Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES		
PENSION FUND CASHFLOW **Pensions Committee** **27th June 2017**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **One**

1. INTRODUCTION

1.1 This report provides the Committee with a review of the Pension Fund's cashflow following the changes to the Council's contribution rate as a result of the 2016 valuation. The review considers a range of scenarios for cashflow for the Fund over the coming years and considers actions required over the short to medium term.

2. RECOMMENDATIONS

2.1 The Pensions Committee is recommended to note the report

3. RELATED DECISIONS

3.1 27th November 2013 - Pension Fund Cashflow

4. COMMENTS OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES

4.1 For a number of years, the Pension Fund has received considerably more in contributions than it has paid out in benefits and has therefore experienced strong positive cashflow. However, in light of ongoing budgetary pressures for the Council and the recent reduction in its contribution rate, it is prudent to ensure that the likely impacts of reduced cashflows into the Fund are understood and planned for.

4.2 Budget monitoring on a quarterly and annual basis along with the additional cashflow work undertaken by the Fund actuary assists the Committee in understanding the full impact of potential changes as a result of any significant falls in membership numbers or planned changes in contribution rates. Whilst there are costs to carrying out monitoring exercises, these are negligible in comparison to the benefits of understanding the Fund's likely future cashflows and planning for these accordingly.

5. COMMENTS OF THE DIRECTOR, LEGAL

5.1 The Pensions Committee has been given delegated authority to manage the Pension Fund; under the Council's constitution they must therefore 'set the overall strategic objectives for the Pension Fund, having taken appropriate expert advice, and develop a medium term plan to deliver those objectives'. Monitoring the Pension Fund's financial position including the prospects for cash flow helps the Committee to ensure that they are meeting their fiduciary role in the management of the Fund. Management of the Fund's solvency is a key objective across the short, medium and long term; the monitoring of cash flow performance is an important part of ensuring that objective is met.

5.2 There are no immediate legal implications arising from this report.

6. BACKGROUND TO THE REPORT

6.1 For a number of years, the Pension Fund has received considerably more in contributions than it has paid out in benefits and has therefore experienced strong positive cashflow. Despite ongoing budgetary pressures, active membership has increased thanks to Auto-enrolment and a shift from temporary to permanent staff contracts, whilst the Council's contribution rate has remained consistent. During 2016/17, contributions received exceeded benefits paid by £22.8m, which is relatively consistent with previous years.

6.2 The outcome of the most recent (2016) valuation has been a reduction in the Council's contribution rate from 36.9% to 34.9%, with further reductions to 34.0% and 33.0% planned for 2018/19 and 2019/20 respectively. Contribution rates beyond this point will depend on the outcomes of future valuations.

6.3 Additionally, ongoing reductions to the Local Government settlement mean that the Council remains under considerable financial pressure; whilst officers of the Fund are not currently aware of large scale plans for staff reductions, it is prudent to consider that these may be possible.

6.4 Although the scheme remains open, LGPS funds are beginning to mature, with increasing numbers of pensioners relative to their active membership. Large number of LGPS Funds are now cashflow negative, with many more predicted to become so in the short to medium term. The Fund's contribution rate is at the higher end of those paid by the LGPS, which has helped to insulate it from these pressures in recent years. However, given the ongoing budgetary pressures and planned contribution rate reductions over the next 3 years, it is appropriate to consider cashflow planning in the medium term, to ensure that likely notable reductions in the Fund's cashflow are anticipated and plans made accordingly.

6.5 Increasing scheme maturity and reduced cashflows often necessitate changes to investment strategy. As open schemes, often with substantial deficits, LGPS Funds have tended to use strategies focused on growth, maintaining high allocations to equities. However, this is beginning to change, as deteriorating cashflows require an increased focus on income, to avoid becoming a forced seller of assets. Forward planning is therefore essential to ensure that any necessary changes are made in timely and orderly manner.

7. RESULTS OF CASHFLOW EXERCISE

7.1 Appendix 1 sets out the results of the cashflow exercise undertaken by Hymans Robertson. The exercise modelled four separate scenarios, as follows:

1 Continue to pay the same rate from 2019/20 onwards and no reduction in active membership;

2 Allowance for council rate to reduce by 1% p.a. for 10 years from 2020/21 with the remaining rates being unchanged and no reduction in active membership;

3 Continue to pay the same rate from 2019/20 onwards and a reduction of 10% in the active membership from 1 April 2018;

4 Allowance for council rate to reduce by 1% p.a. for 10 years from 2020/21 and a reduction of 10% in the active membership from 1 April 2018.

The scenarios used are illustrative only and not indicative of likely outcomes. However, they do help to illustrate the sensitivity of the Fund's cashflows to reductions in active membership and to a reducing employer contribution rate.

7.2 Scenario 1, in which active membership does not reduce and the Council's employer contribution rate remains stable at 33% after 2019/20 indicates a stable positive cashflow. This should be contrasted with Scenario 2, which shows the impact of an ongoing gradual reduction in the Council's contribution rate (1% p.a. over 10 years). The modelling suggests that contributions received into the Fund exceed benefits only until 2025, after which the Fund can be considered cashflow negative.

7.3 Scenarios 3 and 4 both show the potential impact of a reduction of 10% in active membership. Even with the 2019/20 contribution rate maintained for the foreseeable future (Scenario 3), the current excess of inflows over outflows would be reduced by over half. Scenario 4 combines a gradual reduction in the contribution rate with a 10% reduction in active membership. It suggests that the Fund would be likely to be cashflow negative from around 2024, with the excess of outflows over inflows rising to around £20m.

7.4 The results suggest that, although under current conditions the Fund's cashflow remains strongly positive, it is highly sensitive to both reductions in contribution rate or to a decline in active membership, with particular sensitivity to a reducing contribution rate. It should also be remembered that a number of other factors will significantly impact the Fund's cashflows, including mortality rates, inflation (as benefit payments are tied to CPI) and salary increases.

7.5 The assumptions used for these factors in this exercise are those underlying the 2016 valuation; however, all are subject to considerable uncertainty. The impact of changes to these factors can also be complex; for example, increased rates of salary increase can be beneficial in terms of short term cashflow, but may have a less positive impact on the funding level, particularly where a large proportion of members still have significant final salary service. Additionally, certain combinations of factors could accelerate the deterioration of the Fund's cashflows, such as higher inflation combined with ongoing restrictions on salary growth.

7.6 In summary, although no immediate action is considered to be required, the Committee should be aware of the impact of reduced Council contributions which, depending on the level of reduction, could result in the Fund becoming cashflow negative within the next 10 years. As set out in the report, in addition to monitoring membership changes and other factors, some further work can be carried out by officers together with the Fund actuary to determine if further analysis is appropriate at employer level. Further updates will be provided to the Committee as necessary.

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Appendices
Appendix 1 – Results of the cashflow exercise

Background papers
None