The YMCA Pension and Assurance Plan

Report on Annual Actuarial Update as at 1 May 2015

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1. Introduction

Purpose of this Report

1.1 This report, addressed to the Trustee, provides an update of the funding position of the YMCA Pension and Assurance Plan (the 'Plan') as at 1 May 2015 for the purposes of Section 224 of the Pensions Act 2004.

1.2 That Act introduced a new Statutory Funding Objective requiring defined-benefit pension schemes to have sufficient assets to cover their 'technical provisions', namely the amount needed on an actuarial calculation to make provision for the accrued benefit liabilities.

1.3 To assess whether the Plan meets the Statutory Funding Objective, full actuarial valuations have to be carried out at least every three years. Where such a valuation indicates a funding deficit, a Recovery Plan is required setting out the steps to be taken to meet the Statutory Funding Objective and the period within which it is to be achieved. The latest such valuation of the Plan was carried out as at 1 May 2014 and is documented in my report dated 4 March 2015. The next full valuation is due to be carried out not later than as at 1 May 2017.

1.4 In the meantime, the Trustee must obtain annual updating reports on developments affecting the Plan's technical provisions and assets since the last actuarial valuation was prepared. This report is the first such update.

1.5 This report enables the Trustee to review their funding documents and consider obtaining a full actuarial valuation for an intervening year instead of an actuarial report where, after taking advice from their actuary, it seems to them that events have made it unsafe to continue to rely on the results of the previous valuation as the basis for the current level of contributions.

1.6 The next update report will need to be commissioned by the Trustee with an effective date no later than 1 May 2016.

1.7 This report and associated work complies with the Financial Reporting Council's Technical Actuarial Standard R: Reporting Actuarial Information, Technical Actuarial Standard D: Data, Technical Actuarial Standard M: Modelling and with the Pensions Technical Actuarial Standard.

This report is solely for the purpose indicated above. It should not be relied upon for any other purpose and it should be noted that neither I nor Xafinity Consulting Limited accept liability to any third party in respect of the contents.

This update should be read in conjunction with the Scheme Funding Assessment Report as at 1 May 2014 dated 4 March 2015 and the Statement of Funding Principles dated 4 March 2015.

The Trustee must ensure this report is made available to the Participating Employers within seven days of receipt.

2. Methodology and Assumptions

Methodology

2.1 The actuarial method used for this update is the Accrued Benefit actuarial funding method. This is the same actuarial method as was used for the actuarial valuation as at 1 May 2014. Further details are available in my report to the Trustee on that valuation, dated 4 March 2015.

2.2 The liabilities have been calculated by rolling forward the valuation liabilities from the previous valuation date to 1 May 2015 and then adjusting the membership data for known member movements to 1 May 2015. The resulting liabilities have then been adjusted to reflect the different assumptions used.

Financial Assumptions

2.3 As part of the actuarial valuation as at 1 May 2014, the Trustee prepared a Statement of Funding Principles the contents of which were agreed with the Employers. In carrying out this update, I have set the financial assumptions using the same principles as in that Statement but with allowance for changes in financial markets in the interim. This is not to say that if a formal actuarial valuation had been conducted at 1 May 2015, the assumptions would be those set out below. A formal valuation would involve a new discussion about the appropriate 'strength' of the assumptions.

Financial Conditions

2.4 The following table sets out the principal changes in financial markets since the previous actuarial valuation, as they relate to setting the financial assumptions:

	Annual Update as at 1 May 2015	Actuarial Valuation as at 1 May 2014
20 year fixed interest gilt yield	2.45%	3.35%
Implied market price inflation	3.33%	3.48%

2.5 The market factors show that underlying gilt yields have decreased by around 0.9%, with the implied long term rate of annual retail price inflation having decreased by around 0.15%.

