Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES		
Actuarial Valuation and Funding Strategy Statement **Pensions Committee** **18th December 2019**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **None** **AGENDA ITEM NO.**

1. INTRODUCTION ¶

1.1 This report provides the Pensions Committee with an update on the Fund's 2019 triennial actuarial valuation. It sets out the initial results of the valuation and presents the results of the contribution modelling exercise carried out to help determine an appropriate contribution rate for the London Borough of Hackney. It also presents a draft Funding Strategy Statement for review by the Committee prior to consultation with employers. The Fund actuary will be attending the Pensions Committee meeting to provide training and discuss the results in more detail.

2. → RECOMMENDATIONS¶

2.1 The Pensions Committee is recommended to:

- Note the whole fund reported funding position and the assumptions on which it is based.
- Agree that the Fund should progress to the next stage of the valuation - identifying key risks and identifying parameters for setting individual employer contribution rates.
- Approve the draft Funding Strategy Statement for consultation with employers.

3. → RELATED DECISIONS¶

3.1 Pensions Committee 29th March 2017 - Pension Fund Actuarial Valuation 2016 - Valuation Report

4. → COMMENTS OF THE GROUP DIRECTOR OF FINANCE & CORPORATE RESOURCES¶

4.1 The triennial valuation outcome is sensitive to both the actuarial and financial assumptions made within the valuation, and the membership data used; significant variations to either the assumptions or the data used could impact the stated funding position or the outcome of the contribution rate modelling, which helps determine the contribution rates payable by the Fund's employers. Given the Council's position as a Fund employer, the inputs to the triennial valuation can therefore impact the level of resources available for other Council services.

4.2 It is therefore critical that both the Pensions Committee and Pension Board have a sound understanding of the valuation process and the assumptions used in making decisions with regards to the valuation.

5. → COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE SERVICES¶

5.1 Regulation 62 of the Local Government Pension Scheme (LGPS) Regulations 2013 prescribes that each administering authority must obtain:

- an actuarial valuation of the assets and liabilities of each of its pension funds as at 31st March 2016 and on 31st March in every third year afterwards;
- a report by an actuary in respect of the valuation; and
- a rates and adjustments certificate prepared by an actuary

5.2 Paragraph 7 of the Pensions Committee's Terms of Reference state that it is responsible for 'mak[ing] arrangements for the triennial actuarial valuation, monitor[ing] liabilities and undertak[ing] any asset/liability and other relevant studies as required.

5.3 Taking into account the regulatory requirements around the actuarial valuation and role of the Pensions Committee as set out in the Terms of Reference, the consideration of the 2019 valuation process would appear to properly fall within the Committee's remit

6. → BACKGROUND TO THE REPORT

6.1 Under the LGPS Regulations 2013, the Pension Fund is required to undertake a formal actuarial valuation every 3 years to establish its funding position and to set the contribution rate for the following three years. The last formal actuarial valuation of the London Borough of Hackney Pension Fund was carried out as at 31st March 2016; this showed an improvement in the funding level from 70%

to 77% and set the contribution rates for the three years commencing 1st April 2017.

6.2 The Fund's actuary, Hymans Robertson, has been reviewing the data supplied to them by the Fund's administrator (Equiniti) and has now been able to provide an initial assessment of the whole fund funding level. This is set out in the Initial Results Report at Appendix 1 and discussed in more detail in Section 7 of this report.

6.3 The actuary has also modelled potential contribution strategies for the London Borough of Hackney as an employer, testing each strategy to assess the extent to which it relies on investment returns to reach the funding target. More detail on this modelling is provided in Section 8 of this report, and in the actuary's summary at Appendix 2

6.4 A draft Funding Strategy Statement is attached at Appendix 3. The Fund is required to produce a Funding Strategy Statement under the LGPS Regulations 2013 and must revise it whenever it changes its policy on funding (i.e. at each valuation). The statement sets out how employer liabilities are measured, the pace at which these liabilities are funded, and how employers pay for their liabilities. This statement also sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis.

6.5 The Fund is running slightly behind its planned valuation timetable. The Fund would generally have expected to provide valuation data to the Actuary by August 2019; however, this was delayed by late receipt of employer data from the Council and the need for Equinti to undertake a significant data cleansing exercise prior to the submission of valuation data.

6.6 A full cut of data was submitted by Equiniti in mid October. Hymans Robertson have checked the data submitted as part of their valuation work and consider it to be of good quality overall. This represents a significant improvement relative to 2016, when although the Fund was able to submit data in line with the original timetable, issues with data quality meant that a significant period of revision was required to ensure the data was fit for purpose. The higher quality of the 2019 data has resulted from the receipt of improved employer data from the Council, and significant data cleansing work undertaken by both Equiniti and the in house pensions administration team prior to the submission of the data.

6.7 Whilst the delay to data submission has compressed the valuation timetable significantly, it is expected that employers will receive results early in the new year, permitting a suitable period of consultation prior to approval of the final valuation report by 31st March 2020.

7. WHOLE FUND FUNDING LEVEL

7.1 The Fund Actuary, Hymans Robertson, has now made an initial assessment of the whole fund funding level for the Hackney Pension Fund. This is set out in the Initial Results Report at Appendix 1. This report:

- presents the current funding position of the Fund using a range of actuarial assumptions;
- explains why the funding position has changed since the previous actuarial valuation was carried out in 2016; and
- shows the sensitivity of the funding position to actuarial assumptions made about the future (e.g. assumptions around investment returns and inflation).

