Title of Report	Actuarial Valuation 2022 - Final Valuation Report & Funding Strategy Statement
For Consideration By	Pensions Committee
Meeting Date	30 March 2023
Classification	Public (including Exempt Appendix)
Ward(s) Affected	All
Group Director	Ian Williams, Group Director Finance & Corporate Resources

1. Introduction

1.1. This report asks the Pensions Committee to approve the final 2022 Valuation Report and Funding Strategy Statement. It presents the final valuation report for approval and summarises both the assumptions used to determine the funding level and the process used to set contribution rates. It also sets out agreed employer contribution rates and presents the Fund's Funding Strategy Statement for approval.

2. Recommendations

2.1. The Pensions Committee is recommended to:

- **Approve the 2022 Valuation Report**
- **Approve the post-consultation Funding Strategy Statement**

3. Related Decisions

3.1. Pensions Committee 29 September 2022 - 2022 Actuarial Valuation - Initial Whole Fund results & Draft Funding Strategy Statement

3.2. Pensions Committee 16 June 2022 - Actuarial Valuation - Contribution Rate Modelling (Hackney Council)

4. Comments of the Group Director of Finance and Corporate Resources.

4.1. The triennial actuarial valuation is an important part of the Fund's risk management framework. Its main purpose is to ensure that the Fund is able to develop contribution and investment strategies that will achieve the objectives set out in the Funding Strategy Statement. The key outcomes from the Valuation process are the setting of employer contribution rates for the period 1 April 2023 to 31 March 2026, and the published single funding level of the Fund as 31 March 2022.

4.2. 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.

4.3. 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.

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. Regulation 66 requires the Administering Authority to publish and supply copies of any valuation report and a contribution rates and adjustments certificate to the Secretary of State, each employing bodies contributing into the Fund and any other body liable to make payments to the Fund.

5.3. This report helps to demonstrate that the Council as administering authority for the Fund is acting in accordance with the Regulations set out above.

5.4. There are no immediate legal implications arising from this report.

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 Fund Actuary has carried out the most recent valuation as at 31st March 2022; this shows an improvement in the funding level from 92% to 106% and sets the contribution rates for a 3 year period commencing 1st April 2023.

6.2. The final Valuation Report is attached at Appendix 1. The report satisfies the requirements of Regulation 62 of the Local Government Pension Scheme (LGPS) Regulations 2013 by presenting the actuarial valuation of the assets and liabilities of the Fund as at 31st March 2022. The report also includes the rates and adjustments certificate, which sets out the minimum contributions required from each employer for each of the next 3 years.

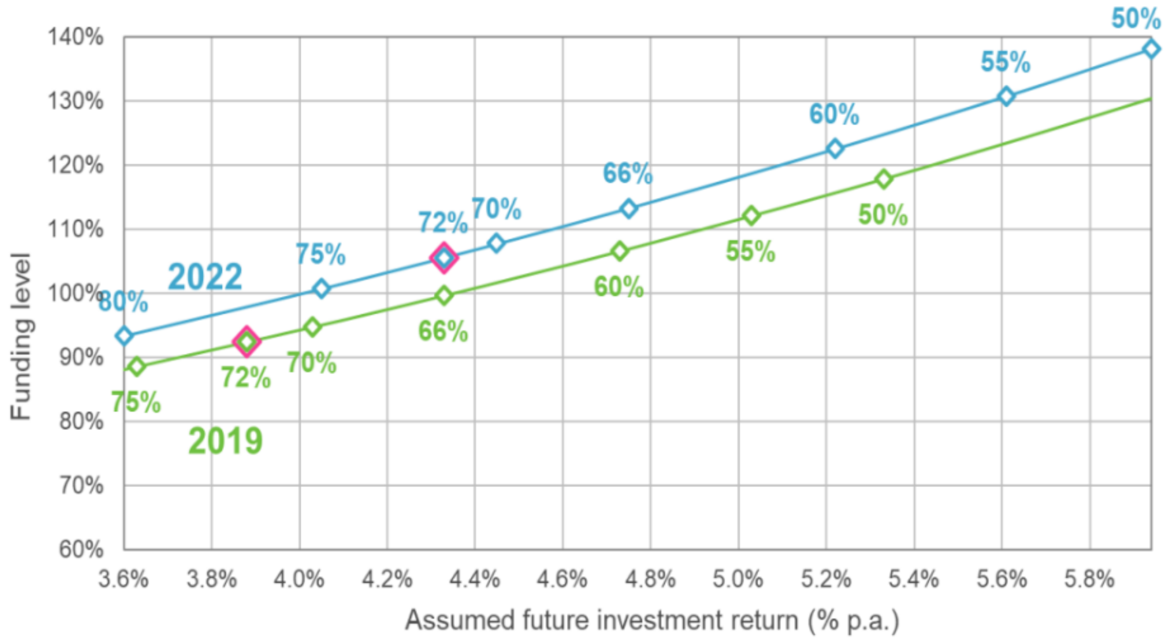
6.3. The Funding Strategy Statement is attached at Appendix 2. The Fund is required to produce a Funding Strategy Statement under the LGPS Regulations 2013 and must revise it whenever it changes its policy on funding (i.e. at each valuation). The statement sets out how employer liabilities are measured, 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.

