Hackney

REPORT OF THE GROUP DIRECTOR, FINANCE & CORPORATE RESOURCES		
Funding and Investment (De-Risking) Considerations **Pensions Committee** **30 September 2021**	**Classification** **Public** **Ward(s) affected** **ALL**	**Enclosures** **One** **AGENDA ITEM NO.** **6**

1. INTRODUCTION

1.1 This report presents a joint paper from the Fund's Investment Consultants and its Actuary in respect of funding and investment considerations. Specifically, it considers how recent asset outperformance has impacted the Fund's funding level; what that improved funding level means for the Fund's ability to meet future benefit payments; and proposed next steps.

2. RECOMMENDATIONS

2.1 The Pensions Committee is recommended to:

- note the report; and
- agree to bring forward the 2022 council contribution rate review to Q4 2021 and to undertake a refreshed asset and liability modelling exercise.

3. RELATED DECISIONS

- Pensions Committee 28th September 2020 - Investment Strategy Review
- Pensions Committee (Urgency Delegation March 2020) – 2019 Final Valuation Report and Funding Strategy Statement
- Pensions Committee 29th March 2017 –Investment Strategy Statement

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

4.1 The Pensions Committee has delegated responsibility for management of the Pension Fund, including matters concerning its investment strategy, funding levels and related matters.

4.2 The funding and the investment strategies adopted have a material impact on the performance of the fund and influence the overall funding level and hence, have a direct impact on the employer contribution levels required going forward. It is therefore important that the Committee understand the impacts of funding level on investment opportunities and strategies in order that it can consider when it might be appropriate to de-risk its investment strategy. In this way, the Committee can ensure that decisions in respect of future funding and investment strategy are relevant and reflective of the ability of the fund to pay future benefits as they become due.

4.4 This report sets out the issues that Committee should consider given the current funding level and discusses the appropriate next steps.

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

5.1 The Pensions Committee's Terms of References sets out its responsibility for management of the Pension Fund. The Committee has delegated responsibility:

- To make arrangements for the triennial actuarial valuation, monitor liabilities and to undertake any asset/liability and other relevant studies as required.
- To monitor the performance and effectiveness of the investment managers and their compliance with the Statement of Investment Principles (Investment Strategy Statement).
- To set an annual budget for the operation of the Pension Fund and to monitor income and expenditure against budget.
- To act as Scheme Manager for the Pension Fund

5.2 Given these responsibilities, it is appropriate for the Committee to consider the actions that need to be taken in respect of the investment and the funding strategies going forward.

6. 2020 INVESTMENT STRATEGY REVIEW

6.1 The Committee considered the Fund's Investment Strategy during 2020 and looked at whether there was scope to de-risk in different scenarios. In doing so, it considered the suitability of the then existing strategy and two alternatives.

6.2 The two alternatives considered were de-risk to protection assets (bonds) adding 10% to protection or diversify to income adding 10% to income generating assets.

6.3 The Committee agreed that the second alternative, allocating 83% to growth and income assets and 17% to protection assets would be implemented - this strategy is currently being implemented.

7. IMPACT OF ASSET OUTPERFORMANCE ON FUNDING LEVEL

7.1 Investment returns since March 2019, the effective date of the last valuation, have been c24% and this increase has been the main driver behind an increase in the asset value from £1.575bn in March 2019 to £1.895bn in June 2021.

7.2 The funding level is derived as the ratio between the value of the Fund's assets to the value of accrued liabilities to date and hence is only in respect of the past service benefits. The current funding level set out in the paper at Appendix 1 is 107%.

7.3 As set out in that paper, it should be noted that this funding level is in fact based on a single set of assumptions at a point in time and it is therefore sensitive to the choice of assumptions, particularly those relating to the expected future investment returns.

7.4 However, regardless of the investment return assumption used, the paper shows that there has been a significant improvement on the funding position of the Fund at 30 June 2021 compared to the 92% at the last valuation effective March 2019.

7.5 Leading on from this improvement and increased returns, the future level of investment returns required to remain notionally fully funded has fallen from 4.3% to 3.3%. The likelihood of achieving the required level of return has increased from 65% to 79% -the Fund is more likely than not to achieve the future returns required to be fully funded.

8. WHAT DOES THE IMPROVED FUNDING LEVEL MEAN?

8.1 As set out above and explained in the appendix in more detail, the 107% funding level refers only to past service funding position.

8.2 The LGPS is an open scheme, open to both future benefit accrual from existing members and new entrants. The report at Appendix 1 explains that the past service benefits only account for c30% of benefits that the Fund will pay out in the future.Therefore around two thirds of the benefit payments made over the next 50 years will relate to benefits yet to be accrued.

8.3 The employer contribution rate is made up of two elements - the primary rate which aims to meet the cost of the future benefit accruals and the secondary rate which aims to target the funding position over an agreed time. For the Hackney Fund, the larger element of the current employer contribution rate is the 18.5% related to the primary rate, with the remaining 11.5% relating to the secondary rate.

8.4 The improved past funding level at 30 June 2021 is likel;y to have a positive impact on the secondary rate providing some opportunity to potentially reduce this element. However, it should be noted that the primary rate is likely to be under pressure to increase as the longer term future market conditions for valuing benefit costs are expected to be more challenging.

9. CONCLUSIONS

9.1 All else being equal, recent strong asset outperformance is good news for the Fund as it will help to meet the cost of both past and future accrued service benefit payments and may provide the Fund the opportunity to reduce risk within its investment strategy.

9.2 However, it should be noted that the current funding level does not consider the benefits which will be accrued in the future.

9.3 Our advisors and Actuary from Hymans are recommending that we undertake an updated Asset Liability Modeling (ALM) exercise that considers how the investment strategy and contribution strategy operate together with the cost of past and future service benefits and that we bring forward the 2022 Council contribution rate review from 2022 to Q4 2021.

9.4 This will allow the Fund to act quickly on any opportunities arising from the recent asset outperformance and to agree a contribution and investment strategy which together continue to provide a high likelihood of meeting the Fund’s long term funding objectives and requirement to pay benefits as they fall due.

9.5 The Investment Consultant and Fund Actuary from Hymans will be at the meeting in September to provide a more detailed review of the findings and recommendations set out Appendix 1.

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Appendix - Funding and Investment Considerations at 30 June 2021

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