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Local Government Pension Schemes - Risk and Reward

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Local Government Pension Schemes: The 'Reward' for taking Risk

- High quality of defined benefit
- Funding deficits
- Increasing cost of future benefits
- Increasing cost of funding deficits
- Conflict with the private sector
- Attention of Central Government
- Industrial relations concerns



Past and continuing risks

- Price inflation
- Long-term interest rates
- Longevity (and other demographic)
- Regulatory
- Asset performance mismatched to liability growth

Acceptance of risk in asset strategy is designed to manage long-term costs to taxpayers, in order to maintain benefits. Failure of risk taking strategy will increase expected costs, leading to demand for benefit changes from ultimate source of funding (taxpayers, as represented by central and local government).

Risk – the interested parties

- Members – solely concerned with provision of benefits. Risks only matter if lead to benefit improvements or reductions.
- Local Government – concerned with cashflow and ability to deliver services. Risk may mean
 - cashflow is reduced/increased, affecting ability to provide services
 - council tax fluctuations
 - At extreme, possibility of capping
- Central Government – concerned with overall costs of local government and reflecting view of electorate. Risks increase likelihood of moves to control long-term costs.
- Taxpayer – interested in efficient use of taxes. Purely subjective view.

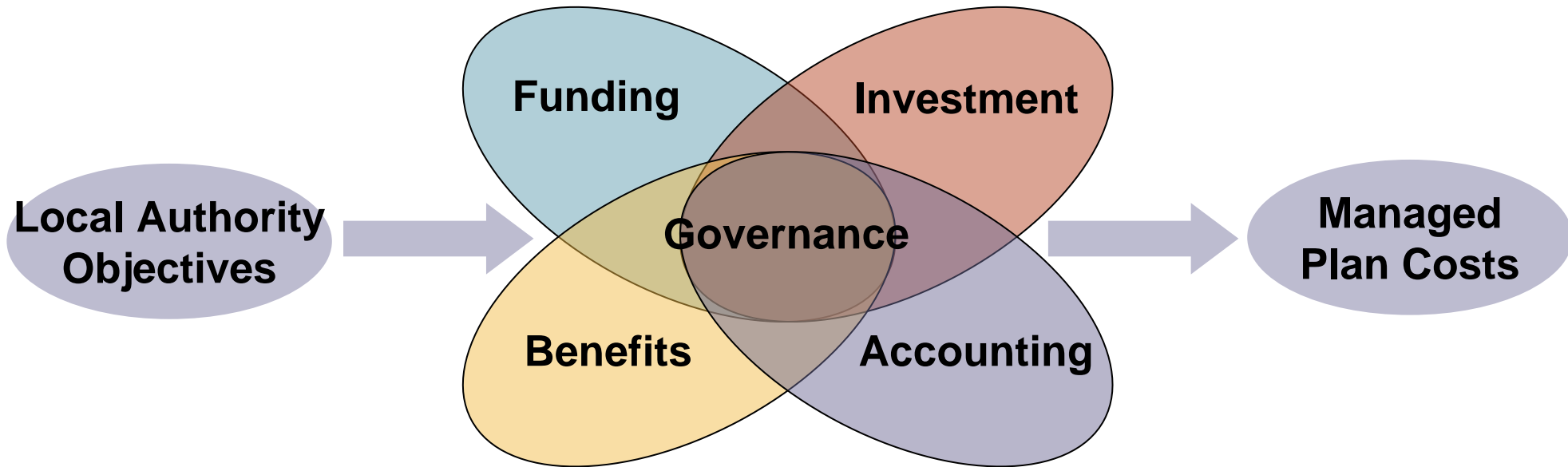
Local Authorities – More ability to take risk?

- Funding guarantee through ability to raise taxes
- Deficit not a long-term cause for concern
- Can afford to take the long-term view

Not necessarily accepted arguments by ultimate sponsor. Deficits are a deferral of tax to future tax payers by current tax payers. Future tax payers unlikely to be happy with this!

- Risk must be understood and possible outcomes recognised
- Benefit promises backed by funding

How do you manage risks?



“A framework of principles, guidelines and decision making processes that help a sponsor define, manage and deliver benefits in a way that best meets its human resource and financial objectives.”

