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LPFA Monthly Solvency Report as at 31 July 2018 Preliminary Month End Data

Purpose and summary

This report is prepared for the LPFA Board. It provides an up to date estimate of funding level and sets out an analysis of LPFA solvency as at 31 July 2018, together with an analysis of change from the end of June 2018. It also gives an indication of the approximate sensitivity of funding level to changes in economic and demographic assumptions.

Net Asset Values and LPFA Asset Mix at 31 July 2018:

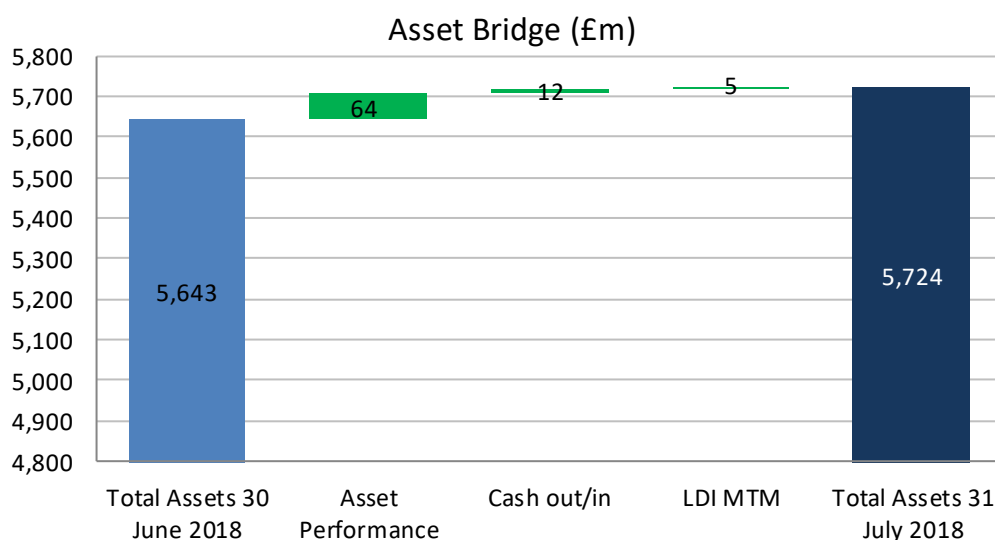
31 July 2018	Funds		Exposure		Policy Portfolio		
	£m	%	£m	%	Benchmark	Minimum	Maximum
Global Equities:	2,619	45.8%	2,828	49.4%	45.0%	35.0%	55.0%
Private Equity:	519	9.1%	519	9.1%	7.5%	5.0%	15.0%
Fixed Income:	220	3.8%	220	3.8%	2.5%	0.0%	15.0%
Infrastructure:	293	5.1%	293	5.1%	10.0%	5.0%	15.0%
Credit:	449	7.8%	449	7.8%	9.0%	0.0%	12.5%
Real Estate:	508	8.9%	508	8.9%	10.0%	5.0%	15.0%
Total Return:	826	14.4%	826	14.4%	15.0%	0.0%	20.0%
Cash:	290	5.1%	80	1.4%	1.0%	0.0%	5.0%
<i>Diversified Growth Fund:</i>	1	0.0%	1	0.0%	N/A	N/A	N/A
Total	5,724	100%	5,724	100%	100.0%		

- The 31 July 2018 asset values are based on **provisional data** from the custodian Bank of New York Mellon received on 24 August 2018.
- In the Funds columns asset data from Bank of New York Mellon has been grouped by asset class.
 - Cash includes the mark to market (MTM) of the currency hedge and the Liability Driven Investment (LDI) portfolio
 - Global equities includes cash held in the Insight synthetic equity sub-portfolio
- The data in the Exposure columns has been produced by adjusting the Funds data:
 - Net synthetic equity exposure of £286m has been removed from the cash line and added to the equities line
 - Cash held in the Insight synthetic equity sub-portfolio has been added to the cash line and removed from the equities line
 - Derivative mark to market values, the Insight LDI fund and the currency hedge remain treated as being functionally equivalent to cash and included within the cash line