7. Funding Level and Single Funding Position

7.1. The funding level is the ratio of assets to liabilities. The market value of the assets at the valuation date are known. The value of the liabilities is uncertain given that the level of future investment returns are unknown. Therefore, the Valuation Report at Appendix 1 shows the liabilities and funding level calculated across a range of different investment returns (the discount rate as shown in the chart below:

Chart 2: funding level across a range of future investment returns



Figures on each line show the likelihood of the Fund's assets exceeding that level of return over the next 20 years

7.2. The chart shows that the funding position at 2022 is stronger than 2019. The funding level is 100% if future investment returns are c.4.1% pa. The likelihood of the Fund's assets yielding at least this return is around 74%. The comparator at 2019 was a return of 4.3% pa which had a likelihood of 65%.

7.3. Whilst the chart on the previous page provides a useful indication of the sensitivity of the past service funding position to the valuation assumptions, there is still a requirement for the Actuary to report a single funding level at 31 March 2022. To report a single funding level and funding surplus/deficit for the 2022 valuation, a discount rate of 4.3% pa has been used. There is a 72% likelihood associated with a future investment return of 4.3% p.a.

7.4. The table below details the single funding position as at 31 March 2022. The results at the 2019 formal valuation are shown for comparison.

Valuation Year	2022	2019
Assets (£m)	1,965	1,575
Liabilities (£m)	1,861	1,706
Surplus/(deficit) (£m)	104	(131)
Funding Level	106%	92%

7.5. It should be noted that the single 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.

7.6. The liabilities are calculated using a single set of assumptions about the future and so are very sensitive to the choice of assumptions. The market value of assets held by the Fund will change on a daily basis. More detail on how the assumptions have been set can be found in the Valuation Report at Appendix 1.

7.7. The single funding position of 106% represents a significant improvement from the 92% position calculated at the 2019 valuation. A number of factors have driven this rise in the funding position, including higher than expected investment returns and changes in actuarial assumptions.

7.8. The most significant contributor to the increase in funding level is higher than expected investment returns. This has had a material positive impact on the funding position and employers' secondary contribution rates. Expectations about the future, which inform the assumptions used to value the liabilities, have also changed since the last valuation. The most significant changes are:

- Future inflation: this is expected to be on average higher than at the 2019 valuation due to the current level of high inflation.
- Investment returns: due to changes in financial markets, future investment returns are now expected to be slightly higher than at the last valuation.

7.9. The most significant external event to occur since the last valuation has been the Covid-19 pandemic. The analysis of member experience within the Valuation Report shows that there were sadly a higher than expected number of deaths over the period. However, the overall impact on the funding position has been small.

8. Employer Contribution Rates

8.1. The primary objective of the Fund is to set employer contribution rates that will adequately cover the cost of benefits which will accrue in the future and any costs related to benefits already earned. A secondary objective is to ensure the rates are as stable as possible.

