

Local Pension Board

25 June 2020



Title Valuation and Funding Update

Report of Director of Finance

Wards N/A

Status Public

Urgent No

Key No

Enclosures Appendix 1 – Investment Values 2015 to 2020.

Officer Contact Details George Bruce, Head of Pensions
0208 359 7126 george.bruce@barnet.gov.uk

Summary

The paper considers the impact of the Quarter 1, 2020 decline of stock markets on the valuation of the pension fund assets and also the conclusion to the 2019 triennial valuation with reference to the setting of contribution rates for employers.

Officers Recommendations

1. That the Local Pension Board note the update on the valuation and funding position of the pension fund.

1. WHY THIS REPORT IS NEEDED

- 1.1 The Local Pension Board has requested an update on the funding position of the pension fund following the decline in stock markets linked to the outbreak of Covid-19.

- 1.2 The pension fund valuation peaked at 31 December 2019 at £1,241 million. During Q1, 2020 the valuation declined to £1,077 million (13% reduction) but subsequently has recovered to £1,176 million (5% reduction from peak) based on 31 May values for most mandates. It's difficult to judge the factors driving the market's new found optimism but the easing of lockdown restrictions globally and the surprising rise in US employment levels have all been seen as positives. As yet the impact of lockdown on corporates is not entirely clear and there is scope for some of the recent gains to be temporary even though markets have continued to gain in early June.
- 1.3 The graph on appendix A indicates the rise of the fund's investment values over the last five years. Importantly, valuations have now returned to the level at which the 2019 triennial valuation was undertaken.
- 1.4 The Board expressed a desire to be informed of discussions between the investment advisor (Hymans Robertson), the Chairman of the Pension Fund Committee and officers concerning possible actions to mitigate / take advantage of the movements in financial markets.
- 1.5 To date these discussions have concluded that markets are too volatile to take action. The final instalment of the switch from Diversified Growth Funds to Emerging Market Equities (£20 million) due May 2020 was postponed in case emerging markets recorded further declines. The 5% allocation to UK commercial property remains on hold until the implications of 'the new norm' on demand for retail and office buildings is assessed. Hymans have identified opportunities in some sectors of the debt market and we are expecting recommendations to arise at the July Committee meeting. In general, the Hymans view has been to hold positions until pricing volatility is reduced.

Funding Strategy

- 1.6 The triennial valuation as at 31 March 2019 was completed in Q1, 2020 and a copy distributed to Board members, all employers and is now available from the Council web site. The purpose of the triennial valuation is to determine the future contributions due from each employer to cover the current and future promised benefits. As a bi-product, the valuation also generated a point in time funding level that tends to be the main focus.
- 1.7 The Funding Strategy Statement was tabled at the February meeting of the Local Pension Board. This document sets out the agreed approach to determining the funding level and future contribution rates. While the funding level uses a single set of economic assumptions, employers' contributions are based on modelling a range of future economic scenarios and selecting contribution rates that will ensure full timing in a designed percentage of these scenarios.

- 1.8 Taking the funding level first, the Actuary has determined that the assets held at 31 March 2019 equalled 86% of the promised benefits, an improvement from 73% at the previous valuation. The deficit as at 31 March 2019 had declined to £190 million from £339 million.

Valuation Date	31 March 2016	31 March 2019
Past Service Liabilities	(£m)	(£m)
Employees	371	372
Deferred Pensioners	282	326
Pensioners	603	644
Total Liabilities	1,256	1,342
Assets	916	1,152
Surplus / (Deficit)	(339)	(190)
Funding Level	73%	86%

