London Borough of Barnet Pension Fund

London Borough of Barnet – Contribution Review

November 2023

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For and on behalf of Hymans Robertson LLP

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2 Introduction

I understand that the London Borough of Barnet ("the Employer") has requested their contribution rate to be reviewed under Regulation 64A of the LGPS Regulations 2013 ("the Regulations") and that the London Borough of Barnet Pension Fund ("the Fund") is considering the Employer's request for review.

As a result, I have been commissioned by the London Borough of Barnet in its role as Administering Authority to the Fund to set out my views on revising the Rates and Adjustments Certificate issued as part of the 2022 formal valuation of the Fund as required under Regulation 64A(2b).

The advice in this report is addressed to the London Borough of Barnet in its role as the Administering Authority to the Fund and should not be shared with any third parties without our prior written consent. Where permitted, this report may only be released or otherwise disclosed in its entirety, fully disclosing the basis upon which it has been produced (including any and all limitations, caveats or qualifications). A copy of this report may be shared with the London Borough of Barnet in its capacity as an employer in the Fund.

Please note that Hymans Robertson (and myself) accept no liability to any third parties. The conditions, reliances and limitations in the body and appendices of this report apply equally to all users of this report.

3 Background

General

I understand the Employer has requested a review of their contribution rates under Regulation 64A. The Regulations and Fund policies in respect of contribution rate reviews are set out below.

Regulation 64A

Under the Regulations the Administering Authority may review employer contribution rates between formal valuations for any employer where one of a set of conditions is met. These conditions are set out in Regulation 64A and are summarised below:

- The Fund has a policy on amending contribution rates between valuations set out in its funding strategy statement; and
- One of the following is met:
  - It appears likely that the amount of liabilities arising or likely to arise has changed significantly;
  - It appears likely that there has been a significant change in the ability of an employer to meet its obligations to the Fund; and/or
  - An employer requests a review of their contributions and undertakes to meet the costs of the review.

The Fund sets out its policy on contribution reviews its policy dated 26 July 2021. Please let me know as soon as possible if this policy has been superseded.

I understand the Employer has requested a review of their contributions and has undertaken to meet the costs of the review.

Fund's policy

The Fund's Contribution review policy sets out the Fund's policy on contribution rate reviews. It sets out that any employer request for review must be triggered by one of the following conditions:

- There has been a significant change in the liabilities arising or likely to arise; and/or
- There has been a significant change in the ability of the Scheme employer to meet its obligations to the Fund.

I understand the Employer has requested a review due a significant change in their ability to meet their obligations and has substantiated this request by providing evidence to the Fund of their change in circumstances.

Administering Authority Conclusion

I understand the Fund have yet to decide if the conditions of Regulation 64A have been met and that a formal contribution review may take place.

I have been asked to provide advice on the basis that the Fund will determine that a contribution review may take place. As such, the advice in this report is **for information only**, unless the Fund determine that a review of contribution rates under Regulation 64A is appropriate.

I reserve the right to review and alter my advice following the Fund's determination, to allow for any factors arising between now and the date of any future determination.

4 Actuarial Approach

General Comments

In carrying out a review of the contribution rate for the Employer, the Fund and myself must take into account the Fund's current Funding Strategy Statement.

In addition, the Scheme Advisory Board has published guidance in respect of contribution rate reviews.

Funding Strategy Statement

When reviewing the contribution rates for the Employer, I am required to have reference to the Fund's Funding Strategy Statement. The Employer is categorised as a Local Authority which means their contribution rate is set with reference to the following parameters:

- The 'ongoing' funding target;
- The time horizon over which the Fund considers the Employer rate can be no more than 17 years.
- Minimum likelihood of full funding at the end of the time horizon must be at least 70%.

The above parameters are unchanged since the current contribution rate in payment was certified as part of the 2022 formal valuation.

The Fund's contribution review policy also sets out the following requirements:

- Unless an update is deemed more appropriate by the Fund Actuary (e.g. where an employer is targeting exit from the Fund), the market conditions will be in line with those at the most recent actuarial valuation.
- Assets allocated to the employer - To be calculated either as at the date of the most recent triennial valuation or the date of review as determined by the Actuary as appropriate.

This indicates that changes in market conditions since the previous valuation should not be allowed for in respect of reviewing the Employer's rate.

Further, to ensure consistency with the value of the liabilities, the assets allocated to the employer at the 2022 valuation date will be used in this contribution rate review.

Scheme Advisory Board Guidance

While Scheme Advisory Board guidance is not mandatory, it is intended to represent best practice.

Question 6, paragraph b1 sets out that changes in economic and/or demographic conditions since the last Fund valuation should not be taken into account when carrying out a review. Exceptions to this are:

- The Administering Authority believes it is in the best interests of the Fund to do so;
- As a result of transfers of liabilities and notional assets between employers in the Fund, market related calculations are required; or
- There has been a change in employer covenant.