- The cash line in the Exposure columns includes the LDI portfolio. As at end July 2018 the LDI portfolio has a -£1.91m per basis point interest rate exposure (PV01) and a £1.86m per basis point inflation rate exposure (IE01). At 31 July 2018, if interest rate expectations fall by 0.1% p.a. the LDI portfolio will increase by approximately £19.1m. If inflation expectations fall by 0.1% the LDI portfolio will fall by approximately £18.6m. The Exposure data and interest rate and inflation rate exposure of the LDI portfolio have been used to produce the sensitivity information on page 6.
- The LPFA credit portfolio is invested 13% in emerging market debt funds, 21% in direct lending, 33% in debt secured on real assets and the remainder in credit funds. All these investments are unrated.
- Around 11% of Public and Private Equity is invested in the UK equity market, with the majority of equity exposure taken in the United States.
- LPFA has established a foreign exchange hedging program to reduce currency risk but overall, after allowance for that program, LPFA is short of around GBP2.4bn , mainly against USD.
- In the Exposure data, over July net cash has decreased from c6% to c1% of the Fund. The approximate movements in net cash and cash equivalents are detailed below:
 - The cash at bank movements reflect LPFA subscribing a further £175m to the LPPI Credit Pool and £85m to the LPPI Fixed Income Pool

	30 June 2018 £m	31 July 2018 £m	Change over July £m
<i>Cash and cash equivalents:</i>			
Cash at bank, custodian and GLA	294	73	-221
Currency hedge (MTM)	-11	-41	-30
Insight LDI portfolio (cash, bonds, swaps MTM)	254	258	4
<i>Synthetic Equity:</i>			
Net synthetic equity exposure	-277	-286	-9
Cash held in synthetic equity account	68	77	9
Risk Exposure Cash Total	328	80	-247

The change in total net asset value over July 2018 is explained as follows:



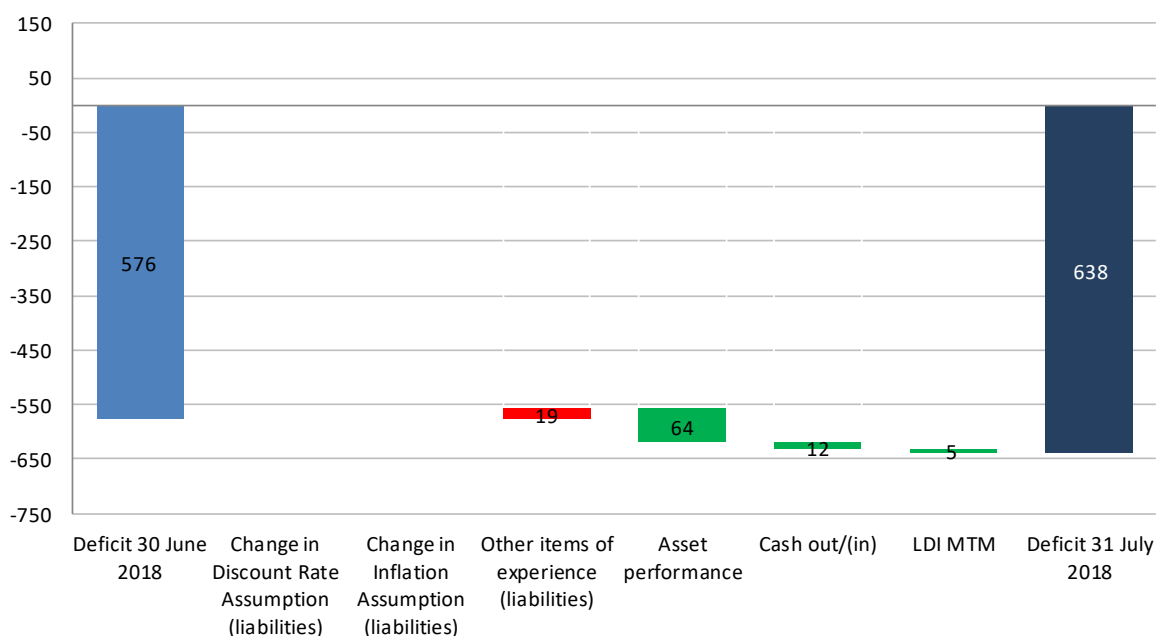
- There was a cash inflow this month due to a bulk transfer in payment

Balance Sheet Modelling

(Unsmoothed) Triennial Valuation Basis

	31 July 2018	30 June 2018
Estimated liabilities Triennial valuation basis	£5,086m	£5,067m
Final NAV	£5,724m	£5,643m
Deficit Triennial valuation basis	(£638m)	(£576m)
Estimated Triennial funding level (Barnett Waddingham basis)*	112.5%	111.4%

Deficit Bridge (Unsmoothed Triennial Valuation Basis) (£m)