2. Methodology and Assumptions

2.6 Factoring these changes into the agreed principles, I have carried out this update using the following financial assumptions:

	Annual Update as at 1 May 2015	Actuarial Valuation as at 1 May 2014
Discount Interest Rate		
- before retirement	4.45%	5.35%
- after retirement	2.95%	3.85%
Retail Price Inflation	3.15%	3.30%
Consumer Price Inflation	2.65%	2.80%
Pension Increases		
- LPI max 5% min 3%	3.45%	3.55%
- LPI max 5%	3.15%	3.30%
Deferred Pension Revaluation (CPI)	2.65%	2.80%
Expected Return on Assets	4.40%	5.30%

Demographic Assumptions

2.7 I have used the same demographic assumptions for this update as adopted for the actuarial valuation as at 1 May 2014, being those set out in the Plan's Statement of Funding Principles dated 4 March 2015.

2. Methodology and Assumptions

2.8 These are summarised in the following table:

Mortality before Retirement	SAPS S2PxA CMI 2013 with 1.5% long term improvements
Mortality in Retirement	SAPS S2PxA CMI 2013 with 1.5% long term improvements
Cash commutation	75% of members are assumed to commute 25% of the value of their pension for cash
Retirements	Allowance for early retirement between ages 60-65 with an adjustment for early retirement factor where appropriate. Valued at earliest age at which entitled to all or part of the pension unreduced by Plan early retirement factors where appropriate.
New entrants	None
Marital statistics	80% of Males and 70% of Females married

3. Data

Membership Data

3.1 The principal source of data on the Plan membership is the actuarial valuation as at 1 May 2014. For example, that valuation recorded each member against their status at the time and ensured that the total membership corresponded with the audited Plan accounts.

Changes to Membership

3.2 This update requires me to comment on how I have taken membership changes into account. I have allowed for this by adjusting the membership data for all known member movements between 1 May 2014 and 1 May 2015. The updated member statuses were then used for the current annual update. The updated member statuses have been supplied to me by our administration department. Having reviewed this data I believe that its quality and completeness are adequate for the purpose of the valuation.

Assets

3.3 I have used the draft Trustee Report and Accounts, dated 1 July 2015, to attain a value of the Plan's assets as at 1 May 2015. The draft Trustee Report and Accounts includes a value of the Plan investments as at 1 May 2015 of £100,801,817 (excluding AVCs) and estimated net current assets of £3,350,536.

3.4 In addition, there are a number of insured annuity contracts which I have valued on a consistent basis to the corresponding pension liabilities (£7,302,042 as at 1 May 2015).

4. Results

Past Service Position

4.1 I have compared the assets held at 1 May 2015 with the value of the benefits earned by members. The following table shows the results of this calculation together with the comparative figures from the previous full actuarial valuation:

	Annual Update as at 1 May 2015 £m	Actuarial Valuation as at 1 May 2014 £m
Technical Provisions (i.e. liabilities)	152.0	129.5
Assets	111.5	90.8
Deficit	(40.5)	(38.7)
Funding Level	73%	70%

4.2 The funding position has improved since the previous valuation was undertaken although the deficit itself has increased. The main reasons for this improvement were the better than expected asset performance and the Employer contributions in relation to the Plan's Recovery Plan and to S75 debt payments. However, this was offset by a decrease in underlying gilt yields leading to a decrease in both the pre and post-retirement discount rates and hence an increased value placed on the Plan's liabilities.

4.3 Gilt yields have remained volatile during the period since 1 May 2015 and Equity markets have fallen significantly in the few days leading up to signature of this report.

4. Results

4.4 The following table summarises the financial effects of the above and other factors which have influenced the changing financial position.

	Year to 1 May 2015 £000s
Surplus/(deficit) at start of year	**(38.7)**
Interest on deficit	(1.3)
Investment returns better than expected	12.9
Inflation experience	0.6
Deficit contributions paid	3.4
Expenses paid	(0.5)
S75 debt contributions received	3.4
Miscellaneous	(0.2)
Change in market conditions	(20.1)
Surplus/(deficit) at end of year	**(40.5)**

5. Further Considerations

Investment Strategy

5.1 Some of the Plan's liabilities are linked to inflation via either pension increases in payment or revaluation in deferment. The assets that would most closely match the liabilities are a combination of index-linked gilts to match these inflation-linked liabilities and fixed-interest gilts to match the fixed liabilities of the Plan.