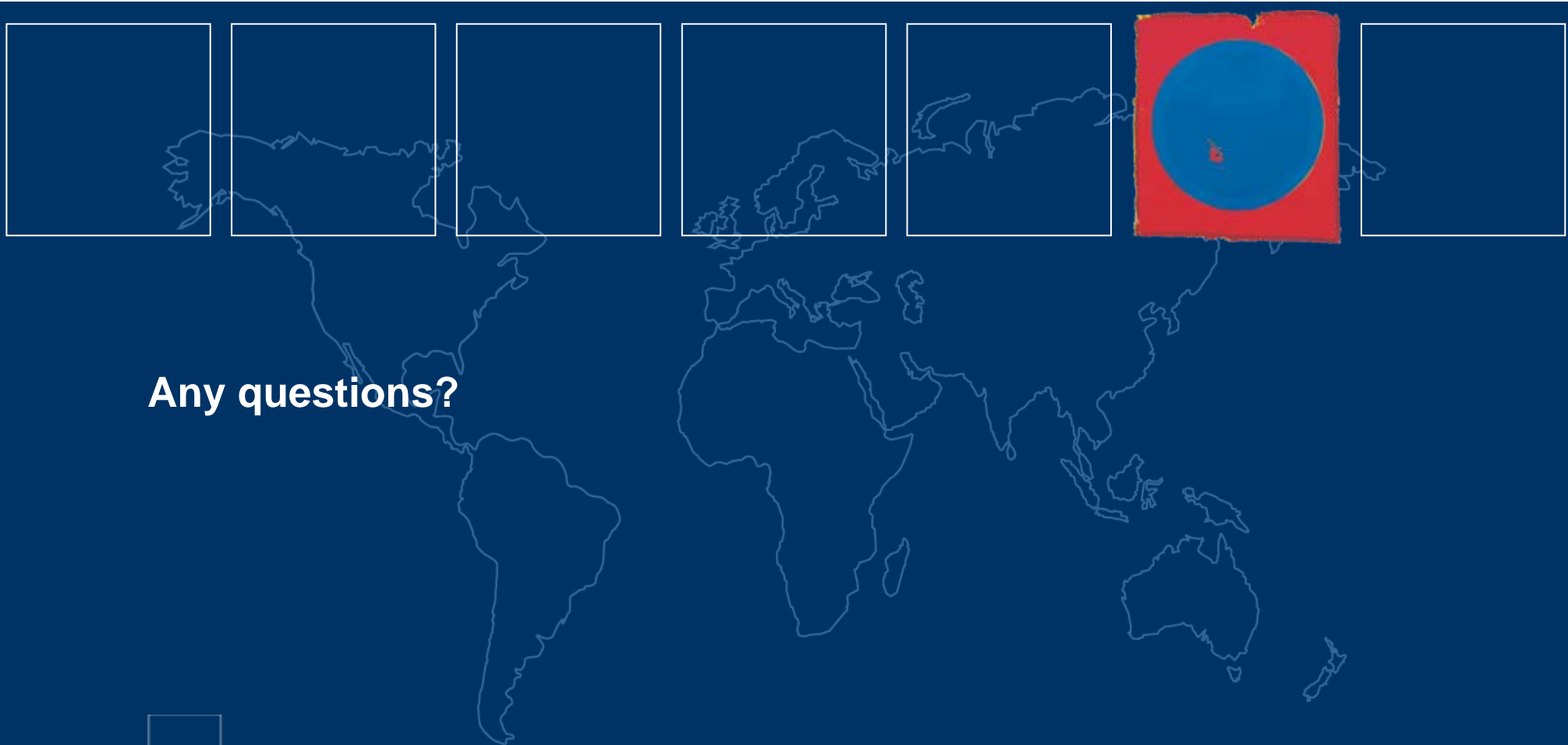
No missed financial opportunities...no costly misalignments...no surprises

What can we do about it?

- Understand the tools available
 - Benefit policy
 - Funding
 - Asset strategy
- Maintain pension funding
- Look at the whole spectrum of asset strategies and classes and select an approach which is 'risk efficient'
- Understand the 'Value at Risk' and be clear within local government at the potential for cashflow impacts
- Monitor, monitor, monitor...

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Any questions?



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