained, we will talk to you about longer recovery plans and additional forms of funding support.

Both the deficit or surplus, and any ongoing contribution rate depend on the assumptions we set, which is what we look at in Section 2. Assumptions determine the "pace of funding" rather than the ultimate cost of the benefits.

Section 2
What has happened since the last valuation

Projected funding level since 31 December 2016

The last valuation at 31 December 2016 showed we had assets of £378.7m but liabilities of £404.9m, meaning an overall deficit of £26.2m. Another way of expressing this is as a percentage, called a “funding level”. In 2016 this was about 93.5%. This chart shows how the deficit is estimated to have moved since then until 31 December 2019, based on the assumptions we agreed during the last valuation. The dark blue line is the estimated position, allowing for investment and market experience since the last valuation and the light blue line is the expected position, had experience developed in line with expectations as at 31 December 2016.



At the end of 2019 the recovery plan was broadly on track, with an estimated funding position of over 96%. **Please DO NOT draw any conclusions from this.** This is still based on our assumptions in 2016 and a projection of the calculations from that time. We are in the process of performing calculations based on updated membership and asset information as at 31 December 2019, which is not reflected in the above estimate, so this figure will change based on actual experience over the three years. Additionally, there has been considerable volatility in investment markets since the end of the year, and it is still unclear to what extent this will have a bearing on the valuation.

We will also update our assumptions as we work through this valuation. This includes assumptions on:

- membership trends (how many members join, leave, retire and die),
- future salary increases,
- what long term inflation might be, and,
- what we allow for future prudent investment returns.

Updating these can have a material positive or negative affect on the deficit.

What does this mean for individual employer sections?

Some employer sections will be in surplus while others might be in deficit. The overall DBS deficit is the accumulation of all the individual employer sections. At this stage we do not know whether your section will be in surplus or deficit, but Section 3 sets out examples.

Section 2
What has happened since the last valuation

Investment returns and gilt yields since 2016

The funding level goes up and down depending on two key drivers, how our assets perform and how much the liabilities change.

Asset performance

Our assets are made up of contributions paid by members and employers, plus investment returns. Our assets have performed well, going from £378.7m in 2016 to £430.8m in 2019. A large part of this is investment returns.

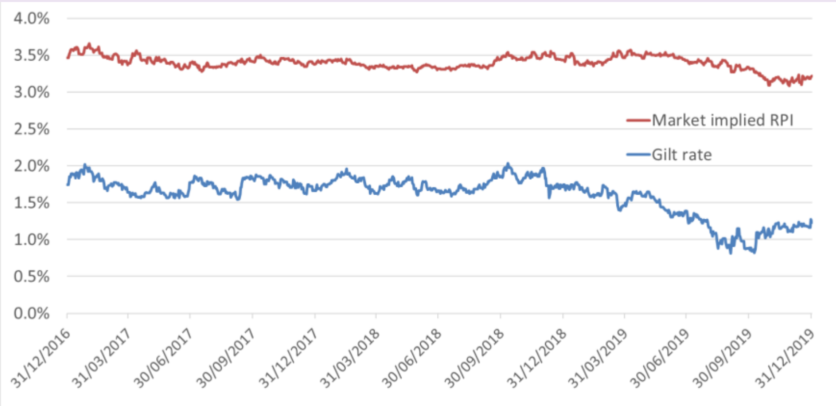
Anticipated future investment returns

Asset performance is one part, but the other vital driver is how our liabilities change. This is the amount we estimate we need now to pay all future benefits. This does not need to be the total expected cost of paying everyone's benefits as we can allow for some reliance on future investment returns. For example, if you know you will need £1,000 in 5 years' time, you can make an allowance for the future interest you may earn on your savings. This indicates how much you need to save today to reach your goal in 5 years.

When we set our liabilities, we use the same idea, but our reference point is long-term interest rates, or gilt yields. This is not because we invest all the assets in gilts, but it gives us a baseline for assessing how much investment risk we are taking. We then set a margin above gilts to reflect the level of investment risk we are comfortable with, allowing for the expected return on the assets we expect to hold in future and the ability of the sponsoring employers to support that level of risk (the covenant). This margin is not fixed but varies from valuation to valuation, depending on how market conditions have changed and our assessment of the covenant. When gilt yields fall however, it pushes our liabilities up.

This chart shows how gilt yields and market implied inflation have moved since 2016.

Since 2016, the liabilities have increased by around £40m, mainly as a result of falls in expected future returns on investments.



Section 2
What has happened since the last valuation

Mortality changes

The mortality assumption, or how long we expect members to live, is one of the important assumptions we need to make. It indicates how long we may need to pay their pension for. Since 2016 people are still living longer, but the rate of improvement in life expectancy has slowed, meaning we expect to pay members' pensions in the future for slightly less time than we did 3 years ago.

