TOWER HAMLETS

PENSIONS COMMITTEE

Thursday, 18 June 2020 at 6.00 p.m.

Online 'Virtual' Meeting - https://towerhamlets.public-i.tv/core/portal/home

This meeting is open to the public to attend.

Members:
Chair: Councillor Kyrsten Perry
Vice Chair**:** Councillor Rachel Blake

Councillor Mohammed Ahbab Hossain, Councillor Eve McQuillan, Councillor Ayas Miah, Councillor Abdal Ullah and Councillor Andrew Wood

Substitutes:
Councillor Faroque Ahmed, Councillor Kevin Brady and Councillor Peter Golds

[The quorum for this body is 3 voting Members].

Contact for further enquiries:
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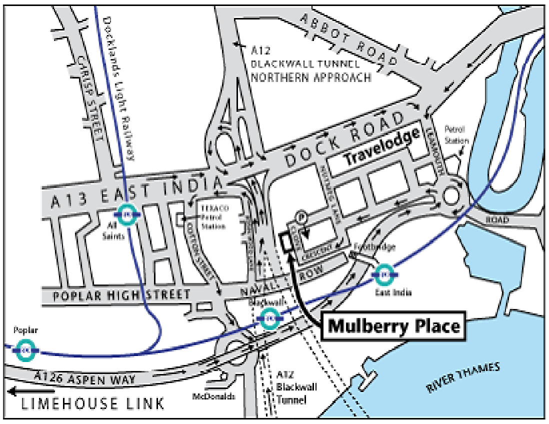

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TO FOLLOW.

5 .7 Administration Remediation Plan

TO FOLLOW.

6. TRAINING EVENTS

7. ANY OTHER BUSINESS CONSIDERED TO BE URGENT

Next Meeting of the Committee:
Monday, 27 July 2020 at 6.30 p.m. to be held in the Online 'Virtual' Meeting - https://towerhamlets.public-i.tv/core/portal/home

DECLARATIONS OF INTERESTS AT MEETINGS– NOTE FROM THE MONITORING OFFICER

This note is for guidance only. For further details please consult the Code of Conduct for Members at Part C, Section 31 of the Council's Constitution

(i) Disclosable Pecuniary Interests (DPI)

You have a DPI in any item of business on the agenda where it relates to the categories listed in **Appendix A** to this guidance. Please note that a DPI includes: (i) Your own relevant interests; (ii)Those of your spouse or civil partner; (iii) A person with whom the Member is living as husband/wife/civil partners. Other individuals, e.g. Children, siblings and flatmates do not need to be considered. Failure to disclose or register a DPI (within 28 days) is a criminal offence.

Members with a DPI, (unless granted a dispensation) must not seek to improperly influence the decision, must declare the nature of the interest and leave the meeting room (including the public gallery) during the consideration and decision on the item – unless exercising their right to address the Committee.

DPI Dispensations and Sensitive Interests. In certain circumstances, Members may make a request to the Monitoring Officer for a DPI dispensation or for an interest to be treated as sensitive interest.

(ii) Non - DPI Interests that the Council has decided should be registered – (Non - DPIs)

You will have 'Non DPI Interest' in any item on the agenda, where it relates to (i) the offer of gifts or hospitality, (with an estimated value of at least £25) (ii) Council Appointments or nominations to bodies (iii) Membership of any body exercising a function of a public nature, a charitable purpose or aimed at influencing public opinion.

Members must declare the nature of the interest, but may stay in the meeting room and participate in the consideration of the matter and vote on it **unless:**

- A reasonable person would think that your interest is so significant that it would be likely to impair your judgement of the public interest. **If so, you must withdraw and take no part in the consideration or discussion of the matter.**

(iii) Declarations of Interests not included in the Register of Members' Interest.

Occasions may arise where a matter under consideration would, or would be likely to, **affect the wellbeing of you, your family, or close associate(s) more than it would anyone else living in the local area** but which is not required to be included in the Register of Members' Interests. In such matters, Members must consider the information set out in paragraph (ii) above regarding Non DPI - interests and apply the test, set out in this paragraph.

Guidance on Predetermination and Bias

Member's attention is drawn to the guidance on predetermination and bias, particularly the need to consider the merits of the case with an open mind, as set out in the Planning and Licensing Codes of Conduct, (Part C, Section 34 and 35 of the Constitution). For further advice on the possibility of bias or predetermination, you are advised to seek advice prior to the meeting.

Section 106 of the Local Government Finance Act, 1992 - Declarations which restrict Members in Council Tax arrears, for at least a two months from voting

In such circumstances the member may not vote on any reports and motions with respect to the matter.

Further Advice contact: Asmat Hussain, Corporate Director, Governance and Monitoring Officer, Tel: 0207 364 4800.

APPENDIX A: Definition of a Disclosable Pecuniary Interest

(Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012, Reg 2 and Schedule)

Subject	Prescribed description
Employment, office, trade, profession or vacation	Any employment, office, trade, profession or vocation carried on for profit or gain.
Sponsorship	Any payment or provision of any other financial benefit (other than from the relevant authority) made or provided within the relevant period in respect of any expenses incurred by the Member in carrying out duties as a member, or towards the election expenses of the Member. This includes any payment or financial benefit from a trade union within the meaning of the Trade Union and Labour Relations (Consolidation) Act 1992.
Contracts	Any contract which is made between the relevant person (or a body in which the relevant person has a beneficial interest) and the relevant authority— (a) under which goods or services are to be provided or works are to be executed; and (b) which has not been fully discharged.
Land	Any beneficial interest in land which is within the area of the relevant authority.
Licences	Any licence (alone or jointly with others) to occupy land in the area of the relevant authority for a month or longer.
Corporate tenancies	Any tenancy where (to the Member's knowledge)— (a) the landlord is the relevant authority; and (b) the tenant is a body in which the relevant person has a beneficial interest.
Securities	Any beneficial interest in securities of a body where— (a) that body (to the Member's knowledge) has a place of business or land in the area of the relevant authority; and (b) either— (i) the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body; or (ii) if the share capital of that body is of more than one class, the total nominal value of the shares of any one class in which the relevant person has a beneficial interest exceeds one hundredth of the total issued share capital of that class.

LONDON BOROUGH OF TOWER HAMLETS

MINUTES OF THE PENSIONS COMMITTEE

HELD AT 6.30 P.M. ON THURSDAY, 28 NOVEMBER 2019

COMMITTEE ROOM ONE - TOWN HALL MULBERRY PLACE

Members Present:

Councillor Kyrsten Perry (Chair)
Councillor Rachel Blake (Vice-Chair)
Councillor Mohammed Ahbab Hossain
Councillor Eve McQuillan
Councillor Ayas Miah
Councillor Abdal Ullah
Councillor Andrew Wood

Apologies:

John Jones – Chair of Pension Board

Kehinde Akintunde – GMB Union Representative

Others Present:

Colin Robertson	Independent Advisor
Hemal Popat	Mercers
Jack Bladon	Schroders
Pedro Moura	Schroders
Steve Turner	Mercers

Officers Present:

David Knight	Principle Committee Services Officer
Kevin Bartle	Interim Divisional Director Finance Procurement & Audit
Miriam Adams	Interim Pension & Investment Manager
Neville Murton	Acting Corporate Director of Resources
Ngozi Adedeji	Team Leader Housing – Legal Services
Rushena Miah	Committee Services Officer

1. DECLARATIONS OF DISCLOSABLE PECUNIARY INTEREST

Declarations of pecuniary interest were made by Ngozi Adedeji (Team Leader Housing –Legal Services) and Neville Murton (Acting Corporate Director of Resources) with regards to item number 9.2 Annual Allowance and the treatment of individual pension tax charges.

2. MINUTES OF THE MEETING HELD ON 24TH SEPTEMBER, 2019

Councillor Blake raised a point of accuracy with regard to the minute 6.3 'Increased Allocation to Low Carbon Equities'. She said the first and second bullet point on page 14 of the agenda pack should be reworded to summarise that a discussion took place on the de-carbonisation approach and that the approach outlined was only one view of a consultant. A decision had not been made on an exclusionary approach. It was agreed that the minute should be redrafted to provide the following information: what was the approach? What was the view of the consultants? And what was agreed at the meeting? Miriam Adams (Interim Pension & Investment Manager) and Kevin Bartle (Interim Divisional Director Finance Procurement & Audit) agreed to draft a paragraph to correct the minute and share with the Chair for approval.

RESOLVED:

1. The minutes of the meeting held on 24 September 2019 we approved as an accurate record subject to the above amendment.

3. PETITIONS

None.

4. SUBMISSIONS / REFERRALS FROM PENSION BOARD

A report was tabled from John Jones Chair of the Pensions Board. The note highlighted the key issues that had been considered by the Board at its meeting on 25 November 2019.

RESOLVED:

1. To note the Chair of Pensions Board report.

5. REPORTS FOR CONSIDERATION

5.1 Equity Protection - Presentation and Training

The Committee received an update from Jack Bladon and Pedro Moura (representatives from Schroders) on the funds equity protection. A presentation booklet was tabled at the meeting.

Following the presentation, a discussion took place on how the equity protection product had affected the fund. Consultants from Schroders explained that the product had fulfilled its objective and by 'forgoing the upside' the fund had been protected from significant loses. It was noted that March 2020 was the end of the protection period. After this date the Committee would have to make a decision on whether it wanted to return to its previous higher risk situation, maintain, or continue with another equity protection product. It was noted the Committee's independent advisors would be consulted for advice.

Members wanted to know the deadline for decision making on the extension of equity protection. Officers said there would be an extraordinary meeting in February to discuss the topic in depth. Committee Services would find a suitable date in February for Members.

Officers reminded the Committee that equity protection was agreed eighteen months ago based on valuations at the time. They said there had always been an intention to re-evaluate the decision with further discussion on options near the end of the product.

Members asked if there were any trends in the global market that could be detrimental to the pension fund in the next few years. Advisors said they did not expect a recession in the next ten years but there were risks in the global market around trade wars. They said equity protection would mean the Committee could worry less about risk.

It was noted that Schroders had launched a new fossil fuel free product. Schroders said they would be happy to come back to talk about the product.

The Committee received a presentation from Hemal Popat (Mercers) and Steve Turner (Mercers) on equity protection.

Following the presentation:

Members asked about the risks around diversification. Mercers representatives said it depended on the product and the proportion of equities being utilised. The independent advisor explained that in the past equities were usually diversified into bonds, however this was no longer common practice and bonds were at a 300 year low yield. The pay out from diversification was an attractive option but would have to be carefully considered.

A Member asked how other London boroughs had reacted to renewing their protection. Mercers representatives said it was a mix. Some clients had reported they would accept the risk of not continuing with protection, whilst others decided to roll over their protection and produced a dynamic risk strategy.

It was noted on average the private sector held 20% equities and the public sector held 50% equities. Private sector funds tended to pay out dividends whereas public funds tended to grow equites. Private funds were inclined to smooth out their profits in favour of greater protection and they generally had more complex strategies. Conversely, LGPS budgets were tight and councils allocated more money into public services rather than the pension fund.

Members requested a view on whether it was prudent to carry on with the fund’s equity protection. Mercers representatives said the pricing had changed from when the protection was first introduced so the Committee would have to make a decision on whether the protection was value for money.

Members asked if there were any developments in the market in the last two years that would warrant continuing with an equity protection product. Mercers representatives summarised that the economy was in the late stage of an economic recovery, equity was higher but GDP had tailed off. They advised that markets were likely to muddle through with low single digits. A crash was not expected. However, they warned that if there was a crash the fund would suffer.

Mercers representatives said one reason for not requiring protection was that the fund had gone through a valuation which had determined protection was unnecessary until review at the next valuation period in 2022.

It was clarified that the table on slide 14 page 31 of the pack was taking an investment view.

There was a discussion around cashflow. A Member pointed out that the fund was cashflow positive for the next two years and queried whether there would be an actual loss (other than dividends), if markets were to fall by 20% but were predicted to recover within six years. The independent advisor said this was an interesting point but cashflow was a bit of a ‘red herring’.

It was agreed that Mercers would bring to the February meeting a list of options for the Committee to consider.

It was noted that the fund already had a product with Schroders that could be rolled over as one option for consideration.

RESOLVED:

1. For Committee Services to set a Pension Committee date for February 2020.
2. Hemal Popat-Mercers to provide the Committee with a range of views for consideration at the February 2020 meeting.
3. Members to receive all meeting papers one week in advance of the February meeting and contact Mercers/pension officers if they had pre-meeting questions.

5.2 Quarterly Voting and Engagement Update for September 2019

RESOLVED:

1. The Committee noted the report on Quarterly Voting and Engagement September 2019.

5.3 Report on Fund Liquidity

The Committee received the report of Miriam Adams (Interim Pension & Investment Manager) on Fund Liquidity.

The Committee agreed to sell Bailey Gifford in order to balance the fund’s risk portfolio. The Committee instructed the Corporate Director of Finance to contact the London CIV on its behalf to initiate the process.

There was a suggestion that the fund could benefit in the longer term if it paid out dividends. Officers were asked to contact the LCIV to find out if there was an option to pay out dividends.

The Committee agreed that the cashflow appendix on page 97 of the pack was useful and requested the document be presented to the Committee on an annual basis, including figures on income received.

ACTIONS:
1. Senior officers to contact the London CIV to find out if the fund could pay out dividends.
2. Senior officers to add Pension Fund Cash Flow Forecast to the committee forward plan to be reviewed on an annual basis.

RESOLVED:
1. To note the estimated cash flow deficit of £13m from operational activities (Appendix A).
2. Approve the recall of £2m dividend and rental from Schroders into the LBTH Pension Fund bank account to help meet the cost of in-year liabilities.
3. To approve the sale of Ballie Gifford equity investments £11m.

5.4 Pensions Administration Quarterly update- Quarter End September 2019

The Committee received the report of Miriam Adams (Interim Pension & Investment Manager), on the Pension Administration Quarterly Update – quarter ending September 2019.