- 1.9 The most influential factor driving the improvement in funding position over the three years was investment returns exceeding projections. Other factors were changes in life expectancy and the discount rate. The improvement in data quality also enabled less prudence where estimation was required. While the improvement in funding level is welcome, it is less significant to employers' than the contribution rates they pay.
- 1.10 The actuary was asked to determine employers' contribution rates on a 17-year deficit recovery period (20 years in 2016) and using a 70% probability of full funding (66% in 2016). The higher probability target is in line with actuarial guidance to reflect the unknown additional liabilities arising from the McCloud judgment. The shorter deficit recovery period reflected a desire to progressively reduce the remaining deficit, provided that the derived contribution rates are deemed affordable to employers. The valuation does not impact on staff contribution rates, which are determined by regulations.
- 1.11 The Actuary calculates an average contribution rate together with individual rates for each employer made up of a primary rate for future service and a secondary rate to recover any deficit. On average the primary (future service rate) increased from 17.9% to 20.6% due to lower projected investment returns and additions benefits e.g. McCloud.
- 1.12 However, the good news is that deficit contributions are dropping. The aggregate deficit contributions in 2020-21 is £11.1 million compared with £16.0 million in 2019-20.
- 1.13 The picture for employers is mixed. The Council's contribution rate will increase by 1% in 2021-22 to 28.9%, while academies will remain unchanged at 23.8%. For other bodies there is a mixture of reductions and increases based on individual circumstances. All the employers rates are set out in the published valuation report.
- 1.14 The Council has circulated the new schedule of rates to all employers and is checking that these have been used to pay over the April contributions.

1.15 The use of a 70% probability of achieving full funding in combination with a 17-year deficit recovery period is one that has a reasonable likelihood of restoring full funding in an acceptable timescale. However, as we have seen investment markets are volatile and a long-term approach needs to be taken to funding to ensure that rates remain affordable to employers.

1.16 The Actuarial contract with Hymans Robertson expires at 31 December 2020. Delegated authority is in place to the Director of Finance to undertake a tender using National Frameworks. Invitations to tender will be sent out at the end of July.

2. REASONS FOR RECOMMENDATIONS

2.1 No action is required as a consequence of the update.

3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 None - statutory function

4. POST DECISION IMPLEMENTATION

4.1 Employers have been notified of the new rates and monitoring is in place to ensure that the new rates are being applied.

5. IMPLICATIONS OF DECISION

5.1 Corporate Priorities and Performance

5.1.1 Employers paid £52 million of contributions into the pension scheme in 2019-20. Changes in contribution rates can have a significant cashflow implication for employers and will impact on the Council's ability to spend in other areas.

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

5.2.1 There are no immediate financial implications from the report. However, higher deficits (particularly if sustained) may translate into higher contributions from the Council and other employers at subsequent valuations.

5.3 Social Value

5.3.1 Contributing to the Pension Fund ensures that contributing members have a secured income on retirement.

5.4 Legal and Constitutional References

5.4.1 The Board's Terms of Reference include "ensuring the effective and efficient governance and administration of the LGPS for the LBB Pension Fund". The actuarial process is central to ensuring that the pension fund has sufficient assets to pay pensioners.

5.4.2 The Local Government Pension Scheme Regulations 2013 (regulation 62) requires the Council to obtain an actuarial valuation of the assets and liabilities of each of its pension funds as at 31 March 2016 and as at 31 March in every third year afterwards. Regulation 58 requires the administering authority to prepare a funding strategy statement.

5.5 Risk Management

5.5.1 The accuracy of the valuation relies on the accuracy of the data provided to the actuaries. Any errors in the provision of the data could have a significant impact on the required contribution rates, particularly for the smaller scheduled and admitted bodies.

5.5.2 The value of the Pension Fund assets at any point in time is determined by the market and a large movement in the markets could have a significant impact on the surplus or deficit of the fund.

5.6 Equalities and Diversity

5.6.1 Pursuant to the Equality Act 2010, the Council is under an obligation to have due regard to 1) eliminating unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act; 2) advancing equality of opportunity between persons who share a relevant 'protected characteristic' and those who do not share it; and 3) 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. The Council also has regard to the additional protected characteristic of marriage and civil partnership even though this does not apply to parts 2) and 3) (above) of the public-sector equality duty.

5.7 Corporate Parenting

5.7.1 Not applicable in the context of this report.

5.8 Consultation and Engagement

5.8.1 Not required.

5.8 Insight

5.8.1 The report provides insight into the future direction of employers' contribution rates.

6. BACKGROUND PAPERS

6.1 The 2019 triennial valuation report. See:

<https://www.barnet.gov.uk/your-council/finance-funding-and-pensions/local-government-pension-scheme>

Investment Values 2015 to 2020

Market value of Pension Fund

