	Local Pension Board **14th February 2018**
Title	**Barnet Council Pension Fund – Review of Funding and Contribution Setting Processes**
Report of	**Interim Director of Finance**
Wards	n/a
Status	Public
Urgent	No
Key	No
Enclosures	Appendix A – Presentation from Hymans Robertson (to follow).
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Summary

Part of the role of the Local Pension Board is to:

- assist the administering authority to secure compliance with legislation and regulations,
- ensure strategies and policies are in place and maintained in line with regulations

One of the key regulations governing the Pension Fund is the Local Government Pension Scheme Regulations 2013. This report sets out the requirements of the regulations and associated CIPFA guidance in respect of funding the pension fund. There is a separate note from Hymans Robertson describing the processes and modelling undertaken to advise the Pension Fund Committee on funding policy and determine the contributions payable by each employer.

The report is designed to demonstrate to the Board that the governance arrangements in connection with the setting and implementation of funding policy are satisfactory.

Recommendations

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

1. WHY THIS REPORT IS NEEDED

1.1 Part of the role of the Local Pension Board is to (a) assist the administering authority to secure compliance with legislation and regulations, and (b) ensure strategies and policies (including the Funding Strategy Statement) are in place and maintained in line with regulations. One of the key regulations governing the Pension Fund is the Local Government Pension Scheme Regulations 2013. This report sets out the requirements of the regulations and CIPFA guidance and reviews the processes in place for the LB Barnet Pension Fund to ensure that the fund has sufficient assets to meet pension liabilities in the long term. This is the main, or one of the main, responsibilities of the administering authority

1.2 The purpose of the paper is to enable the Board to determine if the processes in place meet the requirements of regulations and guidance.

1.3 The responsibility to manage the process of ensuring the scheme is adequately funded is shared between the Pension Fund Committee and the appointed Scheme Actuary, with the Local Pension Board having oversight of compliance with regulations and guidance. The Pension Fund Committee's role is primarily the development of a Funding Strategy Statement that sets the framework for the actuarial valuations. The Actuary then applies the FSS framework to place a value on the liabilities and determine the contribution rates for each employer.

1.4 Taking a step back, there are two sources of income to the pension fund – investment returns and contributions. Employees' contribution rates are determined by Regulations, with employers' contributions set locally by the Actuary in accordance with the Funding Strategy Statement. The Pension Fund Committee must therefore consider funding issues when determining investment strategy and vice versa. In reality, the Actuary will make assumptions concerning investment policy and investment returns at each triennial valuation when setting employers' contribution rates.

1.5 This agenda item is split into (1) a discussion below on the regulations and guidance impacting on funding policy and a (2) a presentation by the Actuary on the practicalities of developing the FSS and the schedule of contributions (the Rates and Adjustment Schedule) at each triennial valuation. It is suggested that the Board compare the requirements of the regulations below with the practices adopted for the Barnet Fund as discussed by the Actuary. The paper also briefly mentions the funding position of Barnet and comparisons with other Local Authorities' Pension Funds, although that is a historical outcome and less important that the future plan to ensure that the scheme is robustly funded.

Regulations and Guidance

1.6 The Regulatory guidance concerning funding is set out in the Local Government Pension Scheme Regulations 2013 as follows:

"Funding strategy statement

58.—(1) 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.

(2) The statement must be published no later than 31st March 2015.

(3) The authority must keep the statement under review and, after consultation with such persons as it considers appropriate, make such revisions as are appropriate following a material change in its policy set out in the statement, and if revisions are made, publish the statement as revised.

(4) In preparing, maintaining and reviewing the statement, the administering authority must have regard to—

(a) the guidance set out in the document published in October 2012 [updated September 2016] by CIPFA, the Chartered Institute of Public Finance and Accountancy, and called "Preparing and Maintaining a Funding Strategy Statement in the LGPS"; and

(b) the current version of the investment strategy under regulation 7 (investment strategy statement) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016."

1.7 The key element above is the requirement to follow CIPFA guidance. The introduction to the CIPPA guidance states that the purpose of the FSS is to document the processes by which the administering authority:

- establishes a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward,
- supports the desirability of maintaining as nearly constant a primary contribution rate as possible, as defined in Regulation 62(5) of the LGPS Regulations 2013,
- ensures that the regulatory requirements to set contributions to ensure the solvency and long-term cost efficiency of the fund are met, and
- takes a prudent longer-term view of funding those liabilities.