The Committee **RESOLVED** to:
1. Note the contents of the report.
2. Note the identified regulatory breaches to be reported to the Pension Regulator.
3. Agreed to report the regulatory breaches to the Pensions Regulator
4. Note that a detailed remediation plan which has the deadlines for all actions, owners and up to date status will be provided to the Board in February 2020.

5.5 The Investment Consultancy and Fiduciary Management Market Investigation Order 2019

The Committee received the report of Neville Murton (Interim Corporate Director of Resources) and Miriam Adams (Interim Pension & Investment Manager), on the Investment Consultancy and Fiduciary Management Market Investigation Order 2019.

The Committee **RESOLVED:**
1. To note the contents of the report.
2. Consider the example investment consultant objectives
3. Note the legal requirement for trustees of occupational pensions (including the LGPS) to set objectives comes into effect from 10 December 2019
4. To consider the draft strategic objectives in relation to the provision of Investment Consultancy and Fiduciary Management Market Investigation Order 2019.
5. To delegate to the Director of Resources/Section 151 Officer further to consultation with the Pension Committee Chair and Vice-Chair, the authority to agree final strategic objectives.

6. TRAINING EVENTS

It was noted that a training needs assessment template had been circulated to Members. Members were encouraged by the Chair to complete the form and return to Miriam Adams (Interim Pension & Investment Manager).

RESOLVED:

1. To send completed training needs form to Miriam Adams (Interim Pension & Investment Manager).

7. ANY OTHER BUSINESS CONSIDERED TO BE URGENT

Nil items

7.1 Investment and Fund Managers Performance Review for Quarter End September 2019

The Committee noted the report of Neville Murton (Interim Corporate Director of Resources) and Miriam Adams (Interim Pension & Investment Manager), on the Investment and Fund Managers Performance Review for Quarter Ending September 2019.

The Independent Advisor highlighted key points from his quarterly commentary. These included:

- That equity markets have gone up by 23% (S&P 500) and 27% (Nasdaq) so although equity markets were vulnerable, the same could be said of other asset classes, such as bond markets, which appeared even less attractive.
- That the funds equity weighting should be no greater than the strategic equity benchmark, funds with a cash plus return target, such as diversified growth funds, could provide a suitable home until other asset classes became more attractive.
- Infrastructure was recommended as an asset class to invest in without delay.
- Baillie Gifford had performed poorly in the quarter and was underperforming by its benchmark by 1.5% over the last year. This could be attributed to Ballie Giffords philosophy for managing the fund, which focuses on longer term themes such as technology, resulting in greater growth stocks rather than value stocks. After a period of waiting it out high returns could be possible as had been the case on previous occasions.
- LCIV did not offer a 'value' fund. The LCIV Sustainable Equity Fund had some similarities with the Ballie Gifford equity fund.
- The LCIV appeared to be in crisis and was facing difficulties retaining or attracting management staff. The chief investment officer had resigned within weeks of joining the CIV and one of two senior managers was due to depart at the end of 2019. There were also concerns about the quality of monitoring reports which showed a limited ability in being able to look beyond what was being told by managers.

The Committee expressed concern at the news that the LCIV was experiencing a management crisis. The independent advisor advised against any new ventures with the LCIV until their management issues had been resolved.

The Chair notified that committee that she was involved in a project with Councillor Mark Engleby at Lewisham Council to form a coalition of councils interested in a green product. She said the LCIV had verbally indicated they would be able start research into the work soon. However, given the news about their management issues, she was hesitant to proceed.

It was advised that the Chair should write to the LCIV for a formal response to the suggestion to start a green fund. The Chair and Senior Officers agreed to draft the letter.

ACTION:

1. The for Chair and Senior Officers to write to the Chair of the LCIV informing them a group of councils are interested in a green fund, feasibility and a request for options to be presented to the Committee in the next year.

The Committee **RESOLVED** to**:**

1. Note the content of the report.
2. Note the independent advisors quarterly commentary report.
3. Note the PIRC reports
4. Note the detailed fund performance by Mercer

8. EXCLUSION OF THE PRESS AND PUBLIC

In view of the contents of items 7.1 and 7.2 on the agenda the Committee agreed to adopt the following motion:

"That, under the provisions of Section 100A of the Local Government Act 1972, as amended by the Local Government (Access to Information) Act 1985, the press and public be excluded from the remainder of the meeting for the consideration of the Section Two business on the grounds that it contains information defined as Exempt in Part 1 of Schedule 12A to the Local Government Act, 1972."

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9.1 EXEMPT/ CONFIDENTIAL MINUTES

There were not exempt minutes to review at this meeting.

9.2 Report on the Annual Allowance and the treatment of individual pension tax charges

Neville Murton (Acting Corporate Director of Resources) and Ngozi Adedeji (Housing Team Leader – Legal Services) declared a pecuniary interest and left the room to omit themselves from the discussion.

The Committee received the report of Kevin Bartle (Interim Divisional Director Finance Procurement & Audit) on Annual Allowance and the treatment of individual pension tax charges.

Interim officers explained that they had discovered a significant and unprecedented backlog of record management in the pension administration team that had resulted in a breach of regulation. Upon discovery of the discrepancies officers sought the advice of Hyman Robertson independent actuary for remediation advice.

Preliminary investigation had found that accurate record keeping had not been maintained in order to produce the Annual Benefit Statement for active and inactive employees, even though this was a statutory requirement. Consequently this had resulted in tax discrepancies owed to HMRC.

In addition to this the pension team had not sent out Annual Allowance Statements to average earners with long service and the work had not been conducted for at least two years. Other areas of concern included a lack of policy and procedure documents, data quality issues, lack of receipts against records and 980 employees had not received refunds.

Officers assured the Committee that the breaches were due to a lack of staff resources, training and development, not dishonesty.

It was noted that the Pension Regulator would be notified of the breaches in regulation including the backlog in recording individual pension tax charges.

It was noted that Miriam Adams (Interim Pension & Investment Manager) had been tasked with producing a remediation plan. She said the pension team required training and development in pension administration, training on how to effectively use the pension system and that online self-service for some elements of record keeping was required to alleviate pressure on the team.

Members asked why the Pension Board had not reported this issue to the Pension Committee. The Interim Divisional Director of Finance and Resources said the Chair of the Pension Board, John Jones, had reported to him that he had raised concerns about pension administration and resourcing, however his concerns had not been picked up until the Interim Officers had come into post and had conducted a planning exercise.

There was a discussion on whether pension administration should be outsourced to a specialist pension administration service. Officers said this was something the Committee could consider however, there was no guarantee an outsourced service would be any better and that the main issue in the pension team was a lack of resources and strong leadership, which could be rectified.

There was a discussion on individual pension tax charges. Officers explained that as of 2014/15 the government had reduced the threshold figure from around £250k to £40k. This had resulted in a significant number of high earning staff from the corporate management level up to the chief officer level with outstanding tax charges of around £30,000.

There was a discussion on the options available to the Committee to pay the tax to HMRC. Officers advised that the Committee should adopt the 'Voluntary Scheme' and introduce a policy document on the scheme.

The Voluntary Scheme was when the pension fund paid the tax charge to HMRC on behalf of the employee and recouped the cost when the employee retired. It was advised the Committee adopt the Voluntary Scheme as a matter of urgency because there was a risk of significant losses for those affected, or fines.

The Committee unanimously agreed to adopt a Voluntary Scheme and draft a policy document for adoption by the council. Officers had prepared a draft policy statement for Member comment. Members agreed to adopt the draft policy on an interim basis to be reviewed in six months.

The policy statement would provide the following advice:

1. **Scenario**: An individual meets the 'mandatory scheme pays' criteria but due to an administrative oversight (e.g. failure to provide the required pension savings statement) on the part of the Fund was unable to make their election within the required timescale – **policy**: in line with the approach taken by other LGPS Funds such as an election would be accepted by the Fund.
2. **Scenario**: Individual's tax charge in respect of LGPS is less than £2000. **Policy** – the fund will not accept such an election.
3. **Scenario**: Individual makes a valid 'mandatory scheme pays' election in respect of LGPS, but has a tax charge relating to another pension arrangement which they are requesting the Fund to meet on their behalf. **Policy** – The Fund will not accept such an election.
4. **Scenario**: An individual meets the 'mandatory scheme pays' criteria but due to their own oversight (i.e. not and administrative oversight on the part of the Fund) fails to make their election within the required timescale. **Policy** – The Fund will not accept such an election.

The Committee rejected the following statement - '**Scenario**: individual subject to the tapered annual allowance and has a tax charge of £2000 or more relating to their total pension growth in the Fund. **Policy** – in line with the approach taken by other LGPS Funds such an election would be accepted by the Fund'.

RESOLVED:

1. For Kevin Bartle (Interim Divisional Director Finance Procurement & Audit) to continue to lead the investigation into pension breaches and to produce a remediation plan.
2. To adopt a Voluntary Scheme Pay solution.
3. For Kevin Bartle (Interim Divisional Director Finance Procurement & Audit) to consult the Pensions Regulator regarding breaches in pension administration.
4. For the Chair and Kevin Bartle (Interim Divisional Director Finance Procurement & Audit) to report the individual pension tax issue to Internal Audit Committee.
5. To note the report and Hyman Robertson's paper.

The meeting ended at 9.30 p.m.

Chair, Councillor Kyrsten Perry
Pensions Committee

LONDON BOROUGH OF TOWER HAMLETS

MINUTES OF THE PENSIONS COMMITTEE

HELD AT 6.00 P.M. ON TUESDAY, 18 FEBRUARY 2020

COMMITTEE ROOM ONE - TOWN HALL MULBERRY PLACE

Members Present:

Councillor Kyrsten Perry (Chair)
Councillor Rachel Blake (Vice-Chair)
Councillor Eve McQuillan
Councillor Ayas Miah
Councillor Andrew Wood

Union and Admitted Bodies, Non-Voting Members Present:

–

Other Councillors Present:

Apologies:

Councillor Mohammed Ahbab Hossain
Councillor Abdal Ullah

Others Present:

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Officers Present:

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1. DECLARATIONS OF DISCLOSABLE PECUNIARY INTEREST

There were no declarations of pecuniary interests.

2. REPORTS FOR CONSIDERATION

2.1 Pensions Committee - Equity Protection Strategy

The Committee received a report on recommendations for equity protection. Kevin Bartle (Divisional Director of Finance, Procurement and Audit) introduced the report. He summarised that in 2018 a decision was made by the Pension Committee to implement an equity protection strategy because a valuation was approaching and market conditions were performing favourably enough to implement a strategy for good value.

It was noted that the equity protection strategy was due to expire in March 2020 and the committee would have to make a decision on whether it wanted to renew the protection or allow the protection to naturally roll off because it had fulfilled its purpose.

In addition, if the committee decided not to renew the protection strategy, it would have to decide on how to handle its equity exposure on the gilts held with Schroders. The following options were presented for consideration:

1. Send equities back to Legal & General for investment according to the previous arrangement.
2. Invest in low carbon equites at Legal & General
3. Maintain exposure at Schroders for a short period whilst considering alternative options.

Officers explained that markets were rallying due to the recent US-China trade deal and a cut to FED rates. They said the existing equity protection had hit its cap and was no longer benefiting the Fund. It was noted that equites tended to fare better in the long term and remain low in the short term.

In order to help inform the decision, the Committee received a presentation from Steve Turner (Investment Consultant Mercers) on approaches to equity risk management, a market view and a summary of the funds existing protection strategy.

Options presented to the Committee included:

- An asset based solution – this was not recommended.
- Static Hedging – this was a fixed term protection structure, equities would be protected up to a certain percentage.
- Dynamic Hedging – this was explained to be similar to static hedging but rolled on. The protection level would change if markets went up. Officers said this was extremely complicated and would not recommend it.

Members asked why the valuation date was significant. Officers explained that the valuation was a financial health check to see if the there was enough money to make pay outs in a crisis situation. A valuation was a legal requirement and had to be carried out every three years.

Officers advised that if the Committee wished to implement a protection strategy, it would be best to do it now as the cost for protection would be lower in the current more stable market.

It was noted the cost of the existing equity protection and benefits would be published on 18 March 2020.

The Chair summarised that the Committee's most feasible options were to either let the protection roll off or initiate a static hedging approach.

Mercers advised that from an investment perspective, a protection strategy was prudent but was not an immediate concern. They suggested that a review on equity protection be put into the Business Plan eighteen months before the next valuation period. However, if the Committee were to decide to continue with a protection strategy, it would be best to implement it now when markets were stable. Equity protection rates tended to increase during times of market instability.

The Chair moved to vote on the decision. Members unanimously resolved to allow the current equity protection to expire. They requested quarterly performance monitoring reports on the Fund’s equity exposure. It was agreed that the first performance monitoring report would come to the Committee in November 2020.

With regards to the decision on gilts managed by Schroders, the Committee were presented with two options:

- The first choice was to transfer equity exposure on gilts back to Legal and General to handle as they had been previously dealt with.
- The second option was to invest in sustainable equities or equities supportive of a transition to a low carbon economy. Schroders had a product the Committee could explore.

Mercers explained that it was important to maintain market exposure so the ‘do nothing’ approach was not advised.

Members asked if it was possible to move money to Legal and General and then move it again to a preferred low carbon investment. Officers said it was possible but not recommended because it would incur having to pay a second transfer fee.

Members said they preferred to invest in sustainable equities. They instructed Mercers to have a discussion with Schroders on sustainable investment options. The Committee requested a briefing paper from Mercers on sustainable or low carbon equities for the next meeting on 19 March 2020.

Mercers requested some extra time to research and draft the briefing paper. The Chair agreed the report could be published late using ‘Chair’s urgency’, citing that consultants required the additional time for research.

ACTION: For Mercers to provide a report on sustainable equity options for the 19 March 2020 Pension Committee.

ACTION: To produce quarterly equity exposure reports. The first report to come to the Committee in November 2020.

A Member suggested reviewing the amount of investment in the CIV at a future meeting.

