Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES		
Actuarial Valuation and Funding Strategy Statement **Pensions Board** **9th March 2020**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **Two** **AGENDA ITEM NO.**

1. INTRODUCTION

1.1 This report provides the Pensions Board with an update on the Fund's 2019 triennial actuarial valuation. It sets out the whole fund results of the valuation and summarises the contribution modelling process used to determine an appropriate contribution rate for the London Borough of Hackney. It also sets out proposed employer contribution rates and presents the Fund's draft Funding Strategy Statement, both of which are due to be sent for employer consultation imminently. The Fund actuary will be attending the Pensions Board meeting to provide training and discuss the results in more detail.

2. RECOMMENDATIONS

2.1 The Pensions Board is recommended to:

- Note the whole fund reported funding position and the assumptions on which it is based.
- Note the draft Funding Strategy Statement

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 The role of the Pension Board is prescribed by Section 106 of the Local Government Pension Scheme Regulations 2013 and includes the following:

- Securing compliance with the Local Government Pension Scheme Regulations 2013 and any other legislation relating to the governance and administration of the Scheme and any connected scheme
- Securing compliance with any requirements imposed by the Pensions Regulator in relation to the Scheme and any connected scheme
- Ensuring the effective and efficient governance and administration of the Scheme and any connected scheme

5.2 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.

5.3 Taking into account the role of the Pensions Board in securing compliance with the Local Government Pension Scheme Regulations 2013 and statutory guidance, the consideration of the triennial valuation would appear to properly fall within the Board'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 reviewed the data supplied to them by the Fund's administrator (Equiniti) and has provided an initial assessment of the whole fund funding level. 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 1.

6.3 A draft Funding Strategy Statement is attached at Appendix 2. 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.

6.4 Individual employer rates are due to be sent for consultation with employers in the week commencing 24th February 2020. The Fund is holding an employer forum on 6th March to allow employers the opportunity to hear about the valuation process from the actuary and discuss their proposed employer rates.

6.5 The Fund is running behind its planned valuation timetable but fully expects to be able to meet the statutory deadline of 31st March 2020. The Fund made the decision in Spring 2019 to delay data submission to allow for data cleansing prior to providing data to the actuary; a full cut of data was submitted to Hymans Robertson in mid-October. Whilst this delay significantly compressed the valuation timetable, it did allow the Fund to submit higher quality data than would otherwise have been possible.

6.6 Since submitting the data, the Fund has experienced one further delay to its timetable. This has resulted from an error in the data submitted by Equiniti with regards to part time members, which has required both individual employer and the whole fund funding level to be reassessed. This issue has delayed the release of proposed contribution to employers for consultation, but will not impact the Fund's ability to sign off the final valuation report by 31st March 2020. More information on this issue is set out in Section 7.

7. WHOLE FUND FUNDING LEVEL

7.1 The Fund Actuary, Hymans Robertson, has assessed the whole fund funding level for the Hackney Pension Fund. The results suggest a funding level of 92%, which can be broken down as follows:

Assets (£m)	1,575
Liabilities (£m)	1,706
Surplus/(deficit) (£m)	(131)
Funding Level	92%

7.2 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.

7.3 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.

7.4 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. Changes to salary increase assumptions have also had an impact; expectations around salary growth have been reduced relative to the 2016 valuation.

7.5 Hymans Robertson 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. The Fund actuary originally recommended a discount rate of 4%, as this was considered to represent a 70% likelihood that the Hackney fund's investments would meet or exceed that annual level of return over the 20 years from the 2019 valuation date.

7.6 Whilst carrying out detailed data checking ahead of calculating individual employer rates, the actuary identified an error in the data provided for active members working part time. The data submitted for these members' final salary service used qualifying service (the number of years and days a member has been a contributing member of the LGPS) rather than the reckonable service (service adjusted for part time hours, which is used to calculate final salary benefits).

7.7 This error resulted in liabilities at the whole fund level being overstated by 2%, with significant differences for some of the smaller employers. The Fund actuary quickly alerted both Equiniti and Fund officers to the issue, which was swiftly resolved by Equiniti. Fund officers are now working with Equiniti to understand how the error arose and to ensure that robust processes are put in place to prevent any such errors from occurring in the future.