5.2 It is a result of the mismatch between the actual assets held by the Plan and these notional "matching assets", which are used as a benchmark for the discount rates, that there is likely to be some volatility in the past service funding position. The Plan investments are mismatched because the Trustee has invested some of the Plan's funds in a diversified portfolio of growth assets such as equities and property that are expected to produce higher future returns than gilts and other bonds. The risk that must be traded off against these expected higher returns is the increased volatility of the Plan's returns and the higher risk of default.

5.3 The Trustee has chosen the current investment strategy in the light of their understanding of the strength of the Employers' covenant. It is not an inappropriate strategy but the Trustee should recognise the volatility that it inevitably implies.

5.4 The basis chosen by the Trustee to value the Plan's liabilities recognises the investment strategy as described above by building in an allowance for a proportion of the Plan assets to achieve returns in excess of the yields available on gilts at the valuation date.

5.5 It is important that the Trustee continues to review their investment strategy as the Plan matures. The strategy should also be reconsidered in the event of any weakening in the Employer's covenant.

5.6 If equities perform strongly in the future the funding position of the Plan would improve, assuming that bond yields are stable. In contrast, poor future equity returns would lead to a deterioration of the Plan's funding position if bond yields remain stable. Similarly, if equity returns are stable but bond yields change, the funding position would vary.

5.7 If the Trustee wished to reduce the risk of such volatility they would need to match the assets to the liabilities to a greater degree by investing more in Government stocks or other bonds. By following such a strategy, a fall in bond yields (and the associated rise in liability values) would be offset by a rise in the value of the Plan's assets. However, bonds and, in particular, Government stocks are a lower risk asset class and consequently the long term expected returns on bonds and gilts are lower than the expected future returns on more risky assets such as equities.

5. Further Considerations

Employer Covenant

5.8 I have not allowed for any change in the Employers' covenant (i.e. the risk that the Employers could prove unable to continue future contributions or that the Plan will not recover the deficit upon insolvency). The Trustee should review the current strength of the covenant regularly.

5.9 If the Trustee feels that the covenant has weakened then it may be appropriate to review the Recovery Plan and Schedule of Contributions. I have assumed here that the covenant has not declined since the last valuation as at 1 May 2014.

5.10 The Regulator expects the Employers, upon request, to give the Trustee adequate data, as they (or their advisors) reasonably require, to assess covenant strength. Employers are encouraged to share relevant information at an early stage. Such information may be confidential and will often include details of the Employer's:

- Business plans and internal management accounts, to assist the Trustee determine free cash flow available to support the Plan; and
- Forthcoming capital expenditure.

5.11 Trustees can also use commercially available services (like information from rating agencies, credit scoring institutions or investigating accountants) and wider information in the public domain to help measure the strength of the employer covenant.

Buyout Cost

5.12 I have not measured the buyout position as at 1 May 2015, but can do so if the Trustee would find this helpful.

6. Summary

Implications for the Recovery Plan

6.1 Following the funding deficit revealed by the actuarial valuation as at 1 May 2014, the Trustee established a formal Recovery Plan. This requires additional employer contributions will be paid to the Plan at the rate of £2.97m per annum, payable in equal monthly instalments for a period of 12 years commencing from 1 May 2015 and increasing by 3% at each 1 May thereafter. Based on conditions as at 1 May 2014, these payments were estimated to be sufficient to clear the funding shortfall by 1 May 2027.

6.2 Although this report identifies an improvement in the existing funding position of the Plan the deficit in the Plan has increased. This will have a negative influence on the length of the recovery period if there are no changes made to the contributions being paid to the Plan.

6.3 Based on conditions as at 1 May 2015, I estimate that payments in accordance with the Plan's current Schedule of Contributions would be expected to clear the funding shortfall by around one year later than the current Recovery Plan.

6.4 The Recovery Plan will be due for formal review as part of the next full actuarial valuation of the Plan, which is to have an effective date no later than 1 May 2017.

6.5 The Trustee should note that there is likely to be volatility in the past service funding position as a result of the partial mismatch between the actual assets held by the Plan and the notional "matching assets". As mentioned in 4.3, falls in Equity markets will have reduced the funding level from the 73% calculated at 1 May 2015.

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