

HEALTH WEALTH CAREER

SCHEME FUNDING REPORT OF THE ACTUARIAL VALUATION

UNIVERSITY OF READING EMPLOYEES' PENSION FUND

AS AT 31 JULY 2017

MAKE TOMORROW, TODAY



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1


INTRODUCTION

This report is addressed to the Trustees of the University of Reading Employees' Pension Fund ("the Fund") and is provided to meet the requirements of Section 224(2)(a) of the Pensions Act 2004. It describes the factors considered by the Trustees when carrying out the actuarial valuation as at 31 July 2017 and the decisions reached as a result.

The purpose of the actuarial valuation is for the Trustees to determine:

- The expected cost of providing the benefits built up by members at the valuation date (the "liabilities"), and compare this against the money held by the Fund (the "assets").
- An appropriate plan for making up the shortfall if the Fund has less assets than liabilities.
- The contributions needed to cover the cost of the benefits that active members will build up in the future and other costs incurred in running the Fund.

SIGNATURE



**DATE OF
SIGNING**

21 September 2018

**SCHEME
ACTUARY**

John Hemsley

QUALIFICATION

Fellow of the Institute and
Faculty of Actuaries

This report has been prepared in accordance with Technical Actuarial Standards TAS 100: Principles for Technical Actuarial Work and TAS 300: Pensions which are issued by the Financial Reporting Council. The calculations referred to in the report use methods and assumptions appropriate for reviewing the financial position of the Fund and determining a contribution rate for the future. Mercer does not accept liability to any third party in respect of this report; nor do we accept liability to the Trustees if the information provided in this report is used for any purpose other than that stated. The report may be disclosed to members and others who have a statutory right to see it. It may also be disclosed to any participating employer and, if the Trustees and Mercer consent, it may be disclosed to other third parties.

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KEY RESULTS OF THE SCHEME FUNDING ASSESSMENT

PAST SERVICE FUNDING POSITION

The table below compares the assets and liabilities of the Fund at 31 July 2017. Figures are also shown for the last valuation as at 31 July 2014 for comparison.

	£m 31 July 2017	£m 31 July 2014
Total assets	185.9	136.7
Liabilities:		
Active members	42.4	44.6
Deferred pensioners	43.4	27.7
Pensioners	83.9	68.8
Total liabilities	169.7	141.1
Past service surplus / (shortfall)	16.2	(4.4)
Funding level	110%	97%

The table shows that at 31 July 2017 there was a surplus of £16.2m. An alternative way of expressing the position is that the Fund's assets were sufficient to cover 110% of its liabilities – this percentage is known as the funding level.

At the previous valuation at 31 July 2014 there was a shortfall of £4.4m, equivalent to a funding level of 97%. The key reasons for the changes between the two valuations are considered in Section 3.

The liability value at 31 July 2017 shown in the table above is known as the Fund's "technical provisions". The technical provisions are calculated using assumptions that the Trustees have determined are appropriate based on the Trustees' assessment of the strength of the employer covenant, having consulted with the University over the approach.

Further details of the way in which the technical provisions are calculated are set out in Appendix A.

FUTURE SERVICE CONTRIBUTIONS

The valuation also looks at the cost of the benefits that will be built up over the year after the valuation date. A summary of the assumptions used is provided in Appendix A.

The table below gives a breakdown of the future service cost at 31 July 2017 and also shows the cost at 31 July 2014 for comparison. Active members pay contributions to the Fund as a condition of membership, at the rate of 6.25% of Pensionable Salary. These are therefore deducted from the future service rate to calculate the University's future service contribution rate.

	% OF PENSIONABLE SALARIES	
	31 July 2017	31 July 2014
Cost of pension benefits	37.85	30.05
Less members' contributions	(6.25)	(6.25)
University future service contribution rate	31.60	23.80

The Trustees and the University have agreed that the University will continue paying future service contributions at the existing rate of 23.8% of total Pensionable Salaries, together with an additional payment of £500,000 per annum for the 3 years commencing 1 November 2018. These contributions cover the cost of future service benefit accrual over the period to the next actuarial valuation.

For members who participate in Pensions+ the member does not pay any contributions and the University pays 6.25% of Pensionable Salaries in addition to the contributions of 23.8% referred to above i.e. 30.05% of Pensionable Salaries in total.

