	Local Pension Board **14th February 2018**
Title	**Review of Pension Scheme Funding Risks**
Report of	**Interim Director of Finance**
Wards	n/a
Status	Public
Urgent	No
Key	No
Enclosures	Appendix A – Funding risk register
Officer Contact Details	George Bruce, Head of Treasury, CSG george.bruce@barnet.gov.uk - 0208 359 7126

Summary

Part of the role of the Local Pension Board is to ensure the effective and efficient governance and administration of the Pension Scheme.

The report considers the section of the risk register relating to scheme funding and discusses the procedures in place to manage these risks and the residual risk being carried by the Fund and employers.

Recommendations

The Local Pension Board is invited to review the report and identify any recommendations or questions it wishes to direct to the Pension Committee.

1. WHY THIS REPORT IS NEEDED

1.1 Part of the role of the Local Pension Board is to ensure the effective and efficient governance and administration of the Pension Scheme. This report reviews the procedures in place for managing funding risk and the residual risk that is carried by the fund and the contributing employers. It is intended that each

section of the risk register will be reviewed periodically by the Local Pension Board.

1.2 The format of the risk register follows the LB Barnet approach, in which impact and probability are rated 1-4 as being:

4 = major / likely
3 = medium / possible
2 = small / unlikely
1 = trivial i.e. fully mitigated

1.3 Risks are mainly considered at a monetary level. However, risks can also be reputational or create inconvenience to employers and scheme members. When considering funding, the risks are normally considered in a monetary context.

1.4 The one obvious omission from the risk register is defining the various risk ratings. For example, what is a major impact on investments? Is it £10 million, £100 million etc? Similarly, when rating probabilities there are no criteria for rating a probability as major, medium etc. The Pension Fund Committee is due to review the risk register during 2018 and will be asked to quantify risk ratings.

1.5 The management of each of the three funding risks is reviewed below.

Effect of possible increase in employers' contribution rate on service delivery and affordability for scheme employers

1.6 The employers' contribution rates are reviewed at each triennial valuation. The contribution rate comprises two elements – a primary rate to cover future service and a secondary rate when there is a past service deficit (or a desire to increase the prudence when calculating past service liabilities).

1.7 In theory, the extent to which the scheme actuary can alter the contribution rate at each triennial valuation is unlimited as solvency and cost efficiency are given greater prominence in the 2013 LGPS Regulations and CIPFA guidance than stability of contributions. In practice, the Scheme Actuary will seek to take a long-term view of funding and provided it is consistent with solvency and cost efficiency will seek to make any changes gradually. For example, following the 2016 valuation, the Actuary agreed that the Council's contribution rate could remain unchanged for 2017/18 and increase by 1% p.a. for the next two years.

1.8 Each employer has individual contribution rates. Non-Council employers are seen as having a higher risk of failure than the Council and therefore the Actuary has less scope to stabilise contributions levels. The administrating authority can assist the Actuary by carrying out credit assessment on each employer that can be used to determine the tolerance to changes in the contribution rate. This is an area that will receive greater attention at the 2019 triennial valuation.

1.9 Input from employers on funding issues and their attitude to risk in the pension fund is achieved through consultation on the drafting of the Funding Strategy

Statement and the discussion of the triennial results. The Actuary and the Pension Fund Committee will take into consideration representations from employers before finalising the contribution schedule.

Significant reduction in funding level following the triennial actuarial valuation

1.10 As discussed above, each employer's contribution rate is re-assessed by the Actuary at triennial valuations.

1.11 The administering authority and employers have some control over the factors that influence actuarial results such as salary changes and investment returns (through the ability to set investment strategy) and can seek ways to protect other elements – life expectancy, inflation and gilt yields. Local authority pension funds tend not to 'hedge' liabilities as they take a 'long-term' approach to funding and investment returns.

1.12 The Pension Fund Committee has developed an investment strategy with a focus on efficiently generating a return that will not require significant increases in contribution rates in the short term and with the volatility of future funding levels taken into consideration.

1.13 The Committee's focus is less concerned with managing the volatility of the funding level than targeting full funding long term and through contribution stability reducing the short-term impact of funding volatility.