1.8 The above is somewhat technical and is rephrased by CIPFA as:

- manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due,

- enable primary contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies, while achieving and maintaining fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the fund and employers, and the risk appetite of the administering authority and employers alike, and

- seek returns on investment within reasonable risk parameters.

1.9 Two of the terms above are worth exploring as they are somewhat subjective:

- Solvency
- Long term cost efficiency

Solvency

1.10 Solvency is concerned with having sufficient assets in the long term to meet the liabilities as they fall due for payment. There are several factors that need to be considered when gauging solvency:

- The quantum and timing of future benefit cashflows.
- The returns from the scheme investments.
- The potential variability of pension promises and investment returns in different economic and other scenarios.
- The ability of employers to pay the potential range of contributions.

1.11 As the future is uncertain the amount of assets required to pay benefits can only be estimated. The greater the degree of conservatism (prudence) built into assumptions on the future, the higher the value placed on future liabilities. Similarly, when there is a current shortfall in funding (as is the case at present) there is a choice between allowing the deficit to be recovered over a longer period (thereby maintaining stability of contributions) or demanding payment within a shorter period thereby minimising long term payment issues but potentially triggering unpayable short-term liabilities. An important component in this determination is the monitoring of each employer's ability to pay contributions and the protections built into the admission agreement e.g. bonds and guarantors.

1.12 The notes to the Public Service Pensions Act 2013 state that solvency means that the rate of employer contributions should be set at "such level as to ensure that the scheme's liabilities can be met as they arise". It is not a requirement that the pension fund will be 100% funded at all times. Rather, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

- The rate of employer contributions is set to target a funding level for the whole fund (assets divided by liabilities) of 100% over an appropriate period and using appropriate actuarial assumptions; and either
- Employers collectively have the financial capacity to increase employer contributions, and/or the fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or
- There is an appropriate plan in place should there be, or if there is expected in future to be, no or a limited number of fund employers, or a material reduction in the capacity of fund employers to increase contributions as might be needed.

1.13 There are no hard and fast rules, rather an expectation that over time and given stable market conditions, administering authorities should aim to reduce deficit recovery periods.

1.14 The notes to the Public Service Pensions Act 2013 state:

- Long-term cost-efficiency implies that the rate must not be set at a level that gives rise to additional costs. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the time.
- The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long-term cost efficiency if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

1.15 The first part, sufficient provision for current cost accrual, is clear and reflected in the primary rate set by the Actuary. The second element, appropriate adjustment, is less clear and is based on a comparison of the value of the deficit and the deficit payments; deficits accrue an interest charge and longer repayment periods incur a higher interest cost and are deemed less efficient.

1.16 In assessing whether the above condition is met, the Government Actuary's Department (GAD) may have regard to the following considerations:

- the implied average deficit recovery period,
- the investment return required to achieve full funding over different periods, e.g. the recovery period,
- if there is no deficit, the extent to which contributions payable are likely to lead to a deficit arising in the future, and
- the extent to which the required investment return above is less than the administering authority's view of the expected future return being targeted by a fund's investment strategy, taking into account changes in maturity/strategy as appropriate.

1.17 A deficit recovery period of over 20 years as at March 2016 was considered both inefficient and unlikely to ensure solvency. There is an expectation by GAD that at each triennial valuation the target deficit recovery period will be reduced by at least three years.

Solvency of Non-Local Authority Employers

1.18 As noted above, the ability of employers to pay contributions, in particular deficit contributions, is an important consideration in ensuring solvency. An employer who is unable to pay their debts can leave a deficit in the fund that must be shared with other employers. Available forms of protection include:

- The use of stronger actuarial assumptions for weaker employers.
- The existence of a bond or guarantee.
- The responsibility of the ceding employer to meet any liabilities.

1.19 It is anticipated that for the 2019 valuation, a financial analysis will be undertaken for each employer and the results discussed with the Actuary and used to tailor deficit recovery periods and possibly target solvency levels or the prudence of the assumptions. Consideration has not been given to tailoring investment strategy to the needs of individual employers.