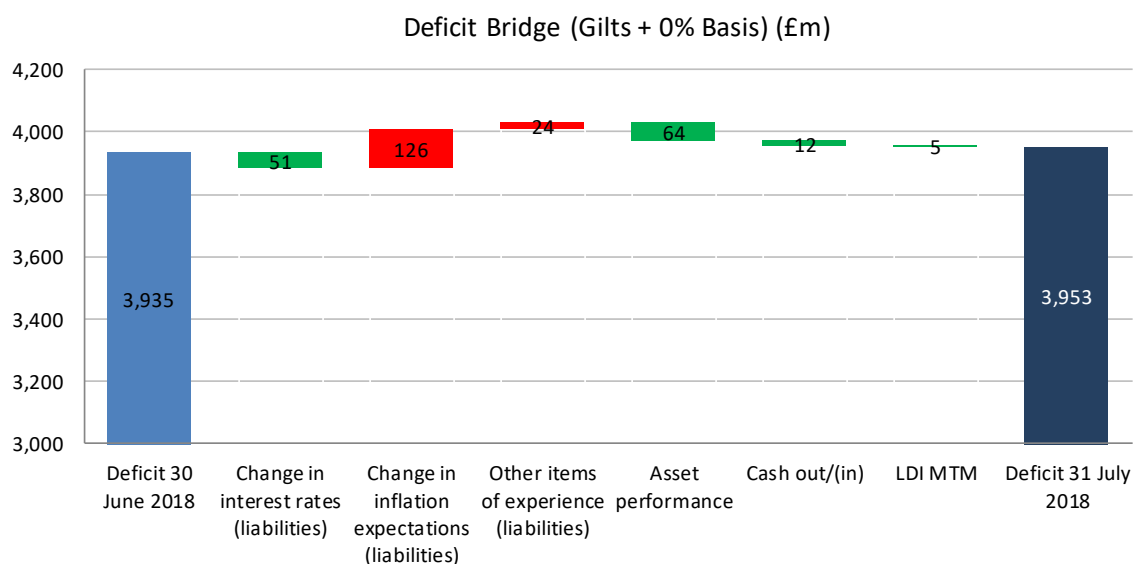
- **Unsmoothed 31 July 2018 Triennial valuation assumptions are supplied by Barnett Waddingham. The discount rate references the LPFA Fund's long term policy portfolio asset allocation benchmark (see table page 1).**
- During July 2018 the Triennial funding level increased from 111.4% to 112.5%, due to positive asset performance.
- The assumption for long term future RPI inflation, based on the 20 year point of the Bank of England implied inflation curve, remained at 3.5% p.a.
- The assumed Triennial discount rate remained at 5.7% p.a.

* *Estimated snapshot of funding level using 2016 Triennial valuation assumptions updated for changes in market conditions, without smoothing.*

Gilts Flat (Gilts + 0%) Basis

At the request of the Board and given the Fund’s inflation hedge is now gilts-based, as well as reporting on the Triennial valuation basis we report results on a Gilts Flat basis. Please note that the primary focus of the LPFA Board is to manage the Fund’s Triennial balance sheet.

	31 July 2018	30 June 2018
Estimated liabilities Gilts Flat basis	£9,677m	£9,578m
Final NAV	£5,724m	£5,643m
Deficit Gilts Flat basis	£3,953m	£3,935m
Estimated funding level Gilts Flat basis	59.2%	58.9%



- The Gilts Flat funding level increased by 0.3% during July 2018. There was an increase in gilts based inflation expectations across the curve (see appendix 2) which increased the present value of the liabilities however this was offset by a decrease in gilts based interest rates and positive asset performance.
- The increase in liabilities is also reflected in the positive mark to market movements experienced on the LDI portfolio over the month. It should be noted however that the real gilts-based inflation hedge is designed to hedge inflation risk in the context of the Triennial valuation basis. This translates to approximately 11% of the sensitivity of the liability cashflows to changes in gilts-based interest rates and inflation.

