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| | **Pension Fund Committee**<br><br>**10 November 2022** |
| **Title** | **2022 Triennial Valuation – Whole of Fund results** |
| **Report of** | Executive Director of Strategy and Resources |
| **Wards** | N/A |
| **Status** | Public |
| **Urgent** | No |
| **Key** | No |
| **Enclosures** | Appendix A - 2022 Funding Strategy Statement – Preface Document<br><br>Appendix B - 2022 Funding Strategy Statement – Core documents (draft)<br><br>Appendix C - Hymans' "Whole of Fund" results paper |
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**Summary**

The funding position of the Pension Fund and rate of contributions paid by employers is assessed every three years by the Fund Actuary. Provisional 'whole of fund' results for the 31 March 2022 have been provided. The Pension Fund Committee should be aware that different employer groups have different covenant characteristics.

The Committee will need to agree with the Fund Actuary the actuarial basis to be used in the calculations for each employer group and for this to be documented in a Funding Strategy Statement. It is a requirement that the Council consults with relevant stakeholders when amending its Funding Strategy Statement.

| Officers Recommendations |
| --- |
| That the Committee:<br>(1) Note the whole of fund provisional Actuarial Results<br>(2) Note differences in covenant and actions taken by Officers to manage this; and<br>(3) Provide comment on the draft Funding Strategy Statement, which is currently being consulted on with employer groups. |

## 1. WHY THIS REPORT IS NEEDED

1.1 The Committee are responsible for appointing a fund actuary and commissioning a triennial actuarial valuation in addition to formulating long term funding and investment strategies that ensure that the Fund has sufficient assets to pay benefits as they fall due.

1.2 Every three years the fund actuary assesses the funding position of the Pension Fund and determines the contributions payable by each employer for the next three years. The next valuation will be as at 31 March 2022 and the new rates and adjustment certificate will be effective from 1st April 2023.

1.3 A key part of the process is to determine the long-term assumptions to be used to calculate the actuarial liabilities and the level of confidence associated with that choice of assumption (i.e. the “prudence margin”). It is a legislative requirement that the collective assumptions used are set prudently. The Council’s policy around actuarial assumptions is documented in a Funding Strategy Statement (“FSS”).

1.4 It is good governance and a requirement of the regulations that the Council consults with interested stakeholders before finalising its FSS.

**High-level valuation timetable**

1.5 Consideration of whole of fund results and considering the FSS for different employer groups is part of the valuation process.

1.6 A high-level overview of the valuation process, with comment on progress, is summarised below.

| Item | Time frame | Progress |
| --- | --- | --- |
| Review Funding Strategy Statement and consider changes to assumptions consistent with maintaining the prudence margin at 2019 levels to calculate initial results (Barnet Pool) | June / July 2022 | Complete |
| Consider prudence levels across employer base recognising covenant risk | July 2022 | Complete – for tax raising bodies, academies and admitted bodies no change |

| Item | Time frame | Progress |
|---|---|---|
| | | For Middlesex University, proposed changes reflecting covenant and likely maturation of liabilities is proposed. For Barnet & Southgate no change to approach pending review of underlying government guarantee |
| Cleanse membership data to use for valuation | By 31 July 2022 | Analysing experience item see 1.11 below |
| Review draft 'whole of fund' results on initial prudence levels. Consider changes to prudence levels and likely contribution impact | November 2022 | Considered at November PFC meeting |
| Consult with employers on any changes to Funding Strategy Statement | November to December 2022 | Consultation to be launched 1 November |
| Share draft results and contribution requirements with each employer | November to December 2022 | Pending |
| Finalise results and implement Rates and Adjustment certificate | By 31 March 2023 | Pending |
| New contributions come into effect | From 1 April 2023 | Pending |

**Hymans' advice for initial 31 March 2022 results**

1.7 The Actuary's report on the whole of fund is provided as Appendix C. A summary is provided below:

- Before allowing for changes in assumptions, the deficit decreased from £190m (in 31 Mar 2019) to £8m. This improvement is primarily down to deficit contributions paid and significantly higher investment returns than expected, offset by a £47m increase to the deficit due to data, that is being analysed by LBB pension team, i.e. without the adjustment due to data there would have been a surplus of c£40m
- However, looking forward, the outlook for inflation is significantly higher than estimated in 2019 and the life expectancy assumptions has been strengthened, which have both contributed to increasing the deficit. However, this has partially been offset by a higher allowance for future investment returns (due to higher interest rate outlook)
- Allowing for changes in assumptions, the deficit for the whole of fund is £71m at 31 March 2022 (i.e. overall funding position of around 96%, up from 86% at 31 March 2019)