The contributions exclude PPF levies (which are paid for directly by the University) and the expenses of administering the Fund, in respect of which the University pays an additional £600,000 per annum into the Fund. This includes allowance for life assurance premiums paid from the Fund.

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EXPERIENCE SINCE LAST VALUATION

SUMMARY OF KEY INTER-VALUATION EXPERIENCE

The last actuarial valuation was carried out with an effective date of 31 July 2014. Since the last valuation, no significant Fund events or changes to benefits have occurred.

The average CARE revaluation over the inter-valuation period was 0.7% per annum compared with 2.5% per annum assumed at the time of the last actuarial valuation.

Pensions in payment (in excess of Guaranteed Minimum Pensions (GMPs)) were increased as guaranteed under the Fund as follows:

DATE	Pension earned before 1 August 2011 (i.e. RPI max 6% p.a.)	Pension earned after 31 July 2011 (i.e. CPI max 5% p.a.)
1 April 2015	2.3%	1.2%
1 April 2016	0.8%	0.0%
1 April 2017	2.0%	1.0%

During the inter-valuation period, the investment return on the Fund's assets has been approximately 11.5% per annum.

The table summarises the contributions paid over the inter-valuation period. These figures are taken from the audited accounts and are in line with the rates agreed at the last actuarial valuation.

DATE	UNIVERSITY CONTRIBUTIONS (£000)	MEMBER CONTRIBUTIONS (£000)
1 August 2014 to 31 July 2015	5,405	38
1 August 2015 to 31 July 2016	5,103	29
1 August 2016 to 31 July 2017	4,682	19

REASONS FOR THE CHANGE IN FUNDING POSITION SINCE THE LAST ACTUARIAL VALUATION

The shortfall at the last valuation date was £4.4m. The table below sets out the main reasons for the change in the financial position of the Fund between 31 July 2014 and 31 July 2017.

	£m
Shortfall at 31 July 2014	(4.4)
Interest on shortfall	(0.6)
Assumed investment out-performance included in recovery plan (additional 0.6% p.a.)	2.5
Investment returns higher than assumed	28.5
University contributions in excess of cost of benefits accrued and expenses paid	6.8
Inflation experience (CARE revaluation / deferred revaluation / pension increases) lower than assumed	7.2
Changes in market conditions / financial assumptions	(34.1)
Changes in demographic assumptions	7.7
Miscellaneous / membership experience	2.6
Surplus at 31 July 2017	16.2

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PROJECTED FUTURE FUNDING LEVEL AND VOLATILITY

PROJECTED FUNDING POSITION AT NEXT ACTUARIAL VALUATION

The next actuarial valuation will take place with an effective date no later than 31 July 2020. If experience up to that date is in line with the assumptions made for this current actuarial valuation and contributions are paid at the agreed rates or amounts, the funding level at 31 July 2020 would be around 110%.

MATERIAL RISKS FACED BY THE FUND

The Fund is subject to some potentially material risks that are, to an extent, outside the Trustees' control, but could affect the funding level. Any material worsening of the funding level will mean more contributions are needed (either at an increased rate or at the same rate over a longer period) to be able to provide the benefits built up in the Fund – unless experience acts in other ways to improve the funding level. Examples of such risks, and how the Trustees manage them, are:

- If the University becomes unable to pay contributions or to make good deficits in the future, the Fund's assets will be lower than expected and the funding level will be worse than expected. The Trustees regularly monitor the financial strength of the University.
- If future investment returns on assets are lower than assumed in the valuation, the Fund's assets will be lower and the funding level worse, than expected. The Trustees have a process in place to monitor investment performance quarterly, and they review the Fund's investment strategy alongside each actuarial valuation. In order to mitigate the risk, the investment strategy takes the make-up of the Fund's membership and the cashflow profile of the future benefit payments into account which reduces the effect of market movements on funding levels.
- If gilt yields change such that the liability values increase by more (or decrease by less) than the assets, the funding level against the technical provisions and on the wind-up basis (see section 5) will be worse than expected. In order to mitigate the risk a proportion of the Fund's assets is invested in gilts.
- If improvements in life expectancy are greater than assumed, the cost of benefits will increase because members are living longer than expected. This will mean the funding level will be worse than expected. The Trustees ensure that the assumptions they make about members' life expectancy take the make-up of the Fund's membership and the most recent information available about UK population life expectancies into account.