Approximate Risk Sensitivities

	Unsmoothed Triennial Valuation Basis	Gilts Flat Valuation Basis
Equities fall by 10%		
Assets	decrease by £309m	decrease by £309m
Liabilities	decrease by £148m	unchanged
Deficit	increases by £161m	increases by £309m
Interest rates (swaps and gilts) fall by 1%		
Assets	increase by £240m	increase by £232m
Liabilities	increase by £190m	increase by £2,000m
Deficit	decreases by £51m	increases by £1,768m
Inflation rises by 1%		
Assets	increase by £186m (LDI portfolio inflation hedge only)	increase by £186m (LDI portfolio inflation hedge only)
Liabilities	increase by £219m	increase by £2,000
Deficit	increases by £33m	increases by £1,814m
Long term rate of mortality improvement increases by 0.25%		
Assets	unchanged	unchanged
Liabilities	increase by £46m	increase by £182m
Deficit	increases by £46m	increases by £182m
10% decrease in member mortality rates		
Assets	unchanged	unchanged
Liabilities	increase by £134m	increase by £382m
Deficit	increases by £134m	increases by £382m
Property decreases by 10%		
Assets	decrease by £51m	decrease by £51m
Liabilities	unchanged	unchanged
Deficit	increases by £51m	increases by £51m
Sterling weakens by 10% against all other currencies		
Assets	increase by £240m	increase by £240m
Liabilities	unchanged	unchanged
Deficit	decreases by £240m	decreases by £240m

This analysis is based on the LPFA current asset allocation at 31 July 2018. As such, the Triennial sensitivities shown in the table are slightly inconsistent with the Triennial solvency results shown earlier. *The analysis considers the approximate funding level immediately after each event. Approximate allowance is made for changes to the assets and future asset class return assumptions used in the discount rate as a result of the market movements described. The discount rate reflects the asset allocation **assuming it has been rebalanced to the allocation in place immediately before the event**. No allowance is made for correlations between asset classes. The sensitivities shown would be different if the asset allocation was not re-balanced following each event.

Recommendations:

[1] LPFA Board is asked to note this report.

Report date: 02 October 2018

Lead Officer: Tom Richardson

Compliance Checks

Governance issues:

The monthly solvency report is provided to all Board Members and is published on LPFA's website monthly. It is a key document to track the financial development of the fund.

Financial implications:

Implicit in this report.

Legal implications:

None – The production of this report is voluntary in nature.

Risk implications:

This report is part of the process to manage and monitor the key investment and financial risks facing the fund.

Equalities impact:

Scheme Members will have the opportunity to request alternative formats as required.

Social, environmental, health and ethical issues:

The move to greater online publication is in line with LPFA's environmental initiatives.

Communication issues:

The report is published monthly on the LPFA website.

Other relevant / supporting documentation:

None.

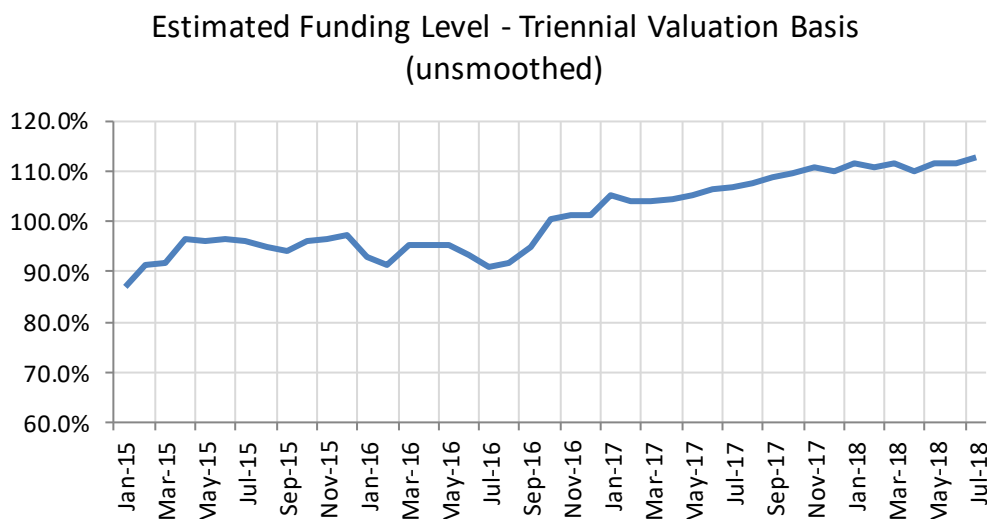
This report has been prepared for the LPFA Board to provide information regarding the Fund's solvency. It does not provide any advice on legal, taxation or investment matters and should not be relied upon for any such or other purposes.

The report is provided 'as is' without any warranty (express or implied) as to the accuracy or completeness of any information contained herein. Neither LPP, its affiliates nor any of their respective employees, directors and officers shall be liable howsoever to any person for any acts and/or omissions proclaimed to be based on this report or any part thereof.

This report complies with Technical Actuarial Standard 100 (TAS100) issued by the Financial Reporting Council.