RESOLVED:

1. To note the paper from Mercers

2. To note there was no link to the next actuarial valuation date
3. To let the equity protection strategy run off and expire
4. To instruct Mercers to liaise with Schroders on a sustainable equity option for equity on gilts and report at the 19 March 2020 meeting of the Committee.

3. ANY OTHER BUSINESS CONSIDERED TO BE URGENT

There was no other urgent business discussed.

The meeting ended at 7.21 p.m.

Chair, Councillor Kyrsten Perry
Pensions Committee

Pension Board Submission to the Pensions Committee

To: Pensions Committee

From: John Jones Independent Chair Tower Hamlets Pension Board

Date:19 March 2020

1. The Pensions Board met on Monday 16th March with a good attendance of 4 Members at the meeting given the current difficult circumstances with the corona virus.

2. The main area of discussion concerned the current position with the pensions administration team and the lack of progress in addressing the resourcing of the team and in tackling the backlog of work. At our last meeting in November, the Board held a long and detailed discussion on the matters raised within pensions administration. We expressed serious concerns over the breaches in regulations, that required a formal report the pensions regulator, and the scale of the backlogs and weaknesses in data quality. At that time, it was clear that there were major issues to address in order to reduce these back logs and develop an effective service. The Board supported the proposed recovery plan and planned action. We agreed to receive a remedial action plan and update in January for both the Board and the Committee, but in the event this did not happen. The Committee will be aware that the Board has previously expressed concern about overall resourcing and performance in pensions administration.

3. We were updated verbally on the current position with this service and the steps needed to resolve the situation in terms of resources and timescales. We were also advised that system and interface problems exacerbate the difficulties faced by the team adding to their workload. Much of the detailed discussion was held in private, but the Committee should be very clear on the level of concern expressed by the Board in the lack of progress in addressing the issues of resourcing and planning within the Pensions administration team. Interim and short term resources can only go so far in supporting the recovery process and a properly resourced team underpins everything in the recovery plan. A decision on a revised resourcing structure is needed quickly with the focus on then

moving forward. The Board agreed to expedite any formal decisions that are required quickly in order to move this forward as soon as practical.

4. As part of this discussion we received an update from the Chief Internal Auditor on audit arrangements for the pensions administration service. The internal audit report prepared in 2019/20 identified a number of issues but these were never finalised and resolved within the Council. A wide ranging brief has now been prepared for an internal audit review to commence in April. The Auditor is open to holding a briefing on the issues arising from the review for the Committee and Board and my view is it would be helpful if this can be agreed.

5. The Executive Director attended the meeting and heard the Board's concerns about the recovery program, and undertook to respond quickly with a timeline for resourcing and implementing a new structure. Wherever possible the Board are willing to help expedite the resourcing and recovery programme. Advice was also sought from the Council's legal officer on whether a further report should be made to the Pensions regulator, and this advice will be considered as soon as it is available.

6. The Board did welcome the work carried out on a new risk model and the updated risk register. Some suggestions were made to the presentation of red and amber risks to enable a greater focus on these areas by the Board and Committee. Given the discussion earlier in the meeting on administration difficulties and reliability of data, concern was expressed over the confidence in the risks currently identified as green. However, overall the revised risk model was seen as a positive step forward. In future the risk register will be reviewed at each Pension Board meeting

7. Finally, the Board agreed the new revised conflicts of interest and Breaches policies. These should also be reported on at each meeting of the Pension Board.

John Jones
18th March 2020

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Non-Executive Report of the: **PENSIONS COMMITTEE** **18 June 2020**	TOWER HAMLETS
Report of: Neville Murton, Corporate Director, Resources	**Classification:** Unrestricted
TRIENNIAL VALUATION	

Originating Officer(s)	Miriam Adams, Pensions and Investment Treasury Manager
Wards affected	All

Summary

The Tower Hamlets Pension Fund, in accordance with Local Government Pension Scheme (LGPS) regulations, undergoes a full actuarial valuation once every three years, the results of which are used to determine contribution rates for each of the employers within the Fund for the following three years.

The whole Fund's funding level has risen to 102% from 83% which is broadly due to investment returns over the period.

In September 2019, the Committee considered the valuation methodology and draft Funding Strategy Statement (FSS). This report brings the final actuarial valuation results and the final FSS to the Committee. The draft FSS was circulated to employers in the Fund and invited to respond with comments. This agenda item was scheduled to be presented during the March 2020 Committee meeting postponed due to covid-19 pandemic.

Recommendations:

Pensions Committee is recommended to:

1. Note the whole Fund and individual employer valuation results as set out in Appendix 1;
2. Note the final Funding Strategy Statement as set out in Appendix 2; and
3. Note and adopt the actuarial valuation report and results which was signed by the actuary on 31 March 2020.

1. <u>REASONS FOR THE DECISIONS</u>

1.1 Regulation 58 of the Local Government Pension Scheme (Administration) Regulations 2013 (as amended) together with the guidance issued by CIPFA provides the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS).

1.2 The purpose of the valuation is to review the current funding strategy and ensure the Fund has a contribution plan and investment strategy in place that will enable it to pay members' benefits as they fall due.

2. ALTERNATIVE OPTIONS

2.1 There is no alternative because the requirements to carry out the triennial revaluation and prepare a Funding Strategy Statement are prescribed in regulations

3. DETAILS OF REPORT

Valuation Methodology

3.1 The valuation report is set out in Appendix 1. The highlights are that since the last valuation was carried out as at 31st March 2019:

The 2016 valuation was based on market conditions at the valuation date – 31 March 2016. The actuary's investment assumptions in 2016 was based on prevailing gilt yield plus a margin. In 2019, the actuary has since changed this approach to consider a wide range of possible outcomes whereby investment return assumption which drives the liabilities is based on modelling using the Fund's current asset allocation strategy, future expected returns for different asset classes and variability of those returns from year to year. For the choice of 4% investment return assumption there is a 70% likelihood that the Fund will achieve a return of at least 4% p.a. over the next 20 years. However, this does not drive how contribution rates are set. The methodology for setting contribution is in line with previous valuation.

McCloud Ruling

3.2 Additional prudence in funding plans via increase in the likelihood for success has been made when setting contribution rates in line with the advice issued by the Scheme Advisory Board in May 2019.

Indexation and equalisation of Guaranteed Minimum Pensions (GMP)

3.3 As part of the introduction of single-tier state pension (STP), THE Government confirmed that public service pension schemes, including the LGPS, will be responsible for funding all increases on GMP as an 'interim solution' which will continue to remain in place up to 5 April 2021. For the 2019 valuation, the actuary has assumed that all increases on GMPs for members reaching State Pension Age after 6 April 2016 will be paid for by the LGPS. This has served to increase the value placed on the liabilities.

Valuation Results: Deficit and Funding Level

3.4 The valuation report is set out in Appendix 1. The highlights are that since the last valuation was carried out as at 31st March 2019:

- The funding level has improved from 83% to 102%.

Valuation Date	31 March 2016	31 March 2019
Past Service Liabilities	(£m)	(£m)
Employees	414	452
Deferred Pensioners	320	350
Pensioners	627	723
Total Liabilities	**1,361**	**1,525**
Assets	**1,126**	**1,552**
Surplus / (Deficit)	**(235)**	**27**
Funding Level	83%	**102%**

3.5 The table shown below analyses the change in the deficit.

Change in the surplus/deficit position	Assets (£m)	Liabilities (£m)	Surplus / (Deficit) (£m)
Last valuation at 31 March 2016	**1,126**	**1,361**	**(235)**
Cashflows			
Employer contributions paid in	156		156
Employee contributions paid in	33		33
Benefits paid out	(167)	(167)	0
Net transfers into / out of the Fund*	1		1
Other cashflows (e.g. Fund expenses)	(3)		(3)
Expected changes in membership			
Interest on benefits already accrued		178	(178)
Accrual of new benefits		129	(129)
Membership experience vs expectations			
Salary increases greater than expected		3	(3)
Benefit increases less than expected		(0)	0
Early retirement strain (and contributions)	6	9	(4)
Ill health retirement strain		1	(1)
Early leavers greater than expected		(1)	1
Pensions ceasing greater than expected		(2)	2
Commutation greater than expected		(0)	0
Other membership experience		(42)	42
Changes in market conditions			
Investment returns on the Fund's assets	399		399
Changes in future inflation expectations		45	(45)
Changes in actuarial assumptions			
Change in demographic assumptions (excl. longevity)		(3)	3
Change in longevity assumptions		(41)	41
Change in salary increase assumption		6	(6)
Change in discount rate		47	(47)
This valuation at 31 March 2019	**1,552**	**1,525**	**27**

* We have insufficient data to value the impact on the liabilities as a result of all transfers in/out.

3.6 A number of assumptions were made during the triennial actuarial valuation process, with the two most significant ones being longevity projections and the real discount rate used to value liabilities.

The changes to the longevity assumptions used for the valuation have resulted in a modest reduction in life expectancies. This has served to reduce the liabilities by £41m.

The assumed rate of future CIPI inflation has increased from 2.1% p.a. at 31 March 2016 to 2.3% p.a. at 31 March 2019. This has increased the value of liabilities by £45m.

The assumed rate of future investment returns has decreased from 4.2% p.a. to 4.0% p.a... This has increased the value of the liabilities by £47m.

The investment return on the Fund's assets for the period 31 March 2016 to 31 March 2019 was 35.3%. This has increased the vale of the assets by £399m.

Contributions Rates

3.7 The contribution rates that are certified in the Rates and Adjustment Certificate ("R and A"), as shown presented by the actuary are made up of two elements:

a) the estimated cost of future benefits being accrued, (the "Primary Rate") – this is the cost of an officer earning an extra year of pension benefit; plus

b) an adjustment for the funding position of the benefits accrued in the past – usually where there is a deficit in the pension fund, (the "Secondary Rate"). If there is a deficit/surplus there will be an increase/decrease in the employer's contribution rate, with the surplus or deficit spread over an appropriate period. The aim is to return the employer to full funding over that period.

3.8 ***Individual Employer Contribution Rates*** - While the fund is managed as a whole, it is effectively a number of sub funds for each individual employer. This means that each employer contributes according to a contribution rate that specifically reflects the individual employer's membership profile. Under guidance from the actuary, we have continued to set deficit recovery as monetary amounts. Employee contributions are payable in addition to the employer contributions.

The table below shows the council's contribution rate and rates for LEA maintained schools.

Financial Year	Council		LEA Maintained Schools
2020/21	19.9%	£13,650,000	20.3%
2021/22	19.3%	£13,650,000	21.8%
2022/23	18.6%	£13,650,000	23.3%

3.9 The FSS set out in Appendix 2 has been drawn up by the Fund's actuary, Hymans Robertson, in conjunction with Officers of the Council. The Pension Fund previously published a FSS following the 2016 valuation and this has been updated to reflect changes made for the 2019 valuation.

3.10 The FSS also sets out the different treatments for different types of employers ranging from tax raising bodies such as the Council and other scheduled bodies such as Academies to Community and Transferee Admission Bodies. Various factors are considered during the contribution setting process, including the funding target (the assets required to pay member benefits), the time horizon and the probability of reaching the funding target over that time horizon. Each of these factors may be varied according to employer type, as this will influence the level of risk posed by each employer.

3.11 No comments were received during consultation. The Committee is therefore asked to approve the final Funding Strategy Statement and the consultation period.

Post valuation events

3.12 There has been significant volatility in the financial markets as a result of economic uncertainty associated with covid-19 pandemic. At 29 March 2020, the actuary estimates that the whole fund investment return since 31 March 2019, would be in the region of 0% to -5%. It is uncertain how this will affect the long- term economy and investment returns. No allowance has been made for the ongoing volatility in the 2019 valuation results or contribution rates detailed in the Rates & Adjustment Certificate.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The performance of the Pension Fund's investments affects the required level of contributions due from employers.

4.2 The employers' contribution rate for the London Borough of Tower Hamlets is remains at 19.9% as a result of the 2019 triennial review. The Council will continue to pay this rate for the next three years up until 31 March 2023. The next valuation exercise will occur in March 2022 with the results taking effect from 1 April 2023.

5. LEGAL COMMENTS

5.1 The Constitution delegates to the Pensions Committee the function of setting the overall strategic objectives for the Pension Fund.

5.2 Regulation 58 of the Local Government Pension Scheme Regulations 2013 requires the Council as an administering authority to publish and maintain a funding strategy statement.

5.3 When preparing, maintaining or publishing the funding strategy statement, the Council is required to make such revisions as it considers appropriate following material change to the policy set out in the statement; any revisions must be made following consultation with such persons as the Authority considers appropriate.

5.4 When reviewing the funding strategy statement, the Council is required to have regards to:

a) the CIPFA Pensions Panel Guidance on Preparing and Maintaining a Funding Strategy Statement; and

b) the Council's statement of investment principles/Investment Strategy Statement.

The review of the funding strategy statement has been undertaken by the Fund Actuary and Fund officers with reference to a and b above as required.

5.5 When performing its functions as administrator of the LBTH pension fund, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty).

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 The London Borough of Tower Hamlets Pension Fund represents an asset to the Council in terms of its ability for attracting and retaining staff who deliver services to residents. The adoption of a Work Plan should lead to more effective management of the Fund.

6.2 A significant element of the Council's budget is the employer's contribution to the Fund. Therefore, any improvement in the efficiency of the Fund that leads to improvement in investment performance or cost savings will likely reduce contributions from the Council and release funds for other corporate priorities.

7. BEST VALUE (BV) IMPLICATIONS

7.1 The preparation and production of a Funding Strategy Statement ought to result in a more efficient process of managing the Pension Fund.

7.2 Without sound financial management of the Pension Fund, the Council and other employers in the Pension Fund could see increased volatility in their contribution rates and increases in the cost of providing for the benefits of scheme members.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

8.1 There is no Sustainable Action for A Greener Environment implication arising from this report.

9. RISK MANAGEMENT IMPLICATIONS

9.1 All material, financial and business issues and possibility of risks have been considered and addressed within the report and its appendices, and that the actuarial report and funding strategy statement will provide the Pension Fund with a solid framework in which to achieve a full funding status over the long term.