- If members make decisions about their options, which increase the Fund's liabilities, the funding level will be worse than expected. An example would be if less than 70% of members commute the maximum allowable pension for cash, as is being assumed. The Trustees review the underlying assumptions at each valuation to ensure that their treatment of member options remains appropriate.

SENSITIVITY OF FUNDING POSITION TO CHANGES IN KEY ASSUMPTIONS

The value placed on the Fund's liabilities is critically dependent on the assumptions used to carry out the calculations. If future experience differs from the assumptions the Trustees have agreed with the University, then the projected future funding level will be different from the level described above.

To illustrate how sensitive the funding level is to experience being different from assumed, the table below shows how the valuation results at 31 July 2017 would have differed given small changes in the key assumptions.

DATE	CHANGE IN LIABILITIES AT 31 JULY 2017 (£M)
Technical provisions	169.7
Pre-retirement investment return is 0.25% lower than assumed	+2.0
Post-retirement investment return is 0.25% lower than assumed	+5.7
Long-term inflation is 0.25% higher than assumed	+6.1
Members live longer than assumed – one year change to baseline table age rating	+6.6

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WIND-UP POSITION

If the University were to become insolvent or decide not to support the Fund, the Trustees could decide to wind up the Fund and secure the benefits built up with an insurance company. Insurance companies use different assumptions to the Trustees' technical provisions when calculating the value of the Fund's liabilities and the price they would charge to provide the benefits.

The table below shows an estimate of the funding level of the Fund at 31 July 2017 assuming all benefits were bought out with an insurer. The wind-up position at 31 July 2014 is also shown for comparison. The wind-up position is shown for information only, and does not mean that the Trustees or University are considering winding up the Fund.

	£m 31 July 2017	£m 31 July 2014
Total assets	185.9	136.7
Liabilities:		
Active members	69.8	64.2
Deferred pensioners	78.5	44.6
Pensioners	91.0	71.4
Expenses	5.9	5.4
Total liabilities	245.2	185.6
Past service surplus / (shortfall)	(59.3)	(48.9)
Funding level	76%	74%

As the table shows, the Fund would have had shortfall of £59.3m if it had been wound up at 31 July 2017. This means that, on average, members could expect to receive around 76% of the benefits earned to date (although the percentage coverage would differ between members depending on age and when their benefit was earned).

In practice, if the Fund was wound up due to the University becoming insolvent, the members may be eligible for compensation from the Pension Protection Fund (PPF) if the Fund's assets were less than needed to buy that compensation from an insurance company. If this was the case, members could receive a higher proportion of the benefits they have earned to date. Further details of the compensation payable from the PPF are set out in the Section 179 valuation report dated 26 March 2018.

If experience is in line with the assumptions underpinning the technical provisions, and contributions are paid at the agreed rates or amounts, the funding level at 31 July 2020 on a wind-up basis would be around 78%.

APPENDICES



A

ASSUMPTIONS

HOW THE BENEFITS ARE VALUED

In order to calculate the liabilities, the Trustees need to make assumptions about various factors that affect the cost of the benefits provided by the Fund – for example, how long members will live or the future level of inflation. The table below explains the key assumptions being made in the valuation.

ASSUMPTION	WHY IT IS IMPORTANT AND HOW IT IMPACTS ON THE LIABILITIES
Discount rate	<p>The majority of benefits in a pension scheme are paid many years in the future. In the period before the benefits are paid, the Trustees invest the money held by the Fund with the aim of achieving a return on those funds. When calculating how much money is needed now to make these benefit payments, it is appropriate to make allowance for the investment return that is expected to be earned on these funds. This is known as “discounting”.</p> <p>The higher the investment return achieved, the less money needs to be set aside now to pay for benefits. The calculation reflects this by placing a lower value on the liabilities if the “discount rate” is higher.</p> <p>The Trustees’ investment policy is to invest the funds held in respect of retired members in lower risk assets (which therefore have a lower expected return) than those held for members who are still some way from retirement. Therefore, the discount rate assumption is split into pre and post-retirement rates (with pre-retirement being higher).</p>
Inflation	<p>Pensions in payment typically increase in line with either RPI or CPI price inflation, subject to a cap. Deferred pension revaluation and CARE revaluation on active members’ accrued benefits are also normally linked to price inflation. A higher inflation assumption will, all other things being equal, lead to a higher value being placed on the liabilities.</p>
Life expectancy	<p>Pensions are paid while the member (and potentially their spouse or partner) is alive. The longer people live, the greater is the cost of providing a pension. Allowing for longer life expectancy therefore increases the liabilities.</p>