This would be expected to bring the liabilities down compared to previous projections.

Regulatory changes

When we go through the valuation, we are bound by regulations set by the Pensions Regulator (TPR). The Regulator's approach continues to evolve. TPR has recently indicated he will be take a "clearer, tougher, quicker" approach to regulation.

The Regulator's latest funding statement states: "Trustees should be agreeing a clear strategy for achieving their long-term goals, recognising how the balance between investment risk, contributions and covenant support may change over time, particularly as schemes become more mature and potentially better funded." This link between investment risk, contributions and covenant support is called Integrated Risk Management.

GMP equalisation

A recent UK High Court judgment made clear that pension schemes must address inequalities caused by guaranteed minimum pensions. This applies to some of the benefits from contracting out of the state second pensions scheme after 17 May 1990. This would be expected to increase the liabilities compared to previous valuations.

Section 3
Example changes in contributions

There are three types of contributions employers could pay:

- **future service contributions** – to meet the expected cost of members earning future benefits,
- **deficit contributions** – to make good any deficit in their employer section or the Life Risk section, and,
- **expenses** – to cover the expenses of administering the DBS.

Future service contributions

For employers who still have members earning benefits in the DBS, we expect the total contribution rate (employer plus employee) to increase. For example:

If an employer provided an accrual rate of 1/60ths and was previously paying around 40% pa of pensionable salaries, this might increase to [45% pa].

If an employer provided an accrual rate of 1/80ths and was previously paying around 30% pa, this might increase to [34% pa].

If the employer has switched to an accrual rate of 1/100ths and was paying 20%, the new rate might be [23% pa].

However, an additional key driver of changes in the future service contribution rate is experience among the membership of an employer's section. The rate is an average cost across all the members in an employer's section. For example, if the average age of members accruing benefits in the section has increased, we expect contribution rate to increase.

Deficit contributions are paid in addition where necessary.

Deficit contributions

Employers who are paying off their deficit from 2016 over 7 years or less are expected to be broadly on track. However, the timing of retirements can have a material effect because of the transfer of assets to the LRS.

The level of deficit contributions depends on the size of the deficit in the employer's section and the period over which the employer intends to make good this shortfall.

Employers who were in surplus at the last valuation may still be in surplus this time around.

Expenses

We do not expect to significantly increase contributions to cover the cost of administering the DBS.

Section 4
Valuation timeline

Here is our proposed timeline to work through the valuation. We have until 31 March 2021, but we will try to complete the valuation earlier if we can.

Valuation date	31 December 2019
Pensions Committee meeting *The Pensions Committee (a sub-group of the Pensions Board who look at specialised pension issues) will propose the initial assumptions and agree the preliminary results.*	1-2 April 2020
Employer workshops *We will explain the proposed assumptions and result for the DBS and give you the chance to ask us and LCP questions.* ***These sessions will cover DBS as a whole. We will not know your individual results at this stage.*** *We will welcome your early comments on the proposed assumptions at this stage.*	May 2020
Consultation period *We would like to get your formal views and thoughts on our preliminary assumptions and proposals.*	May and June 2020
Pensions Board meeting *The Pensions Board will review feedback from the employer workshops and formal responses to the consultation period, before agreeing the preliminary assumptions and results.*	June 2020
Individual valuation and covenant reports *The valuation report will set out your contribution rates and any deficit contributions based on the preliminary assumptions. We will also include Lincoln Pensions' covenant report, and your individual report (if applicable).*	July / August 2020

Further discussions (including further feedback on the assumptions) and work with you *We will discuss recovery plans with you, and any other actions or issues you want to raise about your section. We will also discuss any concerns you have about the assumptions when you have your individual results.*	August 2020 onwards
Update on progress so far *We will update you at the IDFF and with further communications on the themes coming out of the consultation and next steps.*	October 2020
Pensions Board meeting *We will agree the final assumptions and results but may request further work by the Scheme Actuary.*	December 2020
Final assumptions and results communicated with employers	February 2021
Regulatory deadline for valuation to be completed	**31 March 2021**
New future service and deficit contributions start	**1 April 2021**
Possibility to delay new future service and deficit contributions where budgets have already been agreed	**1 January 2022**

The information in this document

The information within this document is based on approximate calculations undertaken by Lane Clark & Peacock LLP ("LCP") as the actuaries appointed by the Church of England Pensions Board in their capacity as trustee of the Fund. This information is provided for the employers participating in the Fund. It is not intended to be sufficient by itself to assist with any action or decision or for any other possible use. LCP only accepts liability, in respect of this work, to the trustee of the Scheme. LCP accepts no liability to any employer or any other third party to whom this information has been provided (with or without LCP's consent).