I understand the Administering Authority believes that none of these exceptions apply. This further suggests that changes in market conditions since the previous valuation should not be allowed for in respect of reviewing the Employer's contribution rate.

Other interested parties

It should be noted that contribution rate reviews for Local Authority employers have been exceedingly rare. I am mindful GAD and DLUHC are in the process of carrying out their Section 13 valuations and it is not clear how they may view a rate review within these valuations. Any change in rates should be weighed against the potential views of these authorities. We may receive more clarity on this in the near future.

Conclusion

In carrying out a review of the Employer's contribution rate, I am limited to re-examining the contribution rate set as part of the 2022 valuation and should ignore any changes in market conditions since.

5 Analysis and Key Considerations

Background Papers

In carrying out my review, I have referenced the following documents from the 2022 valuation of the Fund:

- The Fund's Funding Strategy Statement;
- The Fund's 2022 valuation report; and
- The Fund's Contribution review policy dated 26 July 2021.

Please refer to these documents which set out the data, assumptions and methodologies underpinning my overall advice. The reliances, limitations and caveats within these papers and advice apply equally to this report.

As set out in Section 3, I have not allowed for any changes in data, assumptions or market conditions. Therefore, my review is limited to a re-examination of the 2022 valuation results.

Contribution Rate – 2022 Valuation

As part of the 2022 valuation of the Fund, a full review of the Fund's funding strategy was carried out. As the Employer is responsible for most of the Fund's liabilities, particular emphasis was placed on how the Employer's rate would be set at this valuation with the objective of achieving a stable contribution rate.

In carrying out the review, we modelled the effect of setting a fixed contribution rate at the level where this led to a 70% likelihood that payment of this amount would lead to full funding at the end of the 17 year time horizon.

This analysis showed that a rate of 27.4% (which includes 1% of pay for expenses) would be sufficient to ensure that the Employer was fully funded at the end of the 17 year time horizon with a 70% probability of success. However, a rate of 28.4% was set with agreement of the Employer, as this reflected a more gradual reduction from the rate in payment in 2022/23. As such, the rate being paid by the Council is slightly higher than the minimum rate that may have been set based on strict application of the funding parameters set at the 2022 valuation (as documented in the Funding Strategy Statement).

Current Contribution Rates

Based on the above, a total employer contribution rate of 28.4% pa was set for the three year period from 1 April 2023 to 31 March 2026;

- 2023/24 – 19.1% of Pay Primary, plus 9.3% Secondary.
- 2024/25 – 19.1% of Pay Primary, plus 9.3% Secondary.
- 2025/26 – 19.1% of Pay Primary, plus 9.3% Secondary.

Revisiting the Employer contribution rates payable

As is noted above, the rate being paid by the Council is slightly higher than the minimum rate that may have been set based on strict application of the funding parameters set at the 2022 valuation. As such, it would have been possible to set a lower contribution rate for the Employer at the 2022 valuation, based on the Fund's contribution strategy.

If the Fund determine that a review of contribution rates under Regulation 64A is appropriate, there are two ways in which rates may be revised:

1. Set the revised Employer contribution rate based on a strict application of the funding parameters set out in the Funding Strategy Statement. **This would lead to a revised Employer rate of 27.4% of pay**, which would be a 1% of pay reduction relative to that shown in the Rates and Adjustments certificate.

2. Apply a **temporary easement** to the Employer contribution rates over the existing period of the Rates and Adjustments Certificate.

Temporary easement in contributions

I understand that the Employer has asked the Fund to consider a temporary easement in the Employer contribution rate, such that the long term rate payable by the Employer remains at the level set at the 2022 valuation (28.4% of pay).

I have determined the maximum two-year easement which may be permitted to ensure that the resulting contribution rates meet the requirements set out in the Funding Strategy Statement, specifically, to provide a 70% probability of the Employer being fully funded on the ongoing valuation assumptions at the end of the 17 year time horizon.

The calculated two-year easement has been calculated such that the present value of expected future contributions under this contribution pattern is equal to the present value of contributions that would be payable based on a strict application of the 2022 valuation funding parameters (i.e. 27.4% of pay), based on the assumptions set at the 2022 valuation.

Based on this approach, the calculated easement is 8% pa of pay in 2024/25 and 2025/26.

Summary

The table below sets out the current contributions payable by the Employer, and the revised contribution that may be payable under the two options identified in this report.