The liabilities of the Fund are calculated by projecting forward all of the future benefit cash flows and discounting them back to the effective date of the valuation, using these assumptions. For example, the liability for a single pensioner is calculated by estimating the amount of each pension payment they will receive in the future, multiplying by the probability that the member will still be alive by the date of each payment, and then discounting each payment back to the effective date of the valuation; and then summing up all of these discounted amounts. The liabilities for the whole Fund are calculated by summing the liabilities for each of the individual members.

FUNDING OBJECTIVE AND INVESTMENT STRATEGY

The assumptions for the technical provisions have been selected by the Trustees to reflect their funding objective, after consulting with the University. The Trustees' stated funding objective (which has also been consulted on with the University) is to maintain a position where the assets are sufficient to fully cover the technical provisions. Further details are available in the Fund's Statement of Funding Principles dated 21 September 2018.

In addition, as part of their process for choosing the assumptions and determining the size of the margins to include, the Trustees have taken into account their objective assessment of the University's covenant and the level of risk present in the investment strategy of the Fund. The Trustees' investment strategy as at the valuation date is set out in Appendix C.

ASSUMPTIONS USED TO CALCULATE TECHNICAL PROVISIONS

The tables below summarise the key assumptions used in the calculation of the technical provisions and those used for the 31 July 2014 actuarial valuation.

FINANCIAL ASSUMPTIONS	31 July 2017	31 July 2014
Discount rate:		
Pre-retirement	3.75% p.a.	5.30% p.a.
Post-retirement	2.25% p.a.	3.60% p.a.
Price inflation (RPI) (pre/post retirement)	3.15% p.a. / 3.35% p.a.	3.30% p.a.
Price inflation (CPI) (pre/post retirement)	2.35% p.a. / 2.55% p.a.	2.50% p.a.
Salary increases	4.15% p.a.	4.30% p.a.
CARE revaluation	2.30% p.a.	2.50% p.a.
Deferred revaluation	2.35% p.a.	2.50% p.a.
Pension increases in payment:		
Pension accrued post-2011 (CPI up to 5% p.a.)	2.45% p.a.	2.50% p.a.
Pension accrued pre-2011 (RPI up to 6% p.a.)	3.25% p.a.	3.30% p.a.
Post 88 GMP (CPI up to 3% p.a.)	2.00% p.a.	2.50% p.a.

DEMOGRAPHIC ASSUMPTIONS	31 July 2017	31 July 2014
Retirement	For members who were in service at 1 April 1988 (or female entrants between 1 April and 30 October 1988 who elected a pension age of 60), it is assumed that 50% of in-service male members, 100% of in-service female members and 100% of deferred pensioners retire at age 60 with an unreduced pension. Female deferred pensioners who left before 1 April 1988 are also assumed to retire at age 60. The remaining in-service members and deferred pensioners are assumed to retire at age 65.	
Mortality – base table	S2PA year of birth	S2NA year of birth
Mortality – future improvements:	In line with CMI 2017 projection model allowing for a 1.75% p.a. long term improvement trend	In line with CMI 2013 projection model allowing for a 1.5% p.a. long term improvement trend
Commutation	70% of members take maximum allowed cash using commutation factors effective from 1 August 2018 (17.5:1 at age 65 for pre 1 August 2011 pension and 16.0:1 for post 31 July 2011 pension)	70% of members take maximum allowed cash using current commutation factors (16.4:1 at age 65 for pre 1 August 2011 pension and 15.2:1 for post 31 July 2011 pension)

Proportion married	100% of 2011 Census Married or Cohabiting table for males 120% of 2011 Census Married or Cohabiting table for females	An age-related table with 90% of members assumed to be married at age 65
Spouse's age	Females 3 years younger than male partners	Females 3 years younger than male partners

The mortality assumptions used for the 31 July 2017 valuation result in the following life expectancies. This information may be useful to the Trustees when completing the annual scheme return.