7.2 The initial results suggest a funding level of 92%, which can be broken down as follows:

31 March 2019 (£m)	LB Hackney
Liabilities	
Active members	459
Deferred members	488
Pensioners	759
Total liabilities	**1,705**
Asset share	**1,575**
Surplus/(deficit)	(130)
Funding level	92%

7.3 It should be noted that the stated funding level is a snapshot in time, and reflects a range of assumptions, including the discount rate, salary assumptions and longevity and demographic assumptions; changing these assumptions would change this reported position. More detail on how the assumptions have been set can be found in Section 3 of the Initial Results Report.

7.4 The stated funding position of 92% represents a significant improvement from the 77% position calculated at the 2016 valuation and the funding updates provided to the Pensions Committee. A number of factors have driven this rise in the funding position, including investment returns, contributions received and changes in actuarial assumptions. More detail on the drivers of the increase can be found on page 10 of the Initial Results Report.

7.5 The most significant contributor to the increase in funding level is investment returns, followed by contributions paid in. Also of note are changes to the longevity assumptions used by Hymans Robertson; the recent slowdown in the rate of increase in life expectancy is now included within the actuary's projections.

7.6 Changes to salary increase assumptions have also had an impact; expectations around salary growth have been reduced relative to the 2016 valuation. Hymans Ropbertson have also changed their approach to setting the long term discount rate, moving from a gilts plus to a risk based approach which better reflects the open nature of the LGPS. This change will also affect the way funding updates are provided in the future, and should lead to a more stable reported funding level.

8. COMPASS MODELLING

8.1 Hymans Robertson's comPASS modelling is used to assess potential contribution strategies for the London Borough of Hackney as an employer. The key aim of the modelling is to assess the risk inherent in different potential funding strategies for the Council by considering the extent to which the proposed strategies are reliant on investment returns.

8.2 The model uses 5,000 different investment return scenarios (giving a wide distribution of outcomes) and models these against a small number of potential contribution strategies, considering for each strategy the probability of success and the extent of the downside risk associated with each scenario as well as performance across different time horizons.

8.3 The model therefore takes into account various factors when considering each strategy, which can be explained as follows:

- Time horizon – the actuary has considered the position at 2039 i.e. 20 years from the valuation date. This is in line with the Employer's current funding time horizon. In some cases she has also looked at the 17 year time horizon to 2036 to give insight into how sensitive the results are to the time horizon.
- Likelihood of success – What is the "risk" tolerance? i.e. how likely is it that the employer will be fully funded within the time horizon? The actuary has assumed use of a minimum 66% measure in line with the current Funding Strategy Statement although this should not be viewed as a target
- Downside risk – How "bad" is the worst case scenario? i.e. how low could the funding level fall by the end of the time horizon? The modelling shows the averages of the worst 5% of funding levels for each strategy to indicate the extent of downside risk.
- Investment strategy – The purpose of the modelling is to compare the results with the current investment strategy to understand the impact on funding outcomes. The impact of the results on an alternative, lower risk investment strategy are also considered to test whether the contribution strategy remains appropriate if the Fund reduces investment risk in future (this analysis applies to the contribution rate only and does not replace appropriate investment advice when making strategy changes.)

8.4 The results of the modelling are set out in more detail in Appendix 2. Initial indicators are that thanks to a period of strong asset returns and a prudent approach to rate setting, the Fund is able to continue its trajectory of incremental reductions in London Borough of Hackney's contribution rate.

Whilst the model provides the Fund with a framework to help determine an appropriate contribution rate for the London Borough of Hackney as an employer, it should be noted that other factors must also be considered.

8.5 Other factors to be considered include:

- Budgets - if contributions are reduced or frozen now, will there be difficulty in increasing contributions if this is required in the future?
- Scrutiny - Proposed rates need to be justified to the Pensions Board and external bodies such as the Government Actuary's Department (GAD)
- External Risks - these include climate change and political uncertainty, and could lead to a less benign investment environment in the future
- Legal/Regulatory Risks - these include the McCloud ruling and the cost cap mechanism, both of which lead to uncertainty around possible benefit changes. Ideally, the contribution strategy needs to be flexible enough to absorb the impact of changes. Hymans recommend that this be achieved by increasing the required probability of success when testing contribution strategies.

8.6 It should also be noted that contribution rates are calculated by employer; different employers have different histories within the Fund and therefore have different contribution rates and funding positions. The change in contribution rate for each employer between 2016 and 2019 will depend on the individual employer's circumstances; the rate payable by the London Borough of Hackney and the proposed direction of travel are not applicable to other employers.

8.7 Once this initial stage of valuation has been reviewed and agreed, the actuary will proceed to the calculation of other employer rates.

8.8 Once this initial valuation approach and outcome has been agreed, the actuary will liaise with fund officers to calculate individual employer rates. A period of consultation with employers is required; we therefore hope to be able to distribute these to employers in January 2020, with 1-2-1 sessions with the actuary being offered to employers at the employer forum in March.

9. FUNDING STRATEGY STATEMENT

9.1 The Funding Strategy Statement (FSS) is a legal requirement under Regulation 58 of the LGPS Regulations 2013, which states that 'an administering authority must, after consultation with such persons as it considers appropriate, prepare, maintain and publish a written statement setting out its funding strategy.' The statement must be updated each time the Fund changes its policy on funding (i.e. after each valuation).

9.2 The statement sets out how employer liabilities are measured, the pace at which these liabilities are funded, and how employers pay for their liabilities. It also sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and

- prudence in the funding basis.

9.3 A draft FSS is attached at Appendix 3 to this report. The Committee are asked to review and approve this draft statement for consultation; the statement will then be provided to employers for feedback prior to final approval in March 2020.

Group Director of Finance & Resources

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Appendices
Appendix 1 - Exempt - Initial Results Report
Appendix 2 - Exempt - ComPASS Modelling Summary
Appendix 3 - Draft Funding Strategy Statement