9.2 The Funding Strategy Statement forms part of the broader framework for funding and management of the London Borough of Tower Hamlets Pension Fund. It sets out how the Fund will approach the future funding of its liabilities and the recovery periods for recovering any deficit.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

10.1 There are no any crime and disorder reduction implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report - NONE

Appendices
Appendix 1 – Actuarial Valuation Whole Fund Results
Appendix 2 – Funding Strategy Statement

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report - NONE

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HYMANS ROBERTSON

London Borough of Tower Hamlets Pension Fund

Actuarial valuation as at 31 March 2019

Valuation report

31 March 2020

Contents

1 Introduction

Background to the actuarial valuation

We have been commissioned by London Borough of Tower Hamlets ("the Administering Authority") to carry out an actuarial valuation of the London Borough of Tower Hamlets Pension Fund ("the Fund") as at 31 March 2019 as required under Regulation 62 of the Local Government Pension Scheme Regulations 2013 ("the Regulations").

The actuarial valuation is a risk management exercise with the purpose of reviewing the current funding plans and setting contribution rates for the Fund's participating employers for the period from 1 April 2020 to 31 March 2023. This report summarises the outcomes of the valuation and the underlying advice provided to the Administering Authority throughout the valuation process.

This summary report is the culmination of other communications in relation to the valuation, in particular:

- Our 2019 valuation toolkit which sets out the methodology used when reviewing funding plans:
- Our papers dated 8 February 2019 which discuss the valuation assumptions;
- Our Initial Results Report dated 5 February 2020 which outlines the whole fund results and inter-valuation experience;
- The Funding Strategy Statement which details the approach taken to adequately fund the current and future benefits due to members.

[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work.

Reliances and Limitations

This report has been prepared for the sole use of London Borough of Tower Hamlets in its role as Administering Authority of the Fund to provide an actuarial valuation of the Fund as required under the Regulations. It has not been prepared for any other third party or for any other purpose. We make no representation or warranties to any third party as to the accuracy or completeness of this report, no reliance should be placed on this report by any third party and we accept no responsibility or liability to any third party in respect of it.

The totality of our advice complies with the Regulations as they relate to actuarial valuations.

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with where material:

- TAS 100 – Principles for technical actuarial work;
- TAS 300 – Pensions.

Use of this report by other parties

This report is addressed to the Administering Authority of the Fund only. We appreciate that other parties may also seek information about the 2019 valuation process and methodology. We would encourage such parties to refer to the following publicly available documents for further information:

- The Fund's Funding Strategy Statement;
- The Fund's Investment Strategy Statement;
- Published meeting papers and minutes for the quarterly meetings of the Fund's Pensions Committee.

Considering these papers alongside this valuation report will provide a more complete view of the Fund's funding strategy and decision-making process surrounding this. These documents are available on the Fund's website or on request.

2 Valuation approach

Employer contribution rates

The purpose of the valuation is to review the current funding strategy and ensure the Fund has a contribution plan and investment strategy in place that will enable it to pay members' benefits as they fall due.

Valuations for open defined benefit multi-employer pension funds such as the London Borough of Tower Hamlets Pension Fund are complex. Firstly, the time horizons are very long; benefits earned in the LGPS today will be paid out over a period of the next 80 years or more, and new members will continue to join in the future. Secondly, as they depend on unknowns such as future inflation and life expectancy, the actual value of future benefit payments is uncertain. Finally, to keep contributions affordable, the Fund invests in return seeking assets which have higher levels of future volatility.

Given the above and that the future cannot be predicted with certainty, employer contribution rates can only ever be an estimate. However, the valuation approach adopted uses an understanding of the Fund, and the uncertainties and risks discussed above, to quantify the likelihood of the contribution plan and investment strategy for each employer being sufficient to fund future benefits.

This is achieved in practice by following the process outlined below.

Step 1: The Fund sets a funding target (or funding basis) for each employer which defines the estimated amount of assets to be held to meet the future benefit payments.

Step 2: The Fund sets the funding time horizon over which the funding target is to be achieved.

Step 3: The Fund sets contributions that give a sufficiently high likelihood of meeting the funding target over the set time horizon.

These three steps are central to the "risk-based" approach to funding which is described in Guide 5 of our 2019 valuation toolkit[2].

The risk-based approach uses an Asset Liability Model (described in Guide 6) of the 2019 valuation toolkit) to project each employer's future benefit payments, contributions and investment returns into the future under 5,000 possible economic scenarios. Future inflation (and therefore benefit payments) and investment returns for each asset class (and therefore asset values) are variables in the projections. Further details of these variables are provided in Appendix 2. The investment strategy underlying the projection of employer asset values is provided in Appendix 1.

By projecting the evolution of an employer's assets and benefit payments 5,000 times, a contribution rate can be set that results in a sufficient number of the future projections being successful i.e. meeting the funding target by the funding time horizon.

The risk-based approach to setting employer contributions allows the Fund and its employers to understand and quantify the level of risk inherent in funding plans, something that is not possible using a single set of assumptions alone.

Further detail on the approach to calculating contributions for individual employers, including the parameters used in the three steps for each type of employer, is set out in the Funding Strategy Statement.

[2] https://www.hymans.co.uk/media/uploads/LGPS_2019_Valuation_Toolkit_Guides.pdf

Funding position as at 31 March 2019

The valuation also offers an opportunity to measure the Fund's funding position as at 31 March 2019. Whilst this measurement has limited insight into understanding the long term ability to be able to pay members' benefits, it is a useful summary statistic.

For the purposes of this valuation we have adopted a "mark to market" approach, for measuring the funding level, meaning that the Fund's assets have been taken into account at their market value and the liabilities have been valued by reference to a single set of assumptions based on market indicators at the valuation date. These assumptions are detailed in Appendix 2. As we have taken a market-related approach to the valuation of both the assets and the liabilities, we believe that they have been valued on a consistent basis.

Significant events

The figures in this report are based on our understanding of the benefit structure of the LGPS in England and Wales as at 31 March 2019. Details can be found at http://www.lgpsregs.org/.

McCloud ruling

The LGPS benefit structure is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. At the time of writing, the format and scope of any benefit changes in light of the McCloud ruling is still unknown. In line with the advice issued by the Scheme Advisory Board in May 2019, the following allowance has been made at the valuation for the McCloud ruling:

- Employer contribution rates: additional prudence in funding plans via an increase in the likelihood of success (step 3) when setting contribution rates;
- Measurement of funding position at 31 March 2019: no allowance.

Further details of the approach taken are set out in Section 2.7 of the Funding Strategy Statement.

Indexation and equalisation of Guaranteed Minimum Pensions (GMP)

As a result of the Government's introduction of a single-tier state pension (STP) there is currently uncertainty around how who funds certain elements of increases on GMPs for members reaching State Pension Age after 6 April 2016.

As part of the introduction of STP, the Government confirmed that public service pension schemes, including the LGPS, will be responsible for funding all increases on GMP as an 'interim solution'. In their January 2018 consultation response, HM Treasury confirmed that the 'interim solution' will continue to remain in place up to 5 April 2021. Thereafter the Government's preferred approach is to convert GMP to scheme pension.

For the 2019 valuation, given the Government's preference for conversion to scheme benefits, we have assumed that all increases on GMPs for members reaching State Pension Age after 6 April 2016 will be paid for by LGPS employers. This has served to increase the value placed on the liabilities.

The Government have also stated that their preferred long term indexation solution of converting GMP to scheme pension will also meet the requirements of equalisation.

3 Valuation results

Employer contribution rates

The key objective of the Fund is to set employer contributions that are likely to be sufficient to meet both the cost of new benefits accruing and to address any funding surplus or deficit relative to the funding target over the agreed time horizon. A secondary objective is to maintain relatively stable employer contribution rates.

In order to meet the above objectives, the methodology set out in Section 2 has been used to set employer contributions from 1 April 2020.

Employer contributions are made up of two elements:

a) the estimated cost of future benefits being built up each year, after deducting members' own contributions and including an allowance for the Fund's administration expenses. This is referred to as the "*Primary rate*", and is expressed as a percentage of members' pensionable pay; plus

b) an adjustment for the difference between the Primary rate above, and the total contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, the Secondary rate is in respect of benefits already accrued at the valuation date. The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The Primary rate and Secondary rate for every contributing employer in the Fund is set out in the Rates and Adjustments Certificate in Appendix 3.

Each employer has been certified primary and secondary contributions that are appropriate for that employer's circumstances and which reflects that employer's experience. However, broadly speaking:

- Primary contribution rates have been subject to some upwards pressure as a result of a weaker outlook for future investment returns and the additional prudence built into funding plans to allow for the McCloud ruling;
- Secondary contributions have decreased as employer assets have increased since 31 March 2016, reducing any extra contributions required in respect of benefits accrued to the valuation date. The impact of this on secondary contributions has been partially offset by the additional prudence built into funding plans to allow for the McCloud ruling.

The table below summarises the whole fund Primary and Secondary Contribution rates at this valuation. The Primary rate is the payroll weighted average of the underlying individual employer primary rates and the Secondary rate is the total of the underlying individual employer secondary rates, calculated in accordance with the Regulations and CIPFA guidance. The whole fund Primary and Secondary contributions calculated at the 2016 valuation of the Fund are shown for comparison.

	Last Valuation 31 March 2016		This Valuation 31 March 2019	
Primary Rate (% of pay)	19.9%		19.9%	
Secondary Rate (£)	2017/18 2018/19 2019/20	13,974,000 14,603,000 15,256,000	2020/21 2021/22 2022/23	15,019,000 15,137,000 15,103,000

The Primary rate includes an allowance of 0.5% of pensionable pay for the Fund's expenses (0.6% at the 2016 valuation).

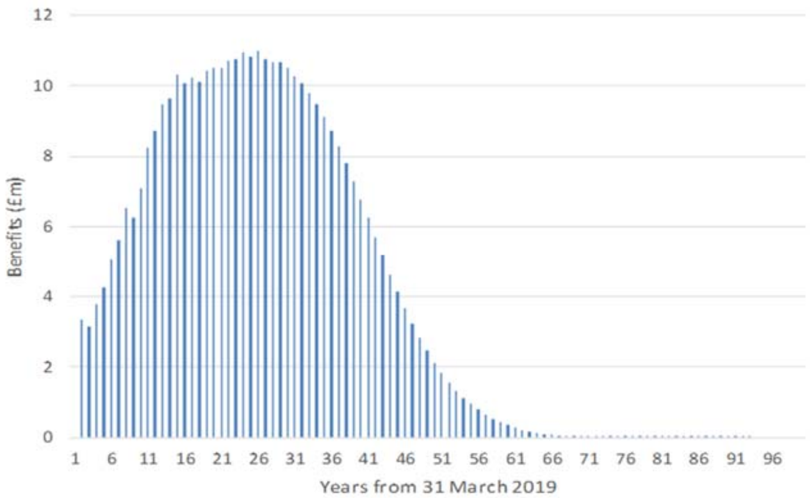
The total expected contributions to be received by the Fund over the period 1 April 2020 to 31 March 2023 is higher in monetary terms than the expected contributions over the period 1 April 2017 to 31 March 2020.

The average employee contribution rate is 6.9% of pensionable pay (6.6% at the 2016 valuation).

Funding position as at 31 March 2019

The funding position is a summary statistic often quoted to give an indication of the health of the fund. It is limited as it provides only a snapshot in time and is based on a single set of assumptions about the future. To measure the funding position at 31 March 2019, we compare the value of the Fund's assets on that date against the expected cost (including an allowance for future investment returns) of all the future benefit payments accrued up to the valuation date (the liabilities).

The chart below details the projected future benefit payments based on the membership data summarised in Appendix 1 and the demographic, salary and benefit increases assumptions summarised in appendix 2.

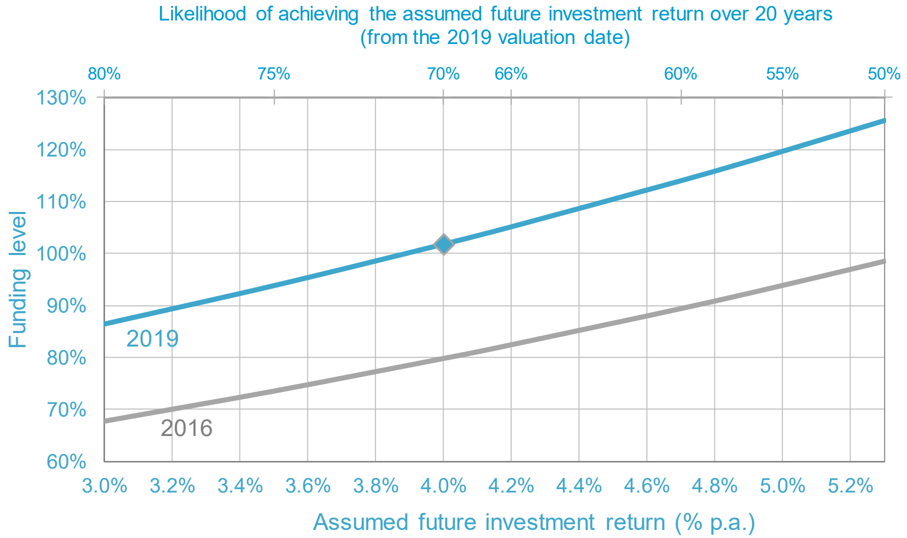


Using an assumption about the future investment return generated from the Fund's assets then allows a value to be placed on these payments in today's money; the liabilities. The higher the assumed investment return, the lower the liability value and therefore the higher the funding level.

The value placed on the liabilities is extremely sensitive to the investment return assumption. Based on the Fund's current investment strategy (detailed in Appendix 1) and the same model used in the contribution rate calculations, it is estimated that:

- There is a 50% likelihood of the Fund's investments achieving at least an annual return of 5.3% p.a. over the next 20 years;
- There is a 70% likelihood of the Fund's investments achieving at least an annual return of 4.0% p.a. over the next 20 years; and
- There is an 80% likelihood of the Fund's investments achieving at least an annual return of 3.0% p.a. over the next 20 years.