8.2. Employer contributions therefore need to be set at a level which ensures the Fund has a reasonable likelihood of having enough money to pay members' benefits. Identifying the amount of benefits that may be paid is complex as those earned today might only start being paid in 50 years' time. Over that time period, there is significant uncertainty over factors which affect the cost of benefits, e.g. inflation, investment returns.

8.3. These uncertainties are allowed for by taking a risk-based approach to setting employer contribution rates. This approach is built around three key funding decisions set by the Fund and asset-liability modelling.

8.4. For each employer, the Fund determines the most appropriate choice for the following three funding decisions.

- What is the funding target for each employer? (i.e. are they in the Fund on an ongoing basis or is there a clear exit date?)
- What is the funding time horizon?
- What is the required likelihood of success? This depends on the level of risk associated with the employer.

Further information on these key decisions can be found in the Funding Strategy Statement at Appendix 2.

8.5. The employer contribution rate is made up of two components:

- The primary rate, which is the rate sufficient to cover all new benefits
- The secondary rate, which covers the cost of sufficiently funding benefits accrued up to the valuation date.

Each employer has an individual contribution rate, set according to the membership and experiences of that employer, and their circumstances as set out in Section 8.5. These rates are set out in the Rates and Adjustments certificate included in the Valuation Report at Appendix 1.

8.6. Broadly speaking, the trend at this valuation has been for primary rates to have increased since 2019 due to rising inflation, whilst secondary rates have generally reduced due to strong investment performance since the previous valuation.

8.7. Individual employer rates were sent for consultation with employers in the week commencing 20 February 2023. The Fund held an employer forum on 21 February to allow employers the opportunity to hear about the valuation process from the actuary and discuss their proposed employer rates.

9. Sensitivity and Risk Analysis

9.1. The valuation results depend on the actuarial assumptions made about the future. By their nature, these assumptions are uncertain which means it is important to understand their sensitivity and risk levels. There is risk and uncertainty inherent with funding benefit payments that will be paid out many years in the future. The Fund is aware of these and has in place a risk register which is regularly reviewed. Additionally, as part of the valuation, the Fund reviews sources of risk that may impact its funding position and the contribution rates payable by employers.

9.2. A summary of the most significant sources of funding risk can be found in the Valuation Report at Appendix 1, with more detailed information contained within the Funding Strategy Statement at Appendix 2. They key funding risks faced by the Fund are set out below.

- Assumptions - including both financial assumptions such as the discount rate and inflation, and demographic assumptions such as longevity.
- Regulatory, administration and governance - Potential risks in this area include change in central government legislation which changes the future cost of the LGPS and failures in administration processes leading to incorrect data and inaccuracies in actuarial calculations. The most notable current risk is the McCloud judgement, for which an allowance has been made as directed by the Department of Levelling Up, Housing and Communities.
- Climate change - Climate change is a major source of uncertainty which could affect future investment returns, inflation and life expectancies. 3 different climate change scenarios have therefore been considered as a stress-test. All the scenarios assume that there will be a period of disruption linked either to the response to climate risk (transition risks) or the effect of it (physical risks). Further detail on

the scenarios is shown in the Valuation Report at Appendix 1.

9.3. It should be noted that since 31 March 2022, there has been significant volatility in the financial markets, changes to short-term inflation expectations and rises in interest rates by central banks. These events affect the value of the Fund's assets and liabilities as follows:

- The Fund's investment return since 31 March 2022 is estimated to be somewhere between -5% and -10%.
- Liability valuations are likely to be lower now than at 31 March 2022 due to rises in expected future investment returns more than offsetting the higher than expected (10.1%) pension increase at April 2023.

9.4. As an open scheme, with a strong covenant, the Fund takes a long-term view when considering the funding impact of such events. For employers who have a very short time horizon, recent volatility may be more immediately impactful, and the Fund has engaged with these employers as appropriate.

9.5. No explicit allowance has been made for this recent volatility in the valuation results or contribution rates detailed in the Rates & Adjustments Certificate. The Fund will continue to monitor changes in the financial and demographic environment as part of its ongoing risk management approach.

Appendices

Appendix 1 - Report on the actuarial valuation at 31 March 2022
Appendix 2 - Funding Strategy Statement (Supplementary Paper)

Background documents

None

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