	COHORT	PERIOD
Life expectancy for a male aged 65 now	87.2	85.7
Life expectancy at 65 for a male aged 45 now	89.2	n/a
Life expectancy for a female aged 65 now	89.1	87.4
Life expectancy at 65 for a female aged 45 now	91.3	n/a

In setting the assumptions, the Trustees have assumed that the Fund is ongoing (it is not in the process of being wound up).

ASSUMPTIONS USED TO CALCULATE FUTURE SERVICE COST

The assumptions used to calculate the cost of future benefit accrual are the same as those used to calculate the technical provisions except that the pre-retirement discount rate is 1% p.a. higher (i.e. 4.75% p.a.).

ASSUMPTIONS USED TO CALCULATE THE WIND-UP POSITION

The wind-up position looks at the Fund's funding on the assumption that it had been discontinued on the valuation date and the benefits bought out with an insurance company. In doing this, it is assumed that no further benefits accrue, no further contributions are paid and active members are entitled to benefits on the basis they had left service on the valuation date. There is no allowance for any discretionary benefits being paid in the future.

The wind-up position has been estimated using Mercer's experience of recent buyout quotations and our understanding of the factors affecting this market. Detailed analysis of the reserves that would need to be held by an insurance company has not been carried out. Consideration has been given to the market terms for the financial instruments in which insurance companies would be expected to invest. An approximate allowance has been made for the reserves an insurance company would maintain to cover the risks involved and the statutory reserving requirements. The results are, therefore, only a guide to the wind-up position and should not be taken as a quotation. Market changes, both in interest rates and in supply and demand for buyout business, mean that if a buyout ultimately proceeds, actual quotations may differ.

The wind-up funding level is only an estimate since it is not based on an actual quotation. The true position could only be established by completing a buyout.

The tables below set out the assumptions used to assess the funding level in the event of the Fund being wound up. The assumptions used at 31 July 2014 are also shown for comparison.

FINANCIAL ASSUMPTIONS	31 July 2017		31 July 2014	
Discount rate:	Non-pensioners	Pensioners	Non-pensioners	Pensioners
Pre-retirement (under 15 years to retirement)	1.30% p.a.	n/a	3.40% p.a.	n/a
Pre-retirement (15 years or more to retirement)	1.30% p.a.	n/a	2.90% p.a.	n/a
Post retirement	1.70% p.a.	1.90% p.a.	3.30% p.a.	3.20% p.a.
Deferred revaluation (pension accrued pre 2009)	3.10% p.a.	n/a	3.20% p.a.	n/a
Deferred revaluation (pension accrued post 2009)	2.50% p.a.	n/a	2.50% p.a.	n/a
Pension increases:				
RPI up to 6% p.a.	3.90% p.a.	3.50% p.a.	3.70% p.a.	3.20% p.a.
CPI up to 5% p.a.	3.40% p.a.	3.00% p.a.	3.50% p.a.	3.00% p.a.
CPI up to 3% p.a.	2.50% p.a.	2.40% p.a.	2.40% p.a.	2.30% p.a.
Expense allowance	In line with PPF expense allowance		In line with PPF expense allowance	

DEMOGRAPHIC ASSUMPTIONS	31 July 2017	31 July 2014
Retirement	Members in service at 1 April 1988 are assumed to retire at age 60 and female deferred members who left prior to 1 April 1988 are assumed to retire at 60. All other members are assumed to retire at 65.	
Mortality – base table	S2PA year of birth table with no adjustment.	S2PA year of birth table with no adjustment.
Mortality – future improvements:	CMI 2016 projections with an improvement trend of 2.0% p.a. and 1.5% p.a. for males and females respectively	CMI 2013 projections with an improvement trend of 2.0% p.a. and 1.5% p.a. for males and females respectively
Commutation	None assumed	None assumed
Proportion married	100% of 2011 Census Married or Cohabiting table for males 120% of 2011 Census Married or Cohabiting table for females	An age-related table with 90% of members assumed to be married at age 65
Spouse's age	Females 3 years younger than male partners	Females 3 years younger than male partners

As the Trustees' current investment strategy includes investment in different assets than would typically be held by an insurer, the wind-up position on a given date may be significantly different from the position estimated at the valuation date.