The following chart shows how the funding level varies with the future investment return assumption (blue line). For comparison, the funding level associated with the same choice of investment return assumption at the 2016 valuation is also shown (grey line).



From this chart, we can see that:

- Regardless of the investment return assumption used, there has been a genuine improvement in the funding position at 31 March 2019 compared to the last valuation, reflecting an increase in the assets held today per pound of benefit to be paid out in future;
- The funding position would be 100% if future investment returns were around 3.9% p.a. (at 2016, the investment return would have needed to be 5.4% p.a.). The likelihood of the Fund's assets yielding at least this return is around 71%;
- If future investment returns were 5.3% p.a. then the Fund currently holds sufficient assets to meet 126% of the accrued liabilities. The likelihood of the Fund's assets yielding at least this return is 50%. 126% can therefore be considered the "best estimate" funding position.

Reported funding position

The valuation outputs are more meaningful when stakeholders can understand the likelihood, and hence the level of prudence, attached to them. The above chart does this for the measurement of the funding position.

However, there is still a requirement to report a single funding position at 31 March 2019. This reported position must include a margin of prudence.

For the purpose of reporting a funding level and an associated funding surplus/deficit for the 2019 valuation, an investment return of 4.0% p.a. has been used. It is estimated that the Fund's assets have a 70% likelihood of achieving this return.

The resulting funding position is as follows:

Valuation Date	31 March 2016	31 March 2019
Past Service Liabilities	**(£m)**	**(£m)**
Employees	414	452
Deferred Pensioners	320	350
Pensioners	627	723
Total Liabilities	**1,361**	**1,525**
Assets	**1,126**	**1,552**
Surplus / (Deficit)	**(235)**	**27**
Funding Level	**83%**	**102%**

There has been an improvement in the reported funding level since 31 March 2016 from 83% to 102% and a reduction in the funding deficit from £235m to a surplus of £27m.

A breakdown of the key factors that have influenced the reported funding position from 31 March 2016 to 31 March 2019 are detailed overleaf.

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Change in the surplus/deficit position	Assets (£m)	Liabilities (£m)	Surplus / (Deficit) (£m)
Last valuation at 31 March 2016	**1,126**	**1,361**	**(235)**
Cashflows			
Employer contributions paid in	156		156
Employee contributions paid in	33		33
Benefits paid out	(167)	(167)	0
Net transfers into / out of the Fund*	1		1
Other cashflows (e.g. Fund expenses)	(3)		(3)
Expected changes in membership			
Interest on benefits already accrued		178	(178)
Accrual of new benefits		129	(129)
Membership experience vs expectations			
Salary increases greater than expected		3	(3)
Benefit increases less than expected		(0)	0
Early retirement strain (and contributions)	6	9	(4)
Ill health retirement strain		1	(1)
Early leavers greater than expected		(1)	1
Pensions ceasing greater than expected		(2)	2
Commutation greater than expected		(0)	0
Other membership experience		(42)	42
Changes in market conditions			
Investment returns on the Fund's assets	399		399
Changes in future inflation expectations		45	(45)
Changes in actuarial assumptions			
Change in demographic assumptions (excl. longevity)		(3)	3
Change in longevity assumptions		(41)	41
Change in salary increase assumption		6	(6)
Change in assumed rate of investment returns		47	(47)
This valuation at 31 March 2019	**1,552**	**1,525**	**27**

Since the previous valuation, various events have taken place which affect the value placed on the liabilities, including:

- There is an interest cost of £178m. This is broadly three years of compound interest (or expected investment returns) at 4.2% p.a. applied to the previous valuation liability value of £1,361m. The benefits that have been accrued to the valuation date are three years closer to payment at 31 March 2019 than they were at 31 March 2016, meaning there is a shorter period for future investment returns to help meet this cost. This serves to increase the value placed on the liabilities;
- The areas of membership experience that have had the greatest impact on the surplus/deficit position of the Fund are set out below, together with their impact on the liabilities:

	Expected	Actual	Difference	Impact on Liabilities
Pre-retirement experience				
Early leavers (no of lives)	1,729	3,270	1,541	Positive
Ill health retirements (no of lives)	55	79	24	Negative
Salary increases (p.a.)	2.6%	2.9%	0.3%	Negative
Post-retirement experience				
Benefit increases (p.a.)	2.1%	2.1%	(0.0%)	Broadly neutral
Pensions ceasing (£000)	3,108	2,863	(245)	Positive

- The changes to the longevity assumptions used for the valuation have resulted in a modest reduction in life expectancies. This has served to reduce the liabilities by £41m;
- The assumed rate of future CPI inflation has increased from 2.1% p.a. at 31 March 2016 to 2.3% p.a. at 31 March 2019. This has increased the value of the liabilities by £45m;
- The assumed rate of future investment returns has decreased from 4.2% p.a. to 4.0% p.a.. This has increased the value of the liabilities by £47m.

There has been a large increase in the value of the Fund's assets since the previous valuation because:

- The investment return on the Fund's assets for the period 31 March 2016 to 31 March 2019 was 35.3%. This has increased the value of the assets by £399m.

Projection of the funding position

The progression of the funding position will depend on various factors including future asset performance, economic conditions and membership movements. If the financial and demographic assumptions made at this valuation are borne out in practice, and there are no changes to the valuation assumptions, we project that the funding level at the 2022 valuation date will be approximately 104%. This allows for contributions to be paid as described in Appendix 3.

4 Sensitivity analysis

The results set out in this report are based on assumptions about the future. The actual cost of providing the benefits will depend on the actual experience of the Fund, which could be significantly better or worse than assumed. This section discusses the sensitivity of the results to some of the key assumptions.

Sensitivity of contribution rates to changes in assumptions

The approach to setting employer contribution rates mitigates the limitation of relying on one particular set of assumptions about the future by recognising the uncertainty around future investment returns and inflation. Therefore, there is no need to carry out additional analysis of the sensitivity of contribution rates to changes in financial assumptions.

The contribution rates are sensitive to changes in demographic assumptions. The results in this section in relation to the funding position can be broadly applied to the contribution rates.

Sensitivity of the funding position to changes in assumptions

The reported valuation funding position is based on one set of actuarial assumptions about the future of the Fund. If all of the assumptions made were exactly borne out in practice then the liability value presented in this report would represent the actual cost of providing accrued benefits from the Fund as it stands at 31 March 2019.

Sensitivity of the funding position to future investment returns

The chart in Section 3 details how the funding position varies with the future assumed investment return.

Sensitivity of the funding position to future inflation

Pensions (both in payment and in deferment) in the LGPS increase annually in line with CPI. Furthermore, benefits accrued in the CARE scheme are revalued annually in line with CPI. If future CPI inflation is higher than the assumed rate of 2.3% p.a. then the cost of the benefits will be higher than we have set out in Section 3.

The table quantifies the impact on the funding position of varying the benefit increases and CARE revaluation (CPI) assumption below.

CPI Assumption	Surplus/(Deficit)	Funding Level
% pa	(£m)	%
2.1%	72	105%
2.3%	27	102%
2.5%	(18)	99%

Sensitivity of the funding position to life expectancy

The main area of demographic risk is people living longer than expected. If long term mortality rates fall at a rate of 1.5% p.a. (compared to the assumed 1.25% p.a.) then members will live slightly longer than we have assumed in this valuation. The impact on the funding position is detailed below.

Long term rate of improvement	Surplus/(Deficit)	Funding Level
% pa	(£m)	%
1.25%	27	102%
1.50%	16	101%

Other demographic risks to consider

There are other risk factors which would have an impact on the funding position. Examples of these include the level of ill health retirements, withdrawals from the scheme and take up of the 50:50 option. These are probably unlikely to change in such a way that would rank them as amongst the highest risks facing the Fund and therefore there has been no further quantification of their risk.

Comment on sensitivity analysis

Note that the tables above show the effect of changes to each assumption in isolation. In reality, it is perfectly possible for the experience of the Fund to deviate from more than one of the assumptions simultaneously and so the precise effect on the funding position is therefore more complex. Furthermore, the range of assumptions shown here is by no means exhaustive and should not be considered as the limits of how extreme experience could actually be.

Other risks to consider

Regulatory, Administration and Governance risks

As well as financial and demographic risks, the Fund also faces:

- Regulatory risks – central government legislation could significantly change the cost of the scheme in the future; and
- Administration and governance risk – failures in administration processes could lead to incorrect data and inaccuracies in the actuarial calculations.

These risks are considered and monitored by the Fund as part of its ongoing risk management framework.

Resource and environment risks

The Fund is exposed to risks relating to future resource constraints and environmental changes. These risks may prove to be material.

Climate change is a complex issue for the Fund. Adverse future climate change outcomes will have an impact on future longevity, inflation, government and corporate bond yields and equity returns.

Whilst there has been no explicit increase in certified employer contribution related to climate change, these risks may be considered by the Administering Authority when assessing the output from contribution rate (‘comPASS’) modelling. These risks were explored further in our paper ‘Climate change modelling’ commissioned by the Administering Authority.

Risk management

Employers participating in the Fund are exposed to a number of risks. These include, but are not limited to:

- Investment risk;
- Market risks;
- Demographic risks;
- Regulatory risks;
- Administration and Governance risks;
- Resource and Environmental risks.

The Funding Strategy Statement has further details about these risks and what actions the Fund takes to monitor, mitigate and manage each one.

Post valuation events

There has recently been significant volatility in the financial markets as a result of the economic uncertainty associated with the COVID-19 pandemic. At 29 March 2020, we estimate that the whole fund investment return since 31 March 2019, would be in the region of 0% to -5%. As an open scheme, with a strong covenant, the LGPS as a whole is able to take a long-term outlook when considering the general funding implications of such external events. For employers who have a very short time horizon, recent market falls may be more immediately impactful, and the administering authority is taking steps to engage individually with these employers about the deteriorated funding position.

At the time of writing, it is very uncertain how this will affect the long-term economy and investment returns. Therefore, no allowance has been made for this ongoing volatility in the 2019 valuation results or contribution rates detailed in the Rates & Adjustments Certificate. This situation will be monitored closely to understand what impact it may have on the Fund and participating employers.

5 Final comments

The Fund's valuation operates within a broader framework, and this document should therefore be considered alongside the following:

- the Funding Strategy Statement, which in particular highlights how different types of employer in different circumstances have their contributions calculated;
- the Investment Strategy Statement, which sets out the investment strategy for the Fund;
- the general governance of the Fund, such as meetings of the Pensions Committee and Local Pension Board, decisions delegated to officers, the Fund's business plan, etc;
- the Fund's risk register; and
- the information the Fund holds about the participating employers.

Intervaluation employer events

New employers joining the Fund

Any new employers or admission bodies joining the Fund should be referred to the Fund Actuary to assess the required level of contribution. Depending on the number of transferring members the ceding employer's rate may also need to be reviewed.

Cessations and bulk transfers

Any employer who ceases to participate in the Fund should be referred to us in accordance with Regulation 64 of the Regulations.

Any bulk movement of scheme members:

- involving 10 or more scheme members being transferred from or to another LGPS fund; or
- involving 2 or more scheme members being transferred from or to a non-LGPS pension arrangement;

should be referred to us to consider the impact on the Fund.

Valuation frequency

Under the provisions of the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2022 where contribution rates payable from 1 April 2023 will be set.

Barry Dodds FFA

Douglas Green FFA

Fellows of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

31 March 2020

Appendices

Appendix 1 – Data

Membership data as at 31 March 2019

A summary of the membership data provided by the Administering Authority for the purposes of the valuation at 31 March 2019 is shown below. The corresponding membership data from the previous valuation is also shown for reference.

Whole Fund Membership Data	Last Valuation 31 March 2016	This Valuation 31 March 2019
Employee members		
Number	6,574	6,429
Total Actual Pay (£000)	153,290	159,277
Total Accrued Pension (£000) (80ths)	-	8,411
Total Accrued Pension (£000) (60ths)	-	7,326
Total Accrued Pension (£000) (CARE)	5,702	12,568
Average Age (liability weighted)	52.5	53.0
Future Working Lifetime (years)	9.4	8.0
Deferred pensioners		
Number	8,010	9,420
Total Accrued Pension (£000)	17,670	19,867
Average Age (liability weighted)	52.3	52.4
Pensioners		
Number	5,605	6,411
Total pensions in payment (£000)	41,107	45,292
Average Age (liability weighted)	67.6	67.4
Average duration of liabilities	16.8	16.9

Benchmark investment strategy

The following investment strategy, has been used to assess employer contribution rates and to set the future investment return assumption as at 31 March 2019:

% allocation	Current strategy
UK equities	50%
Overseas equities	20%
Total growth assets	70%
Index-linked gilts	6%
Total protection assets	6%
Absolute Return Bonds	12%
Property	12%
Total income generating assets	24%
Grand total	100%

Other data used in this valuation

We have also relied upon asset and accounting data from the Fund's published 2016/17, 2017/18 and 2018/19 Annual Report and Accounts. Employer level cashflow data was provided by the Administering Authority and reconciled against the information shown in these documents.

Comment on data quality

The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. We have carried out validations on the membership data provided to ensure it is fit for the purpose of the valuation. Further details can be found in our report issued to the Administering Authority entitled "Data report for 2019 valuation", dated March 2020. We believe the membership data is fit for the purposes of this valuation.

Appendix 2 – Assumptions

Financial assumptions used to set employer contribution rates

Projection of assets and benefit payments

The approach to setting employer contribution rates does not rely on a single set of assumptions but involves the projection of an employer's future benefit payments, contributions and investment returns under 5,000 future economic scenarios. In this modelling, inflation (and therefore benefit payments) and investment returns for each asset class (and employer asset values) are variables and take different values in each projection.

The model underlying these projections is Hymans Robertson's proprietary economic model, the Economic Scenario Service (ESS). The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2019. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to simulated yields at that time horizon.

