Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES		
Pension Fund Budget 2019-20 **Pensions Committee** **25th June 2019**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	Appendices One **AGENDA ITEM NO.**

1. INTRODUCTION

1.1 This report introduces the budget for the Pension Fund for 2019-20. It considers income and expenditure from various sources and the impact on these for the Pension Fund in the next financial year. The budget itself will be presented at the 26th March Committee meeting,

2. RECOMMENDATIONS

2.1 The Committee is recommended to:

- **Approve the budget for 2019-20.**

3. RELATED DECISIONS

- Pensions Committee 29th March 2017 – Pension Fund Budget Report.
- Pensions Committee 25th June 2019 – Strategic Business Plan 2019-22

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

4.1 The Terms of reference for the Pensions Committee sets out its delegated responsibility to set and monitor the Pension Fund budget. This report introduces the budget forecast for the financial year 2019-20 to assist the Committee in fulfilling this responsibility.

4.2 Sound financial management of the Pension Fund, including budget-setting, helps ensure that the Pension Fund is run in an efficient and cost-effective manner. Failure to manage the Pension Fund's expenditure could result in increased costs, which would need to be met through higher employer contributions to the Pension Fund.

4.3 In considering the draft budget the Committee must be clear that the financial assumptions on which the budget is based are sound and realistic. It must also satisfy itself that the budget is robust enough to accommodate the potential pressures outlined in the report whilst ensuring that the fund is managed as efficiently as possible to maximise the benefits to members of the Scheme.

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

5.1 Under the London Borough of Hackney Constitution Terms of Reference for the Pensions Committee, the Committee has responsibility to set a budget for the operation of the Pension Fund and to monitor income and expenditure against budget. This report is being put before the Committee to enable it to fulfil this responsibility.

5.2 Given the above, consideration of the 2019/20 Pension Fund budget report would appear to properly fall within the remit of the Pensions Committee.

6. BACKGROUND TO THE REPORT

6.1 Due to the volatility that exists within most areas of the Pension Fund Account, preparing a budget for the Pension Fund is complex. The budget can be considered across three sections with different characteristics; member cashflows, operating costs and investment income. The three sections are set out in more detail below.

6.2 Member cashflows include contribution inflows from members and employers, benefit payments and transfer to and from other pension funds. These items represent the fund's most significant cashflows but lie mostly outside the control of the Fund. Whilst the Fund has a degree of control during the contribution rate setting process, it has no control over staffing decisions by employers, pay awards, inflation-linked benefit increases or pensioner longevity. Monitoring of these costs should therefore be focused on their significant impact on fund cashflows.

6.2 Operating costs include administration, investment and oversight and governance costs. These are the costs linked to the management of the Fund and represent the one area in which the Fund can exercise a significant degree of cost control. However, it should be remembered that the Fund has a large number of statutory responsibilities which must be discharged which will inevitably incur a degree of cost. Monitoring of these costs should be focused on ensuring that the Fund receives value for money from its suppliers and on cost reduction where this can be done without significant negative impacts on quality of service.

6.3 Investment income is dependent on investment performance but also on the asset classes to which the Fund allocates. The Fund's significant allocation to equities means that investment income levels have been highly volatile in the past; however, with a shift towards cashflow-generating assets such as private debt, the Fund's investment income should begin to stabilise to a certain degree. Monitoring of investment income should therefore be linked back to the Funds overall net cashflow and how this can be influenced by the Committee's investment strategy decisions.

6.4 Changes in the market value of investments can have a significant impact on the Fund's income statement; however, they are not considered within the Pension Fund budget for two reasons. Firstly, changes in market value will not impact cashflow if the changes are unrealised (i.e. the Fund retains the assets). Secondly, the Fund wishes to avoid reliance on asset sales to generate cashflow, as this is not a prudent long-term investment strategy. Including this item in the budget could therefore give a distorted picture of cashflows and encourage reliance on asset sales.

7. 2019/20 BUDGET

7.1 The 2019/20 budget is attached at Appendix 1 to this report and sets out the Fund's expected income and expenditure across the categories outlined in Section 6. .

7.2 Net cash inflows from members are expected to reduce from £24,034k in 2018/19 to £20,934k in 2019/20, driven partly by a forecast reduction in employer contributions and partly by a forecast increase in benefits payable. The budgeted net inflow is made up of £82,892k in member income (including employer and employee contributions, plus transfers in) and £61,959k in member expenditure (including pensions payable, lump sum commutation and death grants, and transfers out).

7.3 Key assumptions made around member cash inflows are as follows:

- Employee and employer contributions are assumed to be increased by a 2% pay increase for Hackney employees for 2019/20
- No material change in active member numbers is assumed, with no significant movement between contribution bands
- Employer contribution rates have been adjusted for 2019/20; the most significant change is a reduction in Hackney's contribution rate from 34% to 33% of pensionable pay. This has driven the bulk of the reduction in employer contributions

7.4 Key assumptions made around member cash outflows are as follows:

- Annual pension and lump sum payments are assumed to increase by 2.4% in line with the Consumer Prices Index (CPI), driving the forecast increase in pensions payable.
- No material change in pensioner numbers, profile or number of deaths is assumed.
- No significant change to lump sum commutation rates is assumed, thus maintaining the pre-existing balance between annual pensions payable and lump sum payments.

7.5 It should be remembered that member cashflows are sensitive to changes in the membership profile of the Fund (e.g. the balance between active, deferred and pensioner members). As set out in 7.3 and 7.4, no allowance has been made in the budget for changes in this balance as the in-year impact cannot be reliably estimated. However, over the longer term, the Fund is maturing and the ratio of pensioner and deferred to active members is increasing. Over time, this effect will reduce the Fund's net cash inflows, as contribution payments reduce relative to benefits paid out.

7.6 Operating costs are forecast to increase slightly from £8,176k in 2018/19 to £8,244k in 2019/20. The forecast increase is driven primarily by an increase in oversight and governance costs, which are forecast to increase as a result of the 2019 actuarial valuation. The increase in actuarial costs is slightly offset by a forecast reduction in governance consultancy costs, as the administration contract implementation project comes to an end.

7.7 Administration costs are forecast to remain relatively stable at £779k for 2019/20, versus £776 for 2018/19. Key costs drivers for the year are the Fund's third party administration costs and the ongoing GMP reconciliation project. It should be noted that the costs of GMP reconciliation are challenging to estimate, as the extent of work required for each case is not known in advance.

7.8 Given the difficulty of producing a reliable estimate, investment management costs are forecast on the basis of the 2018/19 outturn. The majority of investment management fees are charged on the basis of assets under management; as these can fluctuate significantly during the year depending on market conditions, producing a reliable estimate is challenging. Significant increases in asset values during the year would improve the Fund's funding position but would result in an increase in investment management fees relative to budget.

7.9 As set out in Section 6, volatility in the Fund's investment income level makes producing a reliable full year estimate challenging; the 2018/19 outturn has therefore been used as the budgeted amount for 2019/20.

7.10 Overall, the 2019/20 budget indicates a slight reduction in the Fund's net cash inflows, from £28,174k in 2018/19 to £25,006k in 2019/20. The most significant drivers of this reduction are the reduction in the Council's contribution rate from 34% to 33%, and the inflationary increase in the cost of pension payments. It should be remembered that member cashflows are also sensitive to changes in the membership profile (e.g. changes in the balances between active, deferred and pensioner members) and that this balance is likely to change over the longer term, reducing the Fund's net cash inflows.

Appendices
Appendix 1 -Pension Fund Budget 2019-20

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