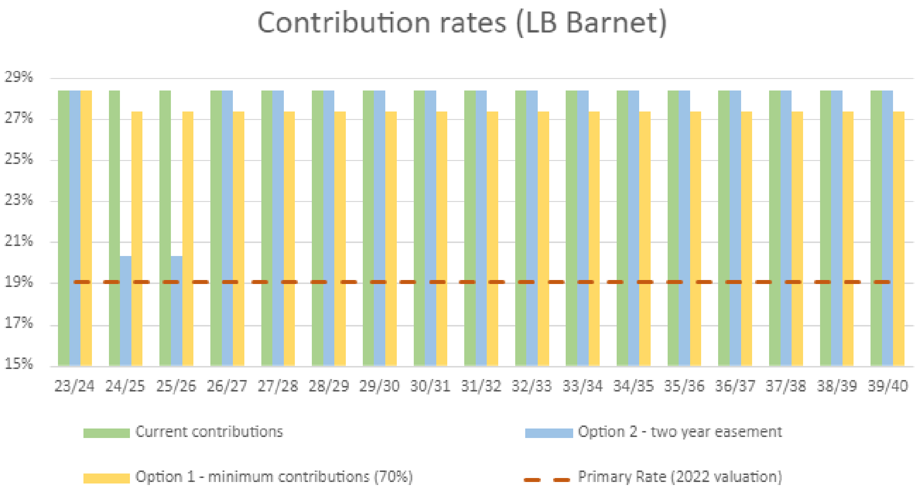
	Current certified rates	Option 1 2022 minimum contributions	Option 2 Two-year easement
2023/24	28.4%	28.4%	28.4%
2024/25	28.4%	27.4%	20.4%
2025/26	28.4%	27.4%	20.4%
2026 – beyond	28.4% pa	27.4% pa	28.4% pa
Probability of full funding at the end of 17 year time horizon	71%	> 70%	70%

Please note the following in respect of the above table:

- Under options 1 and 2, rates are assumed to change with effect from 1 April 2024.
- Rates shown from 1 April 2026 are set for the purpose of determining the probability of the Employer being fully funded at the end of the time horizon. Actual contribution rates payable from 1 April 2026 to 31 March 2029 will be set at the 2025 valuation.
- Option 1 reflects a reduction in prudence from that underlying the contribution rates agreed at the 2022 valuation and currently certified in the Raes and Adjustments Certificate. The probability of success is slightly higher than 70% due to the payment of 28.4% in 2023/24.
- Option 2 shows the contributions payable allowing for the maximum 2-year easement permitted to ensure that the resulting contribution rates have a 70% probability of the Employer being fully funded at the end of the 17-year time horizon.

For the avoidance of any doubt, all contribution patterns illustrated in the above table are consistent with the minimum requirements of the funding strategy set out in the Funding Strategy Statement.

An illustration of the contribution rate patterns modelled is shows in the chart below.



The revised contribution rates under both options are greater than the Primary Rate set at the 2022 valuation. Specifically, the lower contributions payable during the two year easement period (under option 2) are sufficient to meet the assessed cost of benefit accrual at the 2022 valuation.

Other contribution patterns may be possible, but I have not been asked to model these. Any contribution pattern that leads to higher rates than those illustrated over the two year easement period would result in an increase in the probability of success.

6 Other considerations

I have set out below other matters the Fund may wish to consider when making a decision on any revised contribution pattern for the Employer.

Net cashflow position

I understand the Fund expects to be broadly cashflow neutral in 2023/24 (ie the level of contribution income is broadly equal to benefit payments, excluding the effect of transfers). Due to the effect of the 2024 Pension Increase order, which is expected to be 6.7%, it is likely that the Fund will be cashflow negative in 2024/25 and beyond.

Any reduction in contributions will lead to a greater gap between contribution income and benefit payments, with the gap being greater in the short term if a two year easement in contributions (option 2) is applied.

Any reductions in contributions by the Employer (the largest source of contributions in the Fund) could warrant a review of the Fund's cash needs and investment strategy in order to ensure there is sufficient cash available to pay pension benefits.

Future contribution rate reviews

Contribution rates will next be reviewed at the 2025 valuation, at which time rates for the period 1 April 2026 to 31 March 2029 will be set.

Rates will be set in line with the Funding Strategy set by the Fund at that time, and a key element of this will be to ensure that the resulting contributing rates are stable. The starting point for rates payable by the Employer from 1 April 2026 will be the rates set out in the table in the previous section.

The Fund may wish to monitor the financial position of the Employer and/or the funding position of the Employer in the Fund, as part of any agreement to review contribution rates. This could lead to either:

- Contributions rates being 'reset' to the original amounts certified in response to either an improvement in the financial position of the Employer and/or a deterioration in the funding level.
- A request for further contribution review from the Employer.

If the Fund receive any further requests for contribution reviews from the Employer, this should be considered on its merits at that time.

Market conditions

My contribution rate assessment makes no allowance for the change in market conditions, emerging inflation experience, asset values, or changes to investment strategy since the 2022 valuation.