		Annualised total returns									
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Overseas Equity	Property	Corp Medium A	Inflation	17 year real yield	17 year yield
5 years	16th %'ile	-0.4%	-2.3%	-2.9%	-4.1%	-4.1%	-3.5%	-2.7%	1.9%	-2.5%	0.8%
	50th %'ile	0.7%	0.5%	0.3%	4.0%	4.1%	2.4%	0.8%	3.3%	-1.7%	2.1%
	84th %'ile	2.0%	3.3%	3.4%	12.7%	12.5%	8.8%	4.0%	4.9%	-0.8%	3.6%
10 years	16th %'ile	-0.2%	-1.8%	-1.3%	-1.5%	-1.4%	-1.5%	-0.9%	1.9%	-2.0%	1.2%
	50th %'ile	1.3%	0.0%	0.2%	4.6%	4.7%	3.1%	0.8%	3.3%	-0.8%	2.8%
	84th %'ile	2.9%	1.9%	1.7%	10.9%	10.8%	7.8%	2.5%	4.9%	0.4%	4.8%
20 years	16th %'ile	0.7%	-1.1%	0.1%	1.2%	1.3%	0.6%	0.7%	2.0%	-0.7%	2.2%
	50th %'ile	2.4%	0.3%	1.0%	5.7%	5.8%	4.3%	1.9%	3.2%	0.8%	4.0%
	84th %'ile	4.5%	2.0%	2.0%	10.3%	10.4%	8.1%	3.0%	4.7%	2.2%	6.3%
	Volatility (Disp) (1 yr)	1%	7%	10%	17%	17%	14%	11%	1%		

Funding target

At the end of an employer's funding time horizon, an assessment is made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). To value the cost of future benefits, assumptions are made about the following financial factors:

- Benefit increases and CARE revaluation;
- Salary growth;
- Investment returns (the "discount rate").

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is not appropriate for every projection. Therefore, instead of using a fixed value, each assumption is set with reference to an economic indicator. The economic indicators used are:

Assumption	Economic Indicator
Benefit increases	Future CPI inflation expectations
CARE revaluation	Future CPI inflation expectations
Salary increases	As above plus 0.2% p.a.
Future investment returns	Prevailing risk free rate of return plus margin

The Fund has three funding bases which will apply to different employers depending on their type. Each funding basis uses a different margin in the future investment return assumption.

Funding Basis	Margin above risk-free rate
Ongoing participation	2.0%
Contractor exit	2.0%
Gilts exit	0%

Financial assumptions used to assess the funding position

Salary and Benefit Increases

Financial Assumptions (p.a.)	31 March 2016	31 March 2019
Benefit increases and CARE revaluation (CPI)	2.1%	2.3%
Salary increases	2.0%*	2.5%**

*CPI plus -0.1%
**CPI plus 0.2%

Investment Return

The reported funding position is based on an assumed future investment return of 4.0% p.a.. The derivation of this assumption is set out in Section 3. The equivalent assumption at the 2016 valuation was 4.2% p.a.. This was derived in a different way, please see the 2016 valuation report for further details.

Demographic assumptions

The same demographic assumptions are used in setting contribution rates and assessing the current funding position.

Longevity

As the fund is a member of Club Vita, the baseline longevity assumptions are a bespoke set of Vita Curves that are tailored to fit the membership profile of the Fund. These curves are based on the data the Fund has provided us with for the purposes of this valuation.

We have also allowed for future improvements in mortality based on the CMI 2018 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a. for both women and men.

Longevity Assumptions	31 March 2016	31 March 2019
Baseline Longevity	Club Vita	Club Vita
Future Improvements	CMI2013, Peaked, 1.25% p.a. long term	CMI2018, Smoothed, 1.25% p.a. long term

Full details are available on request.

The longevity assumptions result in the following typical future life expectancies from age 65 (figures for 2016 shown for comparison):

Assumed Life Expectancy	31 March 2016	31 March 2019
Male		
Pensioners	22.1 years	21.5 years
Non-pensioners	23.9 years	22.6 years
Female		
Pensioners	24.1 years	23.5 years
Non-pensioners	25.8 years	25.0 years

Non-pensioners are assumed to be aged 45 at the valuation date

Other demographic assumptions

We are in the unique position of having a very large local authority data set from which to derive our other demographic assumptions. We have analysed the trends and patterns that are present in the membership of local authority funds and tailored our demographic assumptions to reflect LGPS experience. The resulting demographic assumptions are as follows:

Demographic Assumptions	
Retirements in normal health	We have adopted the retirement age pattern assumption as used for the purpose of the 2016 LGPS cost cap valuation. Further details are available on request.
Death in Service	See sample rates below
Retirements in ill health	See sample rates below
Withdrawals	See sample rates below
Promotional salary increases	See sample increases below
Family details	A varying proportion of members are assumed to have a dependant at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. The dependant of a male member is assumed to be 3 years younger than him and the dependant of a female member is assumed to be 3 years older than her.
Commutation	50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2008 (equivalent 75% for service from 1 April 2008).
50:50 option	0.5% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option.

Sample rates for demographic assumptions

Males

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.21	252.69	439.47	0.00	0.00	0.00	0.00
25	117	0.21	166.91	290.28	0.00	0.00	0.00	0.00
30	131	0.26	118.43	205.93	0.00	0.00	0.00	0.00
35	144	0.30	92.53	160.88	0.10	0.07	0.02	0.01
40	150	0.51	74.50	129.48	0.16	0.12	0.03	0.02
45	157	0.85	69.98	121.60	0.35	0.27	0.07	0.05
50	162	1.36	57.68	100.12	0.90	0.68	0.23	0.17
55	162	2.13	45.42	78.88	3.54	2.65	0.51	0.38
60	162	3.83	40.49	70.28	6.23	4.67	0.44	0.33
65	162	6.38	0.00	0.00	11.83	8.87	0.00	0.00

Females

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.12	227.37	252.63	0.00	0.00	0.00	0.00
25	117	0.12	152.99	169.97	0.10	0.07	0.02	0.01
30	131	0.18	128.25	142.46	0.13	0.10	0.03	0.02
35	144	0.30	110.69	122.91	0.26	0.19	0.05	0.04
40	150	0.48	92.12	102.26	0.39	0.29	0.08	0.06
45	157	0.77	85.97	95.41	0.52	0.39	0.10	0.08
50	162	1.13	72.48	80.35	0.97	0.73	0.24	0.18
55	162	1.49	54.08	60.02	3.59	2.69	0.52	0.39
60	162	1.90	43.58	48.31	5.71	4.28	0.54	0.40
65	162	2.44	0.00	0.00	10.26	7.69	0.00	0.00

Prudence in assumptions

We are required to include a degree of prudence within the valuation. This has been achieved in both the setting of contributions and assessment of funding position.

Contribution rates

- Employer funding plans have been set such that the likelihood the employer's funding target is met by the end of the funding time horizon is more than 50%. The actual likelihood varies by employer. Further detail in is the Funding Strategy Statement.

Funding position

- The Fund's investments have a 70% likelihood of returning at least the assumed return.

All other assumptions represent our "best estimate" of future experience.

The assumptions used in this valuation have been agreed with the Administering Authority and are set out in the Fund's Funding Strategy Statement.

Appendix 3 – Rates and Adjustments certificate

In accordance with regulation 62(4) of the Regulations we have made an assessment of the contributions that should be paid into the Fund by participating employers for the period 1 April 2020 to 31 March 2023 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in the Funding Strategy Statement and in Appendix 2 of our report on the actuarial valuation dated 31 March 2020. These assumptions underpin our estimate of the number of members who will become entitled to a payment of pensions under the provisions of the LGPS and the amount of liabilities arising in respect of such members.

The table below summarises the whole fund Primary and Secondary Contribution rates for the period 1 April 2020 to 31 March 2023. The Primary rate is the payroll weighted average of the underlying individual employer primary rates and the Secondary rate is the total of the underlying individual employer secondary rates, calculated in accordance with the Regulations and CIPFA guidance.

Whole Fund Contribution Rate		
Primary Rate (% of pay)	19.9%	
Secondary Rate (£)	2020/21	15,019,000
	2021/22	15,137,000
	2022/23	15,103,000

The required minimum contribution rates for each employer in the Fund are set out below.

Employer code	Employer/Pool name	Contributions currently in payment 2019/2020	Primary Rate % 1 April 2020 - 31 March 2023	Secondary Rate						Total Contribution Rate		
				2020/2021		2021/2022		2022/2023		2020/2021	2021/2022	2022/2023
				% of pay	£	% of pay	£	% of pay	£			
London Borough of Tower Hamlets Pool (please see comment 2 below)												
	London Borough of Tower Hamlets (non-schools)	19.9% plus £15,000,000	18.9%	1.0%	£13,650,000	0.4%	£13,650,000	-0.3%	£13,650,000	19.9% plus £13,650,000	19.3% plus £13,650,000	18.6% plus £13,650,000
	London Borough of Tower Hamlets (schools)	20.3%	18.9%	1.4%	£0	2.9%	£0	4.4%	£0	20.3%	21.8%	23.3%
Tower Hamlets Community Housing Pool		37.6%	30.3%	7.3%	£0	7.3%	£0	7.3%	£0	37.6%	37.6%	37.6%
Mulberry Trust		24.5%	20.6%	2.9%	£0	2.9%	£0	2.9%	£0	23.5%	23.5%	23.5%
4	Redbridge Community Housing Limited	17.7%	34.5%	0.0%	£0	0.0%	£0	0.0%	£0	34.5%	34.5%	34.5%
6	East End Homes Limited	29.4%	34.7%	-5.2%	£0	0.0%	£0	0.0%	£0	29.4%	34.7%	34.7%
7	Greenwich Leisure Limited	20.0% plus £14,000	28.6%	0.0%	£0	0.0%	£0	0.0%	£0	28.6%	28.6%	28.6%
10	Gateway Housing Association (Bethnal Green & Victoria Park)	30.0% plus £28,000	34.0%	-4.0%	£28,000	-4.0%	£28,000	-4.0%	£28,000	30.0% plus £28,000	30.0% plus £28,000	30.0% plus £28,000
11	One Housing Group (Toynbee Island Homes)	41.4%	33.8%	7.6%	£0	7.6%	£0	7.6%	£0	41.4%	41.4%	41.4%
13	Tower Hamlet Homes*	18.4%	28.6%	0.0%	£0	0.0%	£0	0.0%	£0	28.6%	28.6%	28.6%
18	Sir William Burrough Primary School	16.4%	22.1%	-6.1%	£0	-6.1%	£0	-6.1%	£0	16.0%	16.0%	16.0%
19	St Pauls Way Trust School	18.9%	20.9%	-3.6%	£0	-3.6%	£0	-3.6%	£0	17.3%	17.3%	17.3%
21	Canary Wharf College	15.9%	20.9%	-1.2%	£0	-1.2%	£0	-1.2%	£0	19.7%	19.7%	19.7%
22	Agilysis	16.8%	34.4%	-34.4%	£0	-34.4%	£0	-34.4%	£0	0.0%	0.0%	0.0%
23	London Enterprise Academy	17.6%	20.5%	-1.0%	£0	-1.0%	£0	-1.0%	£0	19.5%	19.5%	19.5%
24	Wapping High School	16.1%	22.3%	-4.1%	£0	-4.1%	£0	-4.1%	£0	18.2%	18.2%	18.2%
25	City Gateway	16.3%	20.1%	-4.6%	£0	-4.6%	£0	-4.6%	£0	15.5%	15.5%	15.5%
27	Compass contract services	30.9%	34.8%	0.0%	£0	0.0%	£0	0.0%	£0	34.8%	34.8%	34.8%
28	The LETTA Trust	20.9%	20.9%	2.0%	£0	2.0%	£0	2.0%	£0	22.9%	22.9%	22.9%
29	Ian Mikardo Academy	23.6%	20.6%	3.3%	£0	3.3%	£0	3.3%	£0	23.9%	23.9%	23.9%
30	East London Arts and Music	19.6%	21.0%	-1.6%	£0	-1.6%	£0	-1.6%	£0	19.4%	19.4%	19.4%
31	Tower Trust	20.9%	21.2%	3.9%	£0	3.9%	£0	3.9%	£0	25.1%	25.1%	25.1%
33	Paradigm Trust	21.3%	21.0%	-0.2%	£0	-0.2%	£0	-0.2%	£0	20.8%	20.8%	20.8%
34	Wettons Cleaning Services Ltd	36.1%	37.0%	0.0%	£0	0.0%	£0	0.0%	£0	37.0%	37.0%	37.0%

* Subject to discussion and final agreement between the Fund and the employer.

Further comments

1. Contributions expressed as a percentage of payroll should be paid into London Borough of Tower Hamlets Pension Fund (“the Fund”) at a frequency in accordance with the requirements of the Regulations.
2. London Borough of Tower Hamlets, in agreement with the Fund, may choose to prepay some of the contributions due in any given year covered by the Rates and Adjustments certificate for an agreed equivalent discounted amount, calculated by the Fund actuary.
3. Further sums should be paid to the Fund to meet the costs of any early retirements and/or augmentations using methods and factors issued by us from time to time or as otherwise agreed.
4. Payments may be required to be made to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those allowed for within our assumptions. If an employer has ill health liability insurance in place with a suitable insurer and provides satisfactory evidence to the Administering Authority, then their certified contribution rate may be reduced by the value of their insurance premium, for the period the insurance is in place.

5. The certified contribution rates represent the **minimum** level of contributions to be paid. Employing authorities may pay further amounts at any time and future periodic contributions may be adjusted on a basis approved by the Fund Actuary.

6. There has been significant volatility in the financial markets during February and March 2020 as a result of the Covid-19 pandemic. This volatility may impact funding balance sheets for those employers planning to exit the Fund during the period covered by this Rates and Adjustments Certificate. In order to effectively manage employer exits from the Fund, the Administering Authority reserves the right to revisit the contribution rates for employers that are expected to cease participation in the Fund before 31 March 2023. An employer will be contacted by the Administering Authority in this instance.