Estimated Funding Position – 2016 Triennial Valuation Basis

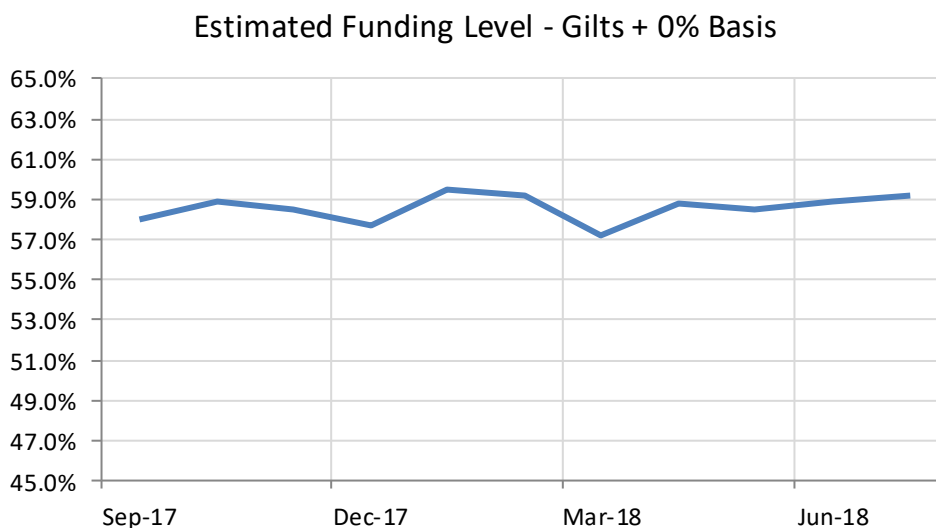
The graph below shows the estimated Triennial funding level since January 2015.



Details of the Triennial valuation assumptions are in appendix 2.

Estimated Funding Position – Gilts Flat Basis

The graph below shows the estimated Gilts Flat Basis funding level progression since September 2017.



The July Gilts Flat and (unsmoothed) Triennial liabilities were calculated using the Barnett Waddingham Valuations on Demand (VoD) system developed for LPFA.

Whilst the funding calculations allow for movements in assets and movements in liabilities resulting from changes in interest rates, inflation and membership information, the funding update information must only be viewed as approximate.

Data

The 31 July 2018 liabilities have been calculated using 31 January 2018 membership data. **During February 2018 Heywoods updated the membership data capture, which has produced erroneous membership data output. Whilst this problem is rectified, liabilities will be calculated using the 31 January 2018 membership data. The output from VoD has therefore been adjusted approximately to allow for the annual pension increase order effective 31 March 2018 and for estimated 31 March 2018 renewal data changes. Annual renewal data is not expected to be reflected in full on the membership database until at least end August 2018 as it is put through a checking and cleaning process once it is received from the Fund employers.**

Assets

The value of the assets used to calculate the funding level are final figures provided by Bank of New York Mellon of net asset value at the month end. Estimates of the assets used in prior months may be updated once the assets have been reconciled by the custodian.

Assumptions

2016 Triennial Valuation Basis (updated to reflect market conditions):

For the purpose of estimating the funding position on the Triennial Valuation basis the financial assumptions and assets have not been smoothed. For the formal Triennial valuation of the Fund at 31 March 2016 the financial assumptions and the assets are smoothed over the six month period from 31 December 2015 to 30 June 2016.

The unsmoothed financial assumptions at 31 July 2018 and 30 June 2018, **supplied by Barnett Waddingham** were as follows:

	31 July 2018	30 June 2018
Discount Rate	5.7% p.a.	5.7% p.a.
Retail Prices Index Inflation (RPI)*	3.5% p.a.	3.5% p.a.
Consumer Prices Index (CPI) Inflation	2.6% p.a.	2.6% p.a.
Long Term Salary Increases post 2020	4.1% p.a.	4.1% p.a.

The asset mix used to calculate the discount rate is based on the LPFA Fund's policy portfolio benchmark as detailed on page 1.