1.20 Neither the LGPS Regulations nor this guidance seeks to prescribe an optimum funding target or period for securing full funding. Rather, the emphasis is on:

- the need to avoid short-term horizons;
- the need for employers' contributions recommended and paid to be set at a level to ensure [vaguely defined] solvency and long-term cost efficiency;
- the desirability for primary contributions to be as stable as possible;
- the need to monitor the quality of the employer covenant; and
- inter fund comparisons being used to challenge those funds deemed less prudent

Barnet's Funding Level

1.21 The last triennial actuarial valuation was undertaken by Hymans Robertson as at March 2016. The results are shown in the table below

	31-Mar-13 £'m	31-Mar-16 £'m	30-Sep-17 £'m
Assets	789	916	1,070
Liabilities	1,000	1,256	1,469
Deficit	-211	-339	-399
Funding level	79%	73%	73%
Scheme wide employers' Contribution rate			
Primary	13.0%	17.9%	
Secondary	11.0%	8.5%	
Total	24.0%	26.4%	

1.22 Despite strong asset grow between March 2013 and today, the deficit has grown in monetary terms as the value placed on the liabilities has increased. This is primarily a function of reductions on the assumed return on investments, as is explained in the Actuary's presentation. Changing actuary to Hymans Robertson prior to the 2016 valuation resulted in a strengthening of the valuation assumptions compared with 2013.

1.23 Employers collectively are paying secondary (deficit) contributions of £13.4 million in 2017/18 increasing to £16 million for 2019/20.

Government Actuary's Department – Section 13 Valuations

1.24 Under Section 13(4)(c) of the Public Service Pensions Act 2013, the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions (cumulative for all employers) to the pension fund is set at an appropriate level to ensure the solvency of the pension fund and long-term cost efficiency of the scheme.

1.25 GAD undertook a ‘dry run’ of this exercise as at March 2013. The results for the 2016 valuation are expected sometime in 2018. The 2013 results were grouped by actuarial firm (four firms are used by local authorities in England and Wales). The results of the comparisons indicated that the degree of prudence incorporated by Barnet’s then actuary was lower than for the current actuary.

1.26 A number of statistics are calculated by GAD. Perhaps the most telling is that the table comparing funding levels on the basis adopted by individual schemes with that on a standardised basis. On the scheme basis Barnet has the 39th highest funding level out of 90 schemes. On a standardised basis, Barnet is 81st out of 90 schemes; although the standardised funding level remains 79% (other funds have seen their funding level improve on the standardised basis). Four funds (not Barnet) were highlighted as worthy of further investigation by GAD.

1.27 Although these comparisons indicate that the Barnet Pension Fund had a weaker funding position than most other Local Authorities on a standardised basis as at March 2013, the subsequent appointment of Hymans Robertson has introduced a greater degree of prudence into the actuarial process and the setting of contribution rates.

1.28 Interesting, GAD is less concerned with the actual funding level rather (1) that primary contributions prudently cover future service costs, and (2) that the contribution plans will realistically eliminate the deficit over an acceptable period.

Conclusion

1.29 Actuarial valuations and the process for setting contribution rates are wholly dependent on assumptions for the future such as asset returns, life expectancy and future salary and pension increases. Although there is much guidance as set out above as to how the Actuary and the Pension Fund Committee should apply their professional judgment there remains considerable uncertainty and outcomes will differ from expectations.

1.30 Judging the reasonableness of funding plans in place is not a matter of looking at the current funding level, but rather the prudence built into the future plans.

1.31 The presentation from Hymans Robertson will demonstrate the way the Actuary applies regulations and guidance to develop a prudent and affordable funding plan for the Barnet employers.

2. REASONS FOR RECOMMENDATIONS

2.1 The LGPS Regulations 2013 are an important part of the regulatory environment for pension schemes. Ensuring compliance and reviewing compliance monitoring procedures falls within the remit of the Local Pension Board.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 The various alternatives are discussed in the paper and the Hymans Robertson modelling.

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 The Council (and other employers) are currently required to make additional contributions to achieve the target funding level of full funding. The discussions in the paper do not entail any changes in financial commitments to the Pension Scheme.

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 (Amendment) 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.

5.4.2 This paper considers the governance arrangement of the LGPS that form part of the remit of the Local Pension Board.

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 Good governance is essential to ensuring that risks are identified and managed.

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 Links to:

The LGPS Regulations 2013

https://www.lgpsregs.org/schemeregs/lgpsregs2013/timeline.php