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Signature:		
Name:	Barry Dodds FFA	Douglas Green FFA
Qualification:	Fellows of the Institute and Faculty of Actuaries	
Firm:	Hymans Robertson LLP 20 Waterloo Street Glasgow G2 6DB	
Date:	31 March 2020	

Appendix 4 – Section 13 dashboard

The following information has been provided to assist the Government Actuary's Department in complying with Section 13 of the Public Service Pensions Act.

Item	
Past service funding position - local funding basis	
Funding level (assets/liabilities)	102%
Funding level (change since last valuation)	19% increase
Asset value used at the valuation	£1,552,158,000
Value of liabilities	£1,524,901,000
Surplus (deficit)	£27,257,000
Discount rate(s)	4.0% p.a.
Assumed pension increases (CPI)	2.3% p.a.
Method of derivation of discount rate, plus any changes since previous valuation	There is a 70% likelihood that the Fund's investments will return at least 4.0% over the next 20 years based on a stochastic asset projection. The assumption at the 2016 valuation was 2.0% above the yield available on long-dated fixed interest gilts.
Assumed life expectancies at age 65:	
Average life expectancy for current pensioners - men currently age 65	21.5 years
Average life expectancy for current pensioners - women currently age 65	23.5 years
Average life expectancy for future pensioners - men currently age 45	22.6 years
Average life expectancy for future pensioners - women currently age 45	25.0 years
Past service funding position - SAB basis (for comparison purposes only)	
Market value of assets	£1,552,158,000
Value of liabilities	£1,377,733,000
Funding level on SAB basis (assets/liabilities)	113%
Funding level on SAB basis (change since last valuation)	19%
Contribution rates payable	
Primary contribution rate	19.9% of pay
Secondary contribution rate (cash amounts in each year in line with CIPFA guidance):	
Secondary contribution rate 2020/21	£15,019,000
Secondary contribution rate 2021/22	£15,137,000
Secondary contribution rate 2022/23	£15,103,000
Giving total expected contributions:	
Total expected contributions 2020/21 (£ figure based on assumed payroll of £163.292m)	£47,495,000
Total expected contributions 2021/22 (£ figure based on assumed payroll of £167.408m)	£48,432,000
Total expected contributions 2022/23 (£ figure based on assumed payroll of £171.629m)	£49,237,000
Average employee contribution rate (% of pay)	6.9% of pay
Employee contribution rate (£ p.a. figure based on assumed payroll of £163.292m)	£11,315,000
Additional information	
Percentage of liabilities relating to employers with deficit recovery periods of longer than 20 years	0%
Percentage of total liabilities that are in respect of Tier 3 employers	4%

TOWER HAMLETS

The London Borough of Tower Hamlets Pension Fund

Appendix 3

Funding Strategy Statement

1 Introduction

1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the London Borough of Tower Hamlets Pension Fund ("the Fund"), which is administered by London Borough of Tower Hamlets Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser. It is effective from [DATE POST CONSULTATION].

1.2 What is the London Borough of Tower Hamlets Pension Fund?

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the London Borough of Tower Hamlets Pension Fund, in effect the LGPS for the London Borough of Tower Hamlets area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth; and
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

1.3 Why does the Fund need a Funding Strategy Statement?

Employees' benefits are determined in accordance with the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and with no certainty. Employees' contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- Long term solvency of the Fund,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis

There are also regulatory requirements for an FSS, as given in Appendix A.

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- all Fund's policies (including admissions, cessations and bulk transfers); which can be found on the Fund's website https://www.towerhamlets.gov.uk/lgnl/jobs_and_careers/Pension_fund/Pension_fund.aspx
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Statement of Investment Principles / Investment Strategy Statement (see Section 4)

1.4 How does the Fund and this FSS affect me?

This depends on who you are:

- a member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;
- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, and in what circumstances you might need to pay more and what happens if you cease to be an employer in the Fund. Note that the FSS applies to all employers participating in the Fund;
- an Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- a Council Tax payer: your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (**NB** this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

1.6 How do I find my way around this document?

In Section 2 there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In Section 3 we outline how the Fund calculates the contributions payable by different employers in different situations.

In Section 4 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail if you are interested:

A. the regulatory background, including how and when the FSS is reviewed,

B. who is responsible for what,

C. what issues the Fund needs to monitor, and how it manages its risks,

D. some more details about the actuarial calculations required,

E. the assumptions which the Fund actuary currently makes about the future,

F. a glossary explaining the technical terms occasionally used here.

If you have any other queries please contact the Pensions & Investments Manager email: pensionsLBTH@towerhamlets.gov.uk or call telephone number 020 7364 4248.

2 Basic Funding issues

(More detailed and extensive descriptions are given in Appendix D).

2.1 How does the actuary calculate the required contribution rate?

In essence this is a three-step process:

- Calculate the funding target for that employer, i.e. the estimated amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;
- Determine the time horizon over which the employer should aim to achieve that funding target. See the table in 3.3 and Note (c) for more details;
- Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon, allowing for various possible economic outcomes over that time horizon. See 2.3 below, and the table in 3.3 Note (e) for more details.

2.2 What is each employer's contribution rate?

This is described in more detail in Appendix D. Employer contributions are normally made up of two elements:

a) the estimated cost of benefits being built up each year, after deducting the members' own contributions and including an allowance for administration expenses. This is referred to as the "Primary rate", and is expressed as a percentage of members' pensionable pay; plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, payment of the Secondary rate is in respect of benefits already accrued at the valuation date. The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of any higher rate will be taken by the Fund actuary at subsequent valuations, i.e. will be reflected as a credit when next calculating the employer's contributions.

2.3 What different types of employer participate in the Fund?

Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate. There are currently more employers in the Fund than ever before, a large part of this being due to new academies.

In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: academy schools, contractors, housing associations, charities, etc.

The LGPS Regulations define various types of employer as follows:

Scheduled bodies - councils, and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such **academies (or Multi Academy Trusts)**, as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as "Scheduled Bodies", the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the MHCLG regarding the terms of academies' membership in LGPS Funds.

Designating employers - employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

Other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer – **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer – **transferee admission bodies** ("TAB"). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund's admissions policy are not met. (NB The terminology CAB and TAB has been dropped from recent LGPS Regulations, which instead combine both under the single term 'admission bodies'; however, we have retained the old terminology here as we consider it to be helpful in setting funding strategies for these different employers).

2.4 How does the calculated contribution rate vary for different employers?

All three steps above are considered when setting contributions (more details are given in Section 3 and Appendix D).

1. The **funding target** is based on a set of assumptions about the future, (e.g. investment returns, inflation, pensioners' life expectancies). If an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation;

2. The **time horizon** required is, the period over which the funding target is achieved. Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and

3. The likelihood of achieving the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker then the required likelihood will be set higher, which in turn will increase the required contributions (and vice versa).

For some employers it may be agreed to pool contributions, see 3.4.

Any costs of non ill-health early retirements must be paid by the employer, see 3.6.

Costs of ill-health early retirements are covered in 3.7 and 3.8.

2.5 How is a funding level calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see Appendix D, section D5, for further details of how this is calculated), to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

It is important to note that the funding level and deficit/surplus are only measurements at a particular point in time, on a particular set of assumptions about the future. Whilst we recognise that various parties will take an interest in these measures, for most employers the key issue is how likely it is that their contributions will be sufficient to pay for their members' benefits (when added to their existing asset share and anticipated investment returns).

In short, funding levels and deficits are short term, high level risk measures, whereas contribution-setting is a longer term issue.

2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher Pension Fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;
- Contributions which Academies pay to the Fund will therefore not be available to pay for providing education; and
- Other employers will provide various services to the local community, perhaps through housing associations, charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services at a reasonable cost.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees;

- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;
- The Fund will seek to moderate short term increases in contribution rates where appropriate and possible. However, a recent shift in regulatory focus means that solvency within each generation is considered by the Government to be a higher priority than stability of contribution rates;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result;
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see 3.1). In deciding which of these techniques to apply to any given employer, the Administering Authority takes a view on the financial standing of the employer, i.e. its ability to meet its funding commitments and the relevant time horizon.

The Administering Authority will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc.

For instance, where the Administering Authority has reasonable confidence that an employer will be able to meet its funding commitments, then the Fund will permit options such as stabilisation (see 3.3 Note (b)), a longer time horizon relative to other employers, and/or a lower likelihood of achieving their funding target. Such options will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, where there is doubt that an employer will be able to meet its funding commitments or withstand a significant change in its commitments, then a higher funding target, and/or a shorter time horizon relative to other employers, and/or a higher likelihood of achieving the target may be required.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see Appendix A.

2.7 What approach has the Fund taken to dealing with uncertainty arising from the McCloud court case and its potential impact on the LGPS benefit structure?

The LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The courts have ruled that the 'transitional protections' awarded to some members of public service pension schemes when the schemes were reformed (on 1 April 2014 in the case of the LGPS) were unlawful on the grounds of age discrimination. At the time of writing, the

Ministry of Housing, Communities and Local Government (MHCLG) has not provided any details of changes as a result of the case. However it is expected that benefits changes will be required and they will likely increase the value of liabilities. At present, the scale and nature of any increase in liabilities are unknown, which limits the ability of the Fund to make an accurate allowance.

The LGPS Scheme Advisory Board (SAB) issued advice to LGPS funds in May 2019. As there was no finalised outcome of the McCloud case by 31 August 2019, the Fund Actuary has acted in line with SAB's advice and valued all member benefits in line with the current LGPS Regulations.

The Fund, in line with the advice in the SAB's note, has considered how to allow for this risk in the setting of employer contribution rates. As the benefit structure changes that will arise from the McCloud judgement are uncertain, the Fund has elected to allow for the potential impact in the assessment of employer contribution rates at the 2019 valuation by increasing the required likelihood of reaching the funding target.

Once the outcome of the McCloud case is known, the Fund may revisit the contribution rates set to ensure they remain appropriate.

The Fund has also considered the McCloud judgement in its approach to cessation valuations. Please see note (j) to table 3.3 for further information.

2.8 When will the next actuarial valuation be?

On 8 May 2019 MHCLG issued a consultation seeking views on (among other things) proposals to amend the LGPS valuation cycle in England and Wales from a three year (triennial) valuation cycle to a four year (quadrennial) valuation cycle.

The Fund intends to carry out its next actuarial valuation in 2022 (3 years after the 2019 valuation date) in line with MHCLG's desired approach in the consultation. The Fund has therefore instructed the Fund Actuary to certify contribution rates for employers for the period 1 April 2020 to 31 March 2023 as part of the 2019 valuation of the Fund.

3 Calculating contributions for individual Employers

3.1 General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, the Fund's three-step process identifies the key issues:

1. What is a suitably (but not overly) prudent funding target?
2. How long should the employer be permitted to reach that target? This should be realistic but not so long that the funding target is in danger of never actually being achieved.
3. What likelihood is required to reach that funding target? This will always be less than 100% as we cannot be certain of the future market movements. Higher likelihood "bars" can be used for employers where the Fund wishes to reduce the risk that the employer ceases leaving a deficit to be picked up by other employers.

These and associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

3.2 The effect of paying lower contributions

In limited circumstances the Administering Authority may permit employers to pay contributions at a lower level than is assessed for the employer using the three step process above. At their absolute discretion the Administering Authority may:

- extend the time horizon for targeting full funding;
- adjust the required likelihood of meeting the funding target;
- permit an employer to participate in the Fund's stabilisation mechanisms;
- permit extended phasing in of contribution rises or reductions;
- pool contributions amongst employers with similar characteristics; and/or
- accept some form of security or guarantee in lieu of a higher contribution rate than would otherwise be the case.

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than required to meet their funding target, over the appropriate time horizon with the required likelihood of success. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the pace of paying contributions;
- lower contributions in the short term will result in a lower level of future investment returns on the deficit. Thus, deferring a certain amount of contribution is likely to lead to higher contributions in the long-term; and
- it is likely to take longer to reach their funding target, all other things being equal.

Overleaf (3.3) is a summary of how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

Section 3.4 onwards deals with various other funding issues which apply to all employers.

3.3 The different approaches used for different employers

Type of employer	Scheduled Bodies			Community Admission Bodies and Designating Employers		Transferee Admission Bodies
Sub-type	**Council**	**Colleges**	**Academies**	**Open to new entrants**	**Closed to new entrants**	**(all)**
Funding Target Basis used	Ongoing participation basis, assumes long-term Fund participation (see Appendix E)			Ongoing participation basis, but may move to "gilts basis" - see Note (a)		Ongoing participation basis, assumes fixed contract term in the Fund (see Appendix E)
Primary rate approach	(see Appendix D – D.2)					
Stabilised contribution rate?	Yes - see Note (b)	No	No	No	No	No
Maximum time horizon – Note (c)	20 years	20 years	20 years	Future working lifetime	Future working lifetime	Outstanding contract term
Secondary rate – Note (d)	% of payroll or monetary amount	Monetary amount	% of payroll	% of payroll or monetary amount	% of payroll or monetary amount	% of payroll or monetary amount
Treatment of surplus	Covered by stabilisation arrangement	Preferred approach: contributions kept at Primary rate. However, reductions may be permitted by the Administering Authority				Preferred approach: contributions kept at future service rate. However, contractors may be permitted to reduce contributions by spreading the surplus over the remaining contract term
Likelihood of achieving target – Note (e)	70%	70%	70%	66% if guaranteed, 75% otherwise	66% if guaranteed, 75% otherwise	66% if guaranteed, 75% otherwise
Phasing of contribution changes	Covered by stabilisation arrangement	At the discretion of the Administering Authority		None	None	None
Review of rates – Note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations					Particularly reviewed in last 3 years of contract
New employer	n/a	n/a	Note (g)	Note (h)		Notes (h) & (i)
Cessation of participation: debt/credit payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation calculation principles applied would be as per Note (j).			Can be ceased subject to terms of admission agreement. debt/credit will be calculated on a basis appropriate to the circumstances of cessation – see Note (j).		Participation is assumed to expire at the end of the contract. Cessation debt/credit calculated on the contractor exit basis, unless the admission agreement is terminated early by the contractor in which case the low risk exit basis would apply. -Letting employer will be liable for future deficits and contributions arising. See Note (j) for further details

* Where the Administering Authority recognises a fixed contribution rate agreement between a letting authority and a contractor, the certified employer contribution rate will be derived in line with the methodology specified in the risk sharing agreement. Additionally, in these cases, upon cessation the contractor's assets and liabilities will transfer back to the letting employer with no crystallisation of any deficit or surplus. Further detail on fixed contribution rate agreements is set out in note (i).