The combination of the above factors has led to an improvement in the funding levels for the Employer since the 2022 valuation, primarily due to an increase in expected future investment returns, which are now higher due, in part, to recent rises in long term interest rates.

It is worth noting however, that the absolute value of future benefits payable is now expected to be higher than at the 2022 valuation due to the Pension Increase orders in 2023 and 2024, of 10.1% and 6.7% respectively, and that the Fund has generated negative asset returns over the period since the 2022 valuation.

This means that the Fund needs to generate a higher return from its assets in the future to remain fully funded than what was required at the 2022 valuation (specifically, returns of 4.9% per annum were required to be fully funded, and as at the end of October, required returns of c. 5.4% are now needed).

Other employers

Other participating employers may also request a review of contribution in response to current financial pressures. The Fund should consider any request on its individual merits, and separate actuarial advice in respect of any revisions to contribution rates should be sought.

This advice applies only to the rates payable by the Employer and it would not be appropriate to apply the same approach to any other employer without seeking actuarial advice.

Increasing risk of future rate increases

All else being equal, if contributions are reduced now then there is a greater chance that they will need to increase in future.

Consideration should be given to the Employer's tolerance for greater contribution increases in future and whether these could reasonably be met if needed.

GAD section 13 analysis

Following each actuarial valuation, the Government Actuary's Department (GAD) carries out a review of all valuations carried out across England and Wales, and their analysis of the 2022 valuation is ongoing.

If GAD are of the opinion that the contribution rates payable to a particular fund are inadequate to achieve full funding over a reasonable period, they will engage with the fund to understand the rationale behind the rate-setting process. In extreme cases, LGPS funds may be 'red flagged' in the final report prepared by GAD.

I understand that GAD have no power to change contribution rates, and so the risk of being 'red-flagged' is of a reputational nature.

I would suggest that the Fund inform GAD of any change in contribution rates payable by the Employer following this review and share the legal and actuarial advice provided to the Fund to support decision making.

I also suggest the Fund notify DLUHC of it's intention prior to making any changes to the certified contribution rates.

7 Conclusions

Key conclusions

The Regulations require the Fund to have regard to my views when revising the Rates and Adjustments Certificate. I have summarised by views below:

- The Fund may agree a contribution rate review based on the Employer's request and evidence provided by the Employer.
- The advice provided as part of the 2022 valuation remains relevant. However, as the Employer agreed to pay a higher contribution rate than the minimum rate deemed to be appropriate and consistent with the funding strategy, the Fund can consider adopting different contributions as part of the contribution rate review, without making any changes to the Funding Strategy Statement.
- A reduction in the contribution rate of 1% per annum over the 17 year time horizon (option 1) is appropriate and in line with the Fund's funding strategy as set out in the Funding Strategy Statement.
- The Employer has requested a temporary easement in contribution rates and this is possible within the constraints of the funding strategy. Specifically, a temporary reduction in rates of 8% per annum over 2024/25 and 2025/26 leads to a contribution pattern which leads to a 70% probability of the employer being fully funded at the end of the 17 year time horizon (option 2).
- Option 1 is better aligned to the Fund's objective to set a stable contribution rate.
- The Fund should consider the other factors set out in the previous section, specifically:

- Any reduction in contribution rates will put pressure on the Fund's net cashflow position and, depending on severity, require a review of the Fund's cash management plan and investment strategy.
- Any reduction in rates increases the reliance on (uncertain) future investment returns and therefore increases the risk of future increases in contributions. The greater the reduction in rates, the greater the risk.
- Any reduction will result in a lower asset base in future. This could reduce the Fund's ability to influence its managers and LCIV over time.

Next steps

Based on my review of the 2022 valuation and contribution rate modelling, I am comfortable with a change in contribution rate under the two options presented in this report.

I recommend a meeting to discuss the Fund's views in respect of the other considerations set out above before concluding what level of contribution rate should apply as a result of this review.

Appendix A – Reliances & Limitations

Reliance on previous modelling and reporting

I have relied on modelling and reporting carried out as part of the 2022 valuation of the Fund. The reliances and limitations within the papers listed apply equally to this report.

Use of results

The purpose of this report is to fulfil the requirements of Regulation 64A of the Local Government Pension Scheme Regulations 2013. It should not be used for any other purposes.

Legal aspects

Please note that we are not lawyers. The advice in this report is actuarial in purpose and any legal aspects, including the interpretation of any relevant legislation, should be referred to an appropriate lawyer.

Appendix B – Professional Notes

The totality of my advice complies with the relevant Technical Actuarial Standards set out below where material:

- TAS 100; and
- TAS 300

This report together with the reports set out in Sections 3 and 4 above constitute the aggregate of my advice.

Hymans Robertson LLP is a limited liability partnership registered in England and Wales with registered number OC310282.