B

SUMMARY MEMBERSHIP DATA

The membership data is summarised in the table below with figures at the previous valuation shown for comparison.

Data in relation to members of the Fund were supplied by the Trustees, via the Fund's administrator (Barnett Waddingham). The accuracy of the data provided has been relied on. While reasonableness checks on the data have been carried out, they do not guarantee the completeness or the accuracy of the data. Consequently Mercer does not accept any liability in respect of its advice where it has relied on data that is incomplete or inaccurate.

	31 July 2017	31 July 2014
Active members		
Number	311	522
Total Pensionable Salaries (£000s p.a.)	6,496	10,319
Average Pensionable Salary (£ p.a.)	20,888	19,768
Average age	52.2	50.8
Average past service (years)	14.9	11.1
Deferred pensioners		
Number	945	948
Total deferred pensions revalued to valuation date (£000s p.a.)	1,737	1,459
Average deferred pension (£ p.a.)	1,838	1,539
Average age	49.3	48.1
Pensioners		
Number	1,101	984
Total pensions payable (£000s p.a.)	4,144	3,651
Average pension (£ p.a.)	3,764	3,710
Average age	73.6	73.4

C

ASSETS

The market value of the Fund's assets was £185,855,556 on the valuation date.

The Trustees' investment strategy at the valuation date was to proportion the Fund's assets by asset class as shown in the table below. The table also shows the actual distribution of assets at the valuation date. The actual distribution of assets will vary over time due to changes in financial markets and a number of changes have been agreed as part of the Trustees' review of investment strategy carried out over 2017/18. These changes have been allowed for in determining the discount rates used for the actuarial valuation.

	INVESTMENT STRATEGY	ACTUAL MARKET VALUE OF ASSETS	
	AT 31 JULY 2017	AT 31 JULY 2017	
	%	£m	%
Bonds:			
Index-linked gilts	25.0	36.1	19.4
Corporate bonds	20.0	39.2	21.1
Equities:			
UK	20.0	31.6	17.0
Overseas	30.0	62.7	33.7
Other assets:			
Property	5.0	8.0	4.3
Alternatives		2.9	1.6
Cash deposits		5.2	2.8
Net current assets/(liabilities)		0.2	0.1
Total	100.0	185.9	100.0

The Trustees also hold money purchase additional voluntary contributions (AVCs), which are separately invested, and a group life insurance policy which insures the lump sum death benefit. All these assets have been excluded from the market value shown above as they exactly match the value of the benefits they cover.

The details of the assets at the valuation date and the financial transactions during the inter-valuation period have been obtained from the audited accounts for the Fund.

D

BENEFIT SUMMARY

The benefits valued are as set out in the benefit summary dated 24 November 2014, provided to the Trustees for the 2014 valuation, as the benefits have not changed since then. This broadly reflects the benefits communicated to members via membership booklets, announcements and correspondence outlining special terms where applicable.

No allowance has been made for discretionary benefits or discretionary increases to benefits.

The benefits that will emerge from money purchase AVCs paid by members have been excluded from the valuation, as have the corresponding assets, since the value of these liabilities is exactly matched by these assets.

The law requires pension schemes to provide equal benefits to men and women in respect of service after 17 May 1990 (the date of the “Barber” judgement) and this includes providing equal benefits accrued from that date to reflect the differences in Guaranteed Minimum Pensions (GMPs). There is currently no consensus or legislative guidance as to what adjustments should be made to scheme benefits to correct inequalities. The valuation makes no allowance for removal of these inequalities. It is consequently possible that additional funding will be required for equalisation once the law has been clarified.

E

CERTIFICATE OF TECHNICAL PROVISIONS

Name of the Scheme

University of Reading Employees' Pension Fund

Calculation of Technical Provisions

I certify that, in my opinion, the calculation of the Fund's Technical Provisions as at 31 July 2017 is made in accordance with regulations under section 222 of the Pensions Act 2004. The calculation uses a method and assumptions determined by the Trustees of the Fund and set out in the Statement of Funding Principles dated 21 September 2018.

Signature



Name

John Hemsley

Date of signing

21 September 2018

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