1.8 A further breakdown in the movement in funding position is summarised in the table below:

| | £'m | |
|---|---|---|
| ***Deficit at 31 March 2019*** | | **190** |
| *Interest on deficit* | 21 | |
| *Deficit contributions* | (48) | |
| *Investment returns higher than discount rate* | (169) | |
| *Inflation lower than expected* | (30) | |
| *Unexplained data* | 47 | |
| *Other miscellaneous* | (4) | |
| ***Deficit at 31 March 2022 (2019 assumptions)*** | | **8** |
| *Higher future investment returns now expected from 2022* | (49) | |
| *Higher future inflation now expected from 2022* | 100 | |
| *Misc. other changes (inc. salary, mortality)* | 12 | |
| ***Deficit at 31 March 2022*** | | **71** |

1.9 The Actuary has not assessed the future service rate at a whole of fund level, but has informally advised that, at an aggregate level, future service costs across the LGPS are likely to increase by c2% of pay, but that individual Funds (and employers within Funds) may experience different levels of changes reflecting their particular assumptions and Fund demographics.

1.10 This means that, in general, any reduction to deficit contributions due to a lower deficit is likely to be offset by an increase to future service contributions.

**Unexplained Data item**

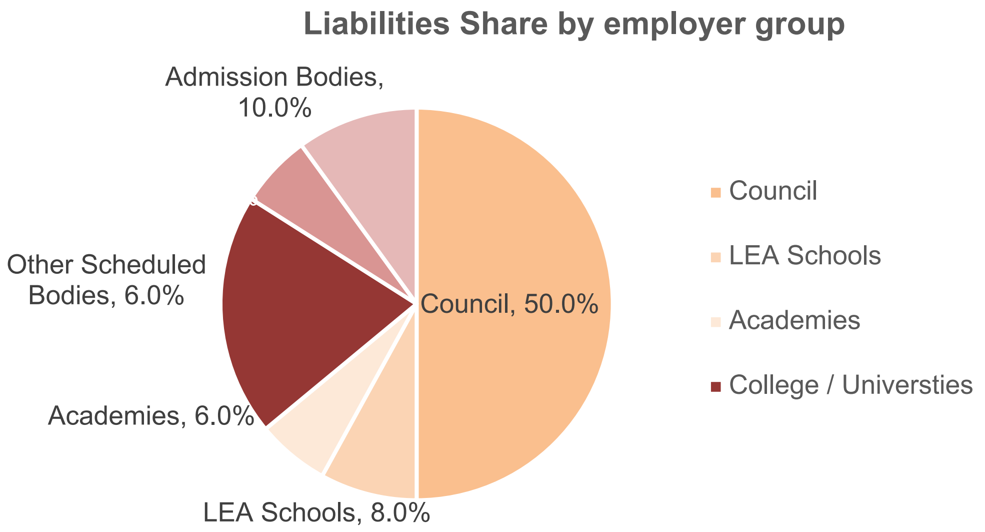
1.11 As noted above, there is a significant experience item due to unexplained data movements. This is likely to be due to improved data compared to the 31 March 2019 valuation. However, the experience item for data is significant and there is a potential risk that the data rectification was "over corrected". We are therefore currently analysing the differences between the 2019 data and the 2022 data and will report back findings at the January 2023 committee meeting. Depending on our findings, the provisional results presented here may change.

**Employer Base**

1.12 The Whole of Fund results provide a picture of the financial health of the Fund at an aggregate level. However, the funding requirements for individual employers within the Fund may be different for the following reasons:

a) Different employers have different membership profiles and this can influence the relative results of each employer
b) Contributions have been paid over different periods and so the average investment return achieved may be different for different employer groups
c) Certain employers have different credit qualities and so we may ask them to pay relatively higher contributions to reflect the higher risk to the Fund

1.13 The breakdown of our employers by different groups is summarised in the Pie Chart below:




1.14 It can be seen that the Council represents around half of the obligations, with Colleges and Universities representing a significant share at 20% - a separate exempt paper considers a proposed approach for Middlesex University.

