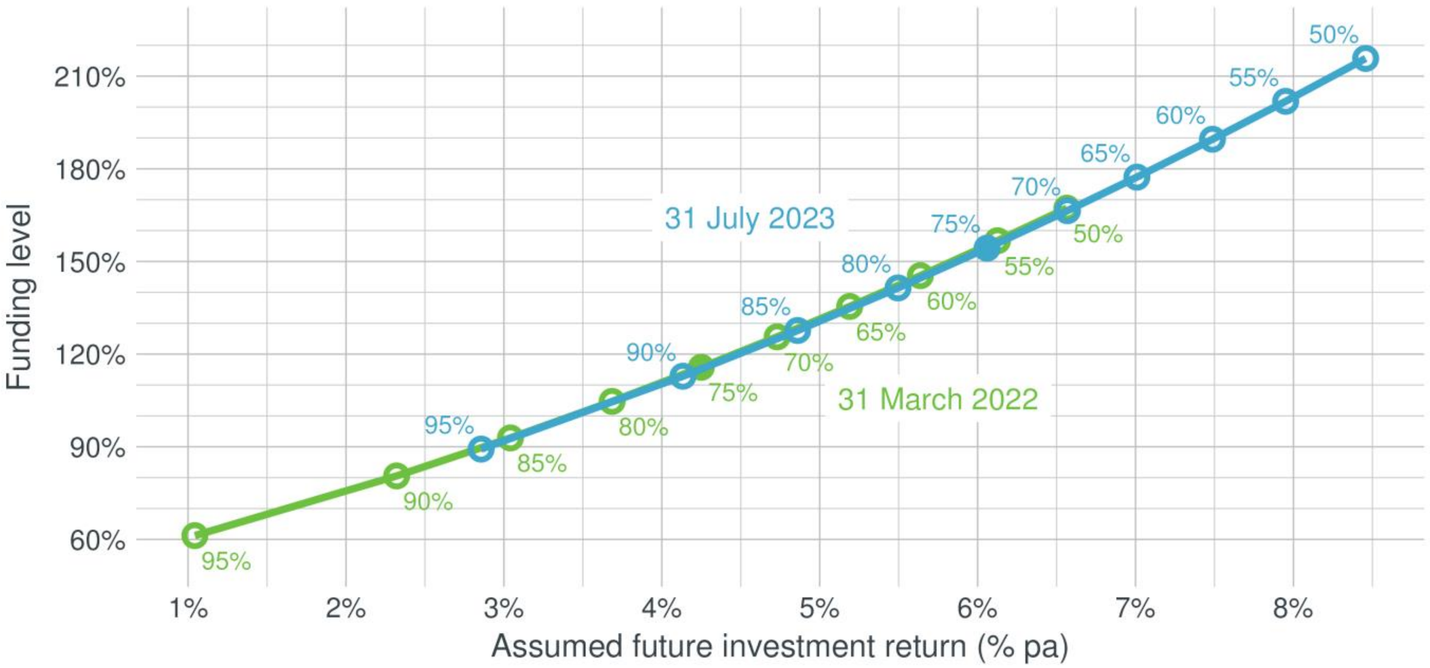
Teesside Pension Fund

Summary of funding objectives

The Fund's funding objectives are to keep employer contributions as low and stable as possible, for as long as possible with a comfortable level of prudence. To achieve these objectives, the Fund takes a long-term view (20 years) when setting contribution rates for tax-payer backed employers but requires at least a 75% likelihood they will be at least fully funded at the end of this period. It should be noted that the Fund invests in assets that can change in value considerably day-to-day. As a result, the funding level and any surplus or deficit can change significantly one day to the next. Taking a long-term view on risk is core to fulfilling the Fund's objective of keeping rates as stable as possible.

Progress of funding objectives since 2022



- The green line and dots represent the likelihood of achieving the returns on the horizontal axis and the corresponding funding level to that level of return on the vertical axis. There was a 75% likelihood the Fund would return at least 4.2% pa. resulting in a funding level of 116% (the filled green dot).
- The required return to remain at least fully funded (a 100% funding level) in 20 years' time was 3.4% pa as at 31 March 2022. There was an 82% likelihood of the Fund's investments return this over the next 20 years.
- Since the 2022 valuation, investment returns have been around 3-4%, however, this has lagged the discount rate of 4.2% pa which puts downward pressure on funding levels. However, expected future returns have been rising on the back of increasing interest rates which puts upwards pressure on funding levels.
- The blue line and dots represent the likelihoods, returns and funding levels as at 31 July 2023. Based on a 75% likelihood, the Fund would now be expected to return 6.1% pa (significantly more than the 4.2% pa identified in 2022). The resulting funding level would be 154% on this measure (the filled blue dot).
- However, the required return to remain at least fully funded in 20 years' time has reduced from 3.4% to 3.2%. The likelihood of achieving 3.2% pa is 94%.

Comments on recent changes to funding level

Over the period from 2016 to 2022, the observed improvements in funding levels have been driven by higher than anticipated investment returns. Over this period, the Fund's investments returned nearly 80%, however, this was damped by low interest rates which depressed market expectations for future returns. Since the 2022 valuation, returns on the Fund's investments have been slightly less than anticipated. In essence, the Fund is holding approximately the same amount of assets today as it did on 31 March 2022 for every £ of pension it expects to pay out. However, increasing interest rates have increased market expectations for long term future returns which has reduced the estimated value placed on the benefits (liabilities). Therefore, a shift has occurred where increases in funding level were previously being driven by actual returns, whereas recent increases are being driven by the promise of greater future returns.

Main risks and their impact at 31 July 2023 (likelihoods measured over 20 years)

Inflation

CPI expectations over 20 years	Likelihood CPI greater than expectation	Impact on funding level
2.2% p.a.	50%	154% - none
3.2% p.a.	27%	130%
4.2% p.a.	11%	110%

Anticipated investment returns

Investment returns expected over 20 years	Likelihood returns less than expectation	Impact on funding level
6.1% p.a.	25%	154% - none
5.1% p.a.	17%	129%
4.1% p.a.	10%	108%

Other risks

Risk	Potential impact
Benefit increase of c5-6% in April 2024	Immediate decrease in funding level of c3%
Model risk	Unquantifiable
Regulatory risk	Unquantifiable at the current time