Strength of covenant of new employer / risk of financial loss to the Pension Fund

1.14 This risk is concerned with the impact of employer insolvency on the pension fund and other employers. An employer's failure can be unrelated to the contributions demanded by the pension fund or may be triggered by a significant increase in the contributions demanded. The pension fund and other employers are protected through the provisions of the admission agreement such as a bond or guarantee and the ceding employer's (the party that awards the contract, normally LB Barnet) indemnity.

1.15 Other protections available to the pension fund and actuary are to utilise greater prudence in the actuarial assumptions e.g. deficit recovery periods. Should an employer fail, the assets and liabilities will be consolidated with those of the ceding employer.

1.16 There is one group of employers for which there is no bond; academies. This is because the Department for Education has provided a guarantee for LGPS administering authorities that, should an academy close, any outstanding LGPS liabilities that arise will not fall back on the fund.

1.17 As mentioned above, greater attention will be devoted to the strength of the employer's covenant to the pension fund at the 2019 triennial valuation.

Conclusion

1.18 The procedures in place to mitigate the impact of changes in funding level or the cost of future service are focused on managing the timing of contribution changes rather than limiting the extent of possible change. The need to return the pension fund to a fully funded state and to keep cost low receives greater prominence than stability of funding and contributions.

2. REASONS FOR RECOMMENDATIONS

2.1 The Local Pensions Board's terms of reference include ensuring the effective and efficient governance and administration of the Pension Scheme.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 The paper discusses the mitigating actions in place. The Board is able to comment on any aspect of the risk register.

4. POST DECISION IMPLEMENTATION

4.1 Recommendations and comments will be forwarded to the Pension Fund Committee.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 Good management of the Pension Fund will minimise the cost of providing benefits thus enabling funds to be directed to Council priorities.

5.2 Resources (Finance and Value for Money, Procurement, Staffing, IT, Property, Sustainability)

5.2.1 Changes to contribution rates impact on all employers participating in the fund, including the Council's general fund.

5.3 Social Value

5.3.1 The Public Services (Social Value) Act came into force on 31 January 2013. It requires people who commission public services to think about how they can also secure wider social, economic and environmental benefits.

5.3.2 Before they start the procurement process, commissioners should think about whether the services they are going to buy, or the way they are going to buy them, could secure these benefits for their area or stakeholders.

5.3.3 The Act is a tool to help commissioners get more value for money out of procurement. It also encourages commissioners to talk to their local provider

market or community to design better services, often finding new and innovative solutions to difficult problems.

5.3.4 There are no specific social value issues arising out of this report, however membership of the Pension Fund ensures the long term financial health of contributing employees on retirement.

5.4 **Legal and Constitutional References**

5.4.1 The LGPS Regulations 2013 place responsibility for the local administration of pensions and other benefits under these Regulations on the administering authority, which is LB Barnet. The Local Government Pension Scheme Regulations 2015 require the Council to establish a Local Pension Board, whose role is to assist the Council in securing compliance with legislation, regulation and best practice, including as set out in the Pensions Regulator's Code of Practice.

5.5 **Risk Management**

5.5.1 Risk management is central to the LGPS. LGPS pension funds are in themselves risk management tools, managing the risk that future employer income streams will be able to meet future pensions liabilities by creating a reserve from which future liabilities will be met.

5.5.2 The paper is concerned with managing the funding risks faced by the Fund.

5.6 **Equalities and Diversity**

5.6.1 Pursuant to the Equalities Act 2010, the Council is under an obligation to have due regard to eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and fostering good relations between persons who share a relevant 'protected characteristic' and persons who do not share it. The 'protected characteristics' are: age, disability, gender reassignment, pregnancy, and maternity, race, religion or belief, sex and sexual orientation.

5.6.2 The rules governing admission to and participation in the Pension Fund are in keeping with the public sector equality duty. The Public Sector Equality Duty requires public authorities in carrying out their functions, to have due regard to the need to achieve the objectives set out under s149 of the Equality Act 2010. Good governance arrangements and monitoring of the Pension Fund's managers will benefit everyone who contributes to the fund.

5.7 **Consultation and Engagement**

5.7.1 Where relevant, consultation and engagement is discussed in the paper.

5.8 **Insight**

5.8.1 Not applicable

6. BACKGROUND PAPERS

6.1 Funding Strategy Statement - see Board papers September 2017 (page 33)

6.2 Triennial valuation report as at 31st March 2016 - see

https://barnetintranet.moderngov.co.uk/ieListDocuments.aspx?CId=191&MId=8837&Ver=4