1.15 Each of these employers have different covenant characteristics, i.e. the ability to support the underlying obligations. The points to consider from a covenant perspective are:

- **Recovery on insolvency** – on insolvency full responsibility for meeting the obligations falls back to the Council and increases our risk exposure and so the ability to recover cash on an insolvency of an employer is an important consideration
- **Covenant visibility** – pension schemes are long-term financial systems and so how confident we can be that the employer will be there in the future will influence the overall level of risk that the Fund is prepared to take
- **Ability to absorb higher contribution rates** – how flexible is the organisation able to absorb increasing pension contributions if experience is poor (which will be linked to the period under which contributions could be recovered).

1.16 Commentary on each of these considerations relative to our employer base is summarised below:

| Employer Group | Insolvency | Covenant Visibility | Ability to absorb contribution increases |
|---|---|---|---|
| **Council** | Unlikely - but no formal monitoring | Can take very long-term view | Limited, extending time frames to manage volatility |
| **LEA Schools** | As per Council | As per Council | As per Council |

| Employer Group | Insolvency | Covenant Visibility | Ability to absorb contribution increases |
|---|---|---|---|
| **Academies** | Government Guarantee provided | As per Council | As per Council |
| **College / Universities** | No government guarantee (guarantee for FE being considered). Pension Fund ranks as unsecured creditor | Medium term? | Limited |
| **Other Scheduled Bodies (i.e. Barnet Group)** | No direct guarantee – formalise Council support? | Depends on formal guarantee from Council | As per Council |
| **Admission Bodies** | Depends on Bond / pass through | Limited | Limited |

**FSS decisions**

1.17 Our overall approach to funding for the different employer groups needs to be documented in a Funding Strategy Statement. It is important that we consult on this Statement

1.18 A draft Funding Strategy Statement preface document and a supplementary paper providing much of the technical detail is included as Appendices A and B respectively. We are currently consulting on these documents – consultation started on 1 November 2022 and is due to close on 31 December 2022. We invite the Pension Fund Committee to comment on the proposal. We will bring a final version of the FSS to the January 2023 Pension Fund Committee meeting for approval.

Overall we recommend:

- Assumptions for whole of fund are agreed
- The approach for the majority of employer groups in left broadly unchanged
- A separate exempt paper discusses the proposed approach for Middlesex University

## 2. REASONS FOR RECOMMENDATIONS

2.1 The actuarial valuation is a statutory requirement and the recommendations have been made to allow the valuation process to proceed and to strike the right balance between long-term cost efficiency and the level of risk faced by the Council.

## 3. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED

3.1 Alternative approaches for the whole of fund were discussed at the July 2022 Pension Fund Committee meeting.

3.2 An alternative approach of continuing to fund Middlesex University's obligations on an ongoing valuation basis, which assumes that Middlesex University's covenant is broadly the same as the Council's and that their membership profile remains stable is not appropriate as it exposes the Council to too much risk.

## 4. POST DECISION IMPLEMENTATION

4.1 The actions set out in the actuarial timetable will be followed.

## 5. IMPLICATIONS OF DECISION

### 5.1 Corporate Priorities and Performance

5.1.1 Employers paid £48 million of contributions into the pension scheme in 2021/22. 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. Engaging with the Scheme Actuary during the 2022 triennial valuation will enable the Committee to identify ways to stabilise future contribution rates.

### 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 Council's Constitution (Article 7) – includes within the responsibilities of the Pension Fund Committee,
"To consider actuarial valuations and their impact on the Pension Fund."

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 level of prudence margin set with the actuarial basis impacts the level of risk pushed forward to future periods – the lower the prudence margin, the higher the likelihood that future cash contributions will need to increase.

5.5.2 The ability of employers to absorb future increases to cash contributions may be limited.

At the same time, setting the prudence margin too high today may impact negatively on current budgets and the long-term viability of employers.

5.5.3 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.

5.6 **Equalities and Diversity**

5.6.1 Pursuant to the Equality 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.

5.7 **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. ENVIRONMENTAL CONSIDERATION

6.1 Not relevant.

## 7. BACKGROUND PAPERS

7.1 The Council's policy around actuarial assumptions is documented in a Funding Strategy Statement ("FSS"). The FSS for the 2019 valuation can be viewed: lbb_-_funding_stategy_statement.pdf (barnet.gov.uk)