Title of Report	Actuarial Valuation - Contribution Rate Modelling (Hackney Council)
For Consideration By	Pensions Committee
Meeting Date	16th June 2022
Classification	Open (Exempt Appendix)
Ward(s) Affected	All
Group Director	Ian Williams, Group Director Finance & Corporate Resources

1. Introduction

1.1. This report provides the Pensions Committee with an update on the Fund's 2022 triennial actuarial valuation. It sets out the results of the contribution modelling exercise carried out to help determine an appropriate contribution strategy for the London Borough of Hackney over the next 3 years. 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 Committee is recommended to:**

- Agree a contribution rate for Hackney Council of at least 27% of payroll for each of the 3 years covered by the 2022 valuation cycle (2023/24, 2024/25, 2025/26), noting that the planning assumption for Medium Term Financial Planning (MTFP) purposes will be 28% pending the finalisation of the revaluation process.

3. Related Decisions

3.1. Pensions Committee 15th June 2022 - Carbon Risk Audit 2022 - Full Results

3.2. Pensions Committee 10th March 2022 - Responsible Investment Policy & Carbon Risk Audit

4. **Comments of the Group Director of Finance and 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, Democratic and Electoral 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 2022 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 review the funding and risk management arrangements in place to ensure that they remain appropriate in the current environment.The last formal actuarial valuation of the London Borough of Hackney Pension Fund was carried out as at 31st March 2019.

6.2. Since the previous valuation, the financial, demographic and political environment within which the Fund operates has changed. When carrying out the valuation the Fund Actuary has therefore taken the following considerations into account:

- Strong asset performance: the value of the Fund's assets has increased (due to investment returns) by more than expected at 2019.

- Future economic outlook: the long-term economic outlook has worsened compared to that at the 2019 valuation.

- Benefit structure changes: whilst there is now greater certainty about the format of the McCloud remedy, there is still uncertainty about the outcome of the 2016 cost cap valuation which may affect the LGPS benefit structure.

- Employer budgets: mainly due to the Covid-19 pandemic, most employers are managing reduced revenues and/or increased costs which increases the focus on affordability of pension contributions.

- Climate change risk: there has been a significant increase in focus on how climate change may affect the Fund with an expectation that pension funds now factor the risk into strategic decision making.

6.3. The current formal valuation is taking place as at 31 March 2022. Membership and other data effective as at 31 March 2022 will be collected from Equiniti, the Fund's administrator, during June 2022 and a review will be carried out of the contribution strategy for all employers in the Fund.

6.4. This paper sets out the results of the review of Hackney Council's contribution strategy. As the Council will participate in the Fund for the long term and continue to admit new entrants, the Fund Actuary has used modelling techniques to review the contribution strategy ahead of the valuation exercise. This allows the Fund to consider and communicate the contribution strategy to the Council early in the valuation process (Q1 – Q2 2022) which, in addition to assisting the Council with its budgeting, has the additional benefit of freeing up Fund Officer resource during the remainder of the 2022 valuation to focus on the Fund's other participating employers.

6.5. During the latter half of 2022, the Fund will review its Funding Strategy Statement which sets out the long term contribution strategy adopted for each employer. Following this exercise, the Fund Actuary will certify a Rates and Adjustments certificate, which sets out the contribution rates payable in each year from 1 April 2023 to 31 March 2026. The statutory deadline for publishing the final valuation report complete with Rates and Adjustments certificate is 31 March 2023.

7. Contribution Rate Modelling

7.1. The Fund Actuary has used asset liability monitoring to review the Council's contribution strategy. This type of modelling involves projecting forward the

Council's assets and liabilities over time. 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.

7.2. The strategies tested are as follows:

Strategy	Rate pattern	Current contribution rate in payment (% of pay)	2023-24 (% of pay)	2024-25 (% of pay)	2025-26 (% of pay)	Thereafter
1	-1.0% for 3 years then +/- 1.0%	30.0%	29.0%	28.0%	27.0%	Maximum annual increase or decrease of 1.0%
2	27% for 3 years then +/- 1.0%	30.0%	27.0%	27.0%	27.0%	Maximum annual increase or decrease of 1.0%
3	25% for 3 years then +/- 1.0%	30.0%	25.0%	25.0%	25.0%	Maximum annual increase or decrease of 1.0%

7.3. All the strategies modelled have been tested using an investment strategy with a 10% lower allocation to growth assets than the Fund's current investment strategy. The Fund is currently reviewing its investment strategy; however, this is at an early stage and no decisions have yet been made – the alternative investment strategy has been modelled for sensitivity purposes only.

7.4. All the strategies modelled assume a long long-term contribution stability mechanism for the Council. The modelling covers time horizons of 20 and 17 years, whilst the contribution strategies described below are short term, covering the 3 year period of the 2022 valuation cycle. The contribution stability mechanism is used to model rates for the remainder of the time horizon. The mechanism limits rate changes to +/- 1% per annum, thus smoothing out the contribution rate volatility inherent in a long-term defined benefit scheme such as the LGPS.

7.5. Each strategy is also stress tested by modifying the following factors:

- Time horizon – the actuary has considered the funding outcomes after 20 years. This is consistent with the approach taken at the 2019 and previous valuations. The time horizon is kept consistent so that the Fund is setting funding plans that are fair between generations of taxpayers. In line with the approach taken at the 2019 valuation, a time horizon of 17 years is also considered to show the sensitivity of the results to time horizon.