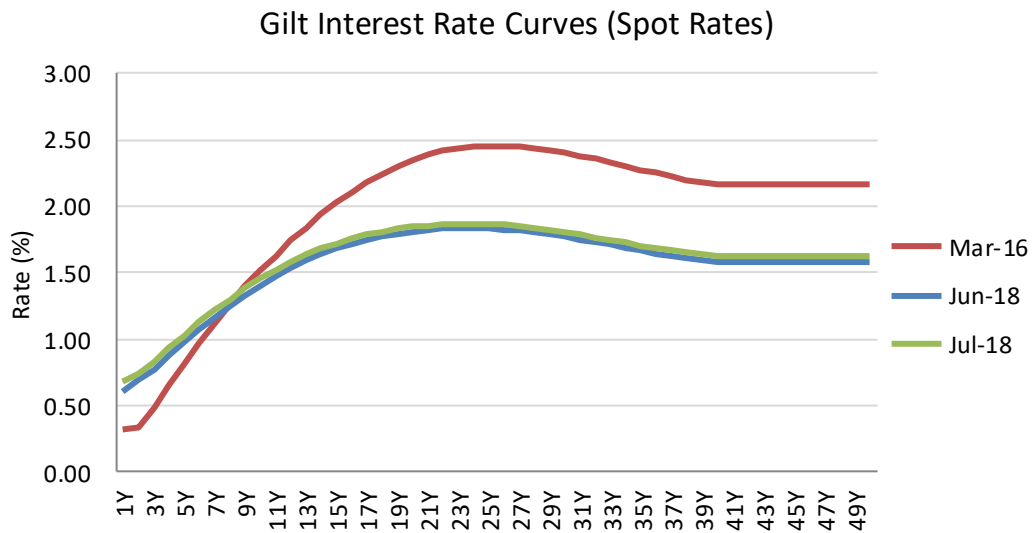
The demographic assumptions are those used for the 31 March 2016 Triennial Fund valuation.

Details of the financial and demographic assumptions are contained in Barnett Waddingham's final results paper dated 24 March 2017.

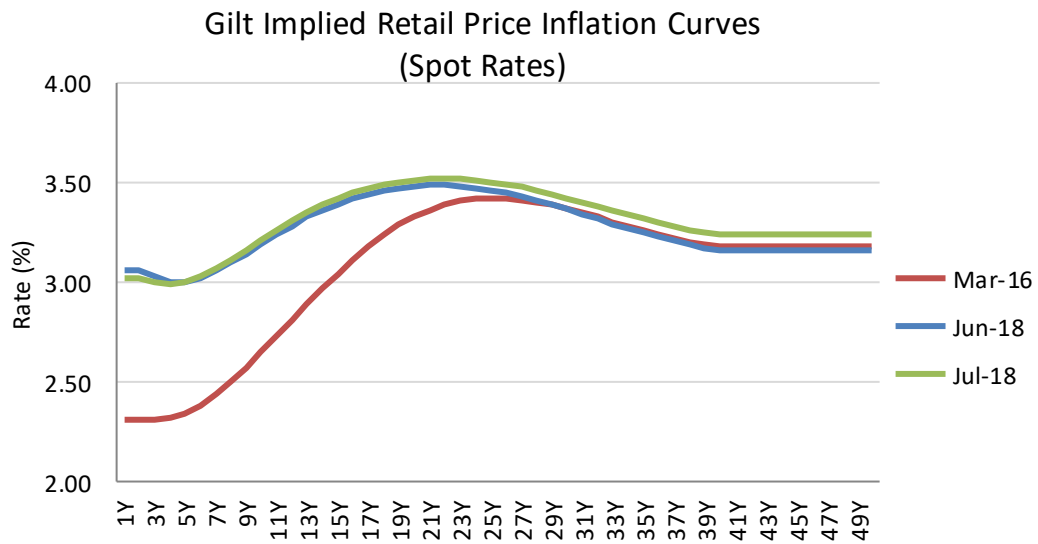
Gilts Flat (Gilts + 0%) Basis:

The liabilities are calculated by discounting expected future cashflows using a gilts yield curve (based on UK government bonds) obtained from the Bank of England website. Retail Price Inflation (RPI) has been based on the Bank of England UK implied inflation curve. The CPI assumption is equal to the RPI assumption with a deduction of 0.9% per annum. Demographic assumptions are those used for the LPFA Fund's 31 March 2016 Triennial valuation.

The graphs below show the current gilt yield and gilt inflation curves (used to calculate the liabilities on the Gilts Flat basis) along with the curves from June 2018 and the previous Triennial valuation date, for comparison. The curves only exist for durations up to 40 years and it is assumed that the rates are flat beyond this point.



Source: Bank of England



Source: Bank of England

Liability Cashflows

The graphs below shows undiscounted expected future liability cashflows. These cashflows allow for future expectations of inflation as assumed in the Gilts Flat Basis. The cashflows if inflation was 0.1% p.a. higher at all points along the curve are also shown in order to show the cashflows' sensitivity to inflation.