7.8 The Fund actuary has now recalculated both the whole Fund and employer level liabilities. Rather than show the reduction in liabilities as an increase in the 92% funding level, the Fund has instead opted to revert to the discount rate used at the 2016 valuation, 3.85%. The actuary considers that the likelihood of achieving this as an annual return over 20 years from the valuation date is 72% and therefore represents a slightly more prudent position.

7.9 The error was identified prior to the calculation of most employer contribution rates; although it has resulted in a delay to the planned timetable, the rates have been calculated using the correct data. The contribution rate for the London Borough of Hackney has been calculated using Hymans Robertson's comPASS modelling (set out in more detail in Section 8). Whilst this was run prior to the discovery of the error, the actuary is of the opinion that re-running the modelling would not produce materially different results to those originally set out. This is because of the relatively small impact on total past service liabilities when spread over the next 20 years.

8. HACKNEY COUNCIL EMPLOYER RATE

8.1 Hymans Robertson's comPASS modelling was used to assess contribution strategies for the London Borough of Hackney as an employer. The key aim of the modelling was 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 used 5,000 different investment return scenarios (giving a wide distribution of outcomes) and modelled 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 took into account various factors when considering each strategy, which can be explained as follows:

- Time horizon – the actuary 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 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 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 set out 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 was 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 were 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 1. The results indicated 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. The Pensions Committee considered the modelling results at its meeting on 18th December and, after consideration of the paper at Appendix 1, set the following rates:

- 2020/21 - 31.5%
- 2021/22 - 30.0%
- 2022/23 - 30.0%

8.5 Whilst the drop from the current rate of 33% to 30% is slightly faster than originally proposed, the actuary's view is that, in this particular case, the changes to the contribution strategy originally proposed are relatively minor and should have an immaterial impact on the likelihood of long term funding success. She has taken this view on this occasion taking into account the current health of the fund, current contribution rate in payment and the 2019 valuation comPASS modelling results.

8.6 Other factors considered included:

- 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.

9. OTHER EMPLOYER RATES

9.1 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.

9.2 Individual employer rates are due to be sent for consultation with employers in the week commencing 24th February 2020. The Fund is holding an employer forum on 6th March to allow employers the opportunity to hear about the valuation process from the actuary and discuss their proposed employer rates.

10. FUNDING STRATEGY STATEMENT

10.1 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).

10.2 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.

10.3 A draft FSS is attached at Appendix 2 to this report. The Committee has approved this draft statement for consultation with employers, who will be asked to provide feedback prior to final approval in March 2020.

11. IMPACT OF MCCLOUD

11.1 In a case in December 2018 the Court of Appeal held that transitional protections that protected older judges and firefighters from the public sector pension scheme changes in 2015, were unlawfully discriminatory. This case is known as the 'McCloud case. The ruling has had implications for the LGPS as similar reforms were implemented.

11.2 The Government sought permission to appeal the case to the Supreme Court, but was not granted the right to do so. As such, the LGPS benefit structure is currently under review but at present it is not clear what alterations will be made to benefits accrued from 1 April 2014 to remedy this discrimination.

11.3 Clearly changes to the benefit structure will impact the LGPS local funding valuations; however, in the absence of any detail on the future changes the exact impact is unclear. The Ministry for Housing, Communities and Local Government (MHCLG) have confirmed that funds must make an allowance in their valuations for the McCloud ruling and explicitly state in their actuarial valuation report and/or Funding Strategy Statement how they have done so.

11.4 In preparing the Hackney Fund's valuation, Hymans Robertson have allowed for the potential impact of McCloud in the assessment of employer contribution rates by building in a slightly higher required likelihood of reaching the funding target, all other things being equal, when setting employer contribution rates. The agreed approach is documented in the draft Funding Strategy Statement.

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Appendices

Appendix 1 - Exempt - ComPASS Modelling Summary
Appendix 2 - Draft Funding Strategy Statement