- Starting asset value - to test the sensitivity of the modelling results to volatile markets, the Actuary has also considered results that assume an immediate fall in asset values of 10% at the beginning of the projection period.

7.6. The outcomes for each strategy are summarised using 2 key risk metrics as follows:

- 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? In line with the Funding Strategy Statement, only contribution strategies that have at least a 70% likelihood of success at the end of the funding time horizon are considered viable options.

- 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. The Fund will not accept a strategy where the downside risk is materially worse than another strategy tested.

7.7. The results of the modelling are set out in more detail in Appendix 1. The results demonstrate that there are options available for the Employer’s contribution rate for the period 1 April 2023 to 31 March 2026 covered by the 2022 valuation Rates and Adjustments certificate:

- Continuing with downward steps in contributions over the 3 years, the Employer would pay 29.0% in 2023/24, 28.0% in 2024/25 and 27.0% in 2025/26. The modelling results show that this contribution strategy (Strategy 1) achieves above the minimum 70% likelihood of success and acceptable downside risk for each option tested.

- Equally, accelerating the step down in contributions such that 27.0% is paid in all 3 years (Strategy 2) does not materially affect the long term funding outcomes, and may also be considered a viable option.

- Accelerating the step down in contributions such that 25.0% is paid in all 3 years (Strategy 3) does not meet the 70% likelihood of success criterion when stress tested against a 10% lower starting asset value. This option may therefore materially affect the long term funding outcomes and should not be considered as a viable option.

7.8. As results have been shown allowing for a 10% reduction in growth assets, the modelling results demonstrate that the above contribution strategies are robust to such a change in investment strategy, should this be considered as part of the ongoing investment strategy review.

7.9. Any contribution scenario outside of the stabilisation mechanism would be a significant deviation from the long-term funding strategy which is the key way the Fund can set contributions at future valuations i.e if contributions are drastically reduced, the quid pro quo could be that at a future valuation they need to drastically increase.

7.10. Given the results of the modelling, the Committee is recommended to agree a contribution rate for Hackney Council of at least 27% of payroll for each of the 3 years covered by the 2022 valuation cycle (2023/24, 2024/25, 2025/26).

8. Cash Flow Modelling

8.1. Given the results of the Fund Actuary's modelling, officers of the Fund have considered the cash flow impacts of a number of different contribution rate strategies at or above the 27% lower threshold. The strategies considered are as follows:

Strategy	Rate Pattern	Current Rate (% of payroll)	Rate 2023/24 (% of payroll)	Rate 2024/25 (% of payroll)	Rate 2025/26 (% of payroll)	Rate Thereafter (% of payroll)
a	-1% for 3 years then +/- 1%	30%	29%	28%	27%	Maximum annual increase or decrease of 1%
b	28% for 3 years then +/- 1%	30%	28%	28%	28%	Maximum annual increase or decrease of 1%
c	27% for 3 years then +/- 1%	30%	27%	27%	27%	Maximum annual increase or decrease of 1%

8.2. The table below shows the results of the analysis. It sets out the estimated cash impact of each of the 3 strategies for the Council's General Fund, Housing Revenue Account and Pension Fund, relative to maintaining the status quo (a contribution rate of 30% of payroll per annum).

Strategy	**Budget**	**Cash Impact 23/24 (£000)**	**Cash Impact 24/25 (£000)**	**Cash Impact 25/26 (£000)**	**3 year Total**
29%/28%/27%	General Fund	1,678	3,424	5,239	10,341
	Housing Revenue Account	334	681	1,042	2,057
	Pension Fund	(2,012)	(4,105)	(6,281)	(12,398)
Flat 28%	General Fund	3,357	3,424	3,492	10,273
	Housing Revenue Account	668	681	695	2,044
	Pension Fund	(4,025)	(4,105)	(4,187)	(12,317)
Flat 27%	General Fund	5,035	5,136	5,239	15,410

	Housing Revenue Account	1,002	1,022	1,042	3,065
	Pension Fund	(6,037)	(6,158)	(6,281)	(18,475)

8.3. The estimates are based on estimated pay budgets produced for the Council and assume a pay increase of 2% per annum. It should be noted that these are an estimate only and that the Council's actual pay budget will fluctuate over the next 3 years depending on a number of factors including future inflationary pay increases and staff numbers.

8.4. Once inflationary increases to benefits are factored in, all of the scenarios modelled suggest that the Fund is likely to move from a cashflow positive to a cashflow negative position during the next valuation cycle. All scenarios suggest a small surplus from dealings with members; however, in all cases this is less than the Fund's estimated administration, governance and investment-related cash outflows, resulting in an overall cashflow negative position.

8.5. This change in cashflow status has been anticipated for a number of years and changes have been made to the investment strategy to ensure that the Fund's investments generate sufficient income as well as capital growth.

8.6. As set out in Section 7, the Fund Actuary will certify a rate at or above 27% of payroll. Given the current economic uncertainty, it is recommended that for Medium Term Financial Planning (MTFP) purposes, the Committee agrees to a flat rate of 28% of payroll.

Appendices

Appendix 1 (EXEMPT) - Hymans Robertson - Contribution Rate Modelling

Exempt

By Virtue of Paragraph 3, Part 1 of schedule 12A of the Local Government Act 1972 this report and/or appendix is exempt because it contains Information relating to the financial or business affairs of any particular person (including the authority holding the information) and it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Background documents

None

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