Note (a) (Gilts exit basis for CABs and Designating Employers closed to new entrants)

In the circumstances where:

- the employer is a Designating Employer, or an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may set a higher funding target (e.g. based on the return from long-term gilt yields. by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Designating Employers and Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease or the Designating Employer alters its designation.

Note (b) (Stabilisation)

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" (and may therefore be paying less than their theoretical contribution rate) should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies to London Borough of Tower Hamlets Council as a tax raising body:

On the basis of extensive modelling carried out for the 2019 valuation exercise (see Section 4), total contributions have been set to ensure that stabilised employers have at least a 70% chance of being fully funded in 20 years under the 2019 formal valuation assumptions.

The stabilisation criteria and limits will be reviewed at the next formal valuation. However the Administering Authority reserves the right to review the stabilisation criteria and limits at any time before then, on the basis of membership and/or employer changes as described above.

Note (c) (Maximum time horizon)

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2020 for the 2019 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative time horizons, for example where there were no new entrants.

Note (d) (Secondary rate)

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2020 for the 2019 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative time horizons, for example where there were no new entrants.

- the employer is relatively mature, i.e. has a large Secondary contribution rate (e.g. above 15% of payroll), or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed the Fund to new entrants.

Note (e) (Likelihood of achieving funding target)

Each employer has its funding target calculated, and a relevant time horizon over which to reach that target. Contributions are set such that, combined with the employer's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum *likelihood* . A higher required likelihood bar will give rise to higher required contributions, and vice versa.

The way in which contributions are set using these three steps, and relevant economic projections, is described in further detail in Appendix D.

Different likelihoods are set for different employers depending on their nature and circumstances: in broad terms, a higher likelihood will apply due to one or more of the following:

- the Fund believes the employer poses a greater funding risk than other employers,
- the employer does not have tax-raising powers;
- the employer does not have a guarantor or other sufficient security backing its funding position; and/or
- the employer is likely to cease participation in the Fund in the short or medium term.

Note (f) (Regular Reviews)

Such reviews may be triggered by significant events including but not limited to: significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

Note (g) (New Academy conversions)

At the time of writing, the Fund's policies on academies' funding issues are as follows:

i. The new academy will be regarded as a separate employer in its own right and will not be pooled with other employers in the Fund. The only exception is where the academy is part of a Multi Academy Trust (MAT) in which case the academy's figures will be calculated as below but can be combined with, for the purpose of setting contribution rates, those of the other academies in the MAT;

ii. The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status;

iii. The new academy will be allocated an initial asset share from the ceding council's assets in the Fund. This asset share will be calculated using the estimated funding position of the ceding council at the date of academy conversion. The share will be based on the active members' funding level, having first allocated assets in the council's share to fully fund deferred and pensioner members. The assets allocated to the academy will be limited if necessary so that its initial funding level is subject to a maximum of 100%. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion;

iv. The new academy's calculated contribution rate will be based on the time horizon and likelihood of achieving funding target outlined for Academies in the table in Section 3.3 above;

v. It is possible for an academy to leave one MAT and join another. If this occurs, all active, deferred and pensioner members of the academy transfer to the new MAT.

The Fund's policies on academies are subject to change in the light of any amendments to MHCLG guidance (or removal of the formal guarantee currently provided to academies by the DfE). Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS. In particular, policy (iv) above will be reconsidered at each valuation.

Note (h) (New Admission Bodies)

With effect from 1 October 2012, the LGPS 2012 Miscellaneous Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date. Under these Regulations, all new Admission Bodies will be required to provide some form of security, agreed in conjunction with the Administering Authority, such as a guarantee from the letting employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a greater than expected rise in liabilities;;

- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit.

Transferee Admission Bodies: For all TABs, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis. See also Note (i) below.

Community Admission Bodies: The Administering Authority will only consider requests from CABs (or other similar bodies, such as section 75 NHS partnerships) to join the Fund if they are sponsored by a Scheduled Body with tax raising powers, guaranteeing their liabilities and also providing a form of security as above.

The above approaches reduce the risk, to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

Note (i) (New Transferee Admission Bodies)

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council or academy) to another organisation (a "contractor"). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

The Fund's standard approach is for the TAB to be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees' Fund benefits. The quid pro quo is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see Note (j).

Employers which "outsource" have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) Pooling

Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which may be under a stabilisation approach.

ii) Letting employer retains pre-contract risks

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor's contribution rate could vary from one valuation to the next. It would be liable for any deficit (or entitled to any surplus) at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) Fixed contribution rate agreed

Under this option the contractor pays a fixed contribution rate throughout its participation in the Fund and on cessation does not pay any cessation deficit or receive an exit credit. In other words, the pension risks “pass through” to the letting employer.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement.

Alternatively, letting employers and Transferee Admission Bodies may operate any of the above options by entering into a separate Side Agreement. The Administering Authority would not necessarily be a party to this side agreement, but may treat the Admission Agreement as if it incorporates the side agreement terms where this is permitted by legislation or alternatively agreed by all parties.

OR

[IF FUND WANTS TO MANDATE PASS THROUGH OR SAY IT IS THE PREFERRED APPROACH]
The Administering Authority’s preferred approach is that a new TAB will participate in the Fund via a fixed contribution rate arrangement with the letting employer. The certified employer contribution rate will be set equal to the fixed contribution rate agreed between the letting authority and the contractor. The fixed rate that will be paid is at the discretion of the letting authority and contractor subject to a minimum of the letting authority’s primary rate on the contract start date. Upon cessation the contractor’s assets and liabilities will transfer back to the letting authority with no crystallisation of any deficit or surplus.

[IF PASS THROUGH ISN’T TO BE SET OUT IN THE ADMISSION AGREEMENT]
In order to avoid the Administering Authority becoming involved in any disputes relating to risk sharing and to protect the other participating employers, the Fund will not be party to any risk sharing agreement between any letting employer and a contractor. Accordingly any such arrangements will not be detailed in the admission agreement and the admission body will be required to follow the principles of the agreement as if no such risk sharing was in place. It is at the sole discretion of the Administering Authority as to whether any risk sharing agreement is recognised in the certified employer contribution rate. If the risk arrangement is not recognised, then the letting employer and the contractor will need to put in place separate steps to allow the risk sharing to be implemented (e.g. via the contract payments). Accordingly the contractor will be required to pay the certified employer contribution rate to the Fund and any other contributions required e.g. early retirement strain costs, regardless of the risk sharing arrangement in place.

Any risk sharing agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from:

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above; and

- redundancy and early retirement decisions.

Note (j) (Admission Bodies Ceasing)

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund (NB recent LGPS Regulation changes mean that the Administering Authority has the discretion to defer taking action for up to three years, so that if the employer acquires one or more active Fund members during that period then cessation is not triggered. The current Fund policy is that this is left as a discretion and may or may not be applied in any given case);
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus following the LGPS (Amendment) Regulations 2018 which came into effect on 14th May 2018, this will normally result in an exit credit payment to the Admission Body. If a risk-sharing agreement has been put in place (please see note (i) above) no cessation debt or exit credit may be payable, depending on the terms of the agreement.

As discussed in Section 2.7, the LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The Fund has considered how it will reflect the current uncertainty regarding the outcome of this judgement in its approach to cessation valuations. For cessation valuations that are carried out before any changes to the LGPS benefit structure (from 1 April 2014) are confirmed, the Fund's policy is that the actuary will apply a [x%] loading to the ceasing employer's post 2014 benefit accrual value, as an estimate of the possible impact of resulting benefit changes.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

(a) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final surplus/deficit will normally be calculated using a "gilts exit basis", which is more prudent than the ongoing participation basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

(b) Where there is a guarantor for future deficits and contributions, the details of the guarantee will be considered prior to the cessation valuation being carried out. In some cases the guarantor is simply guarantor of last resort and therefore the cessation valuation will be carried out consistently with the approach taken had there been no guarantor in place. Alternatively, where the guarantor is not simply guarantor of last resort, the cessation may be calculated using the ongoing participation basis or contractor exit basis as described in Appendix E;

(c) Again, depending on the nature of the guarantee, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit or surplus. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee.

Under (a) and (b), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund may spread the payment subject to there being some security in place for the employer such as a bond indemnity or guarantee. The approach to calculating the cessation payment will be as per the Admission Body's Admission Agreement.

In the event that the Fund is not able to recover the required payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit on the gilts exit basis, and would carry out the cessation valuation on the ongoing participation basis. Secondary contributions would be derived from this cessation debt. This approach would be monitored as part of each formal valuation and secondary contributions would be reassessed as required. The Admission Body may terminate the agreement only via payment of the outstanding debt assessed on the gilts exit basis. Furthermore, the Fund reserves the right to revert to the "gilts exit basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Admission Body would have no contributing members.

3.4 Pooled contributions

From time to time, with the advice of the Actuary, the Administering Authority may set up pools for employers with similar or complementary characteristics. This will always be in line with its broader funding strategy. Currently the pools in place within the Fund are as follows:

- Schools generally are also pooled with their funding Council. However there may be exceptions for specialist or independent schools.
- Smaller Transferee Admission Bodies may be pooled with the letting employer, provided all parties (particularly the letting employer) agree.

The intention of the pool is to minimise contribution rate volatility which would otherwise occur when members join, leave, take early retirement, receive pay rises markedly different from expectations, etc. Such events can cause large changes in contribution rates for very small employers in particular, unless these are smoothed out for instance by pooling across a number of employers.

On the other hand it should be noted that the employers in the pool will still have their own individual funding positions tracked by the Actuary, so that some employers will be much better funded, and others much more poorly funded, than the pool average. This therefore means that if any given employer was funding on a stand-alone basis, as opposed to being in the pool, then its contribution rate could be much higher or lower than the pool contribution rate.

It should also be noted that, if an employer is considering ceasing from the Fund, its required contributions would be based on its own funding position (rather than the pool average), and the cessation terms would also apply: this would mean potentially very different (and in particular possibly much higher) contributions would be required from the employer in that situation.

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

Employers who are permitted to enter (or remain in) a pool at the 2019 valuation will not normally be advised of their individual contribution rate unless agreed by the Administering Authority.

Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not usually permitted to participate in a pool.

3.5 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended time horizon, or permission to join a pool with another body (e.g. the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan; and
- whether the admission agreement is likely to be open or closed to new entrants.

3.6 Non ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). (**NB** the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014). Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

With the agreement of the Administering Authority the payment can be spread as follows:

Major Employing bodies	- up to 5 years
Community Admission Bodies and Designating Employers	- up to 3 years
Academies	- up to 3 years
Transferee Admission Bodies	- payable immediately.

3.7 Ill health early retirement costs

In the event of a member's early retirement on the grounds of ill-health, a funding strain will usually arise, which can be very large. Such strains are currently met by each employer, although individual employers may elect to take external insurance (see 3.8 below).

Admitted Bodies will usually have an 'ill health allowance'; Scheduled Bodies may have this also, depending on their agreement terms with the Administering Authority. The Fund monitors each employer's ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis as apply for non ill-health cases. Details will be included in each separate Admission Agreement.

3.8 Ill health risk management

The Fund recognises ill health early retirement costs can have a significant impact on an employer's funding and contribution rate, which could ultimately jeopardise their continued operation.

The Administering Authority therefore has considered an approach to help manage ill health early retirement costs. This approach was put in place on [DATE], has been reviewed on [DATE] and will next be due for review on [DATE].

If an employer provides satisfactory evidence to the Administering Authority of a current external insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged, and
- there is no need for monitoring of allowances.

When an active member retires on ill health early retirement the claim amount will be paid directly from the insurer to the insured employer. This amount should then be paid to the Fund to allow the employer's asset share to be credited.

The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

3.9 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt or receive an exit credit on an appropriate basis (see 3.3, Note (j)) and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:

a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;

b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the remaining assets would be apportioned pro-rata by the Fund's actuary to the other Fund employers.

c) In exceptional circumstances the Fund may permit an employer with no remaining active members and a cessation deficit to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases, as the employer would have no contributing members.

3.10 Policies on bulk transfers

The Fund has a separate written policy which covers bulk transfer payments into, out of and within the Fund. Each case will be treated on its own merits, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;

- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities; and

- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.

4 Funding strategy and links to investment strategy

4.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Investment Strategy Statement which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out as part of each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

4.2 What is the link between funding strategy and investment strategy?

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa

Therefore, the funding and investment strategies are inextricably linked.

4.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The actuary's assumptions for future investment returns (described further in Appendix E) are based on the current benchmark investment strategy of the Fund. The future investment return assumptions underlying each of the fund's three funding bases include a margin for prudence, and are therefore considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government (see Appendix A1).

In the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility in asset values. However, the actuary takes a long term view when assessing employer contribution rates and the contribution rate setting methodology takes into account this potential variability.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.4 Does the Fund monitor its overall funding position?

The Administering Authority monitors the relative funding position, i.e. changes in the relationship between asset values and the liabilities value, annually. It reports this to the regular Pensions Committee meetings.

5 Statutory reporting and comparison to other LGPS Funds

5.1 Purpose

Under Section 13(4)(c) of the Public Service Pensions Act 2013 ("Section 13"), the Government Actuary's Department must, following each triennial actuarial valuation, report to the Ministry of Housing Communities & Local Government (MHCLG) on each of the LGPS Funds in England & Wales. This report will cover whether, for each Fund, the rate of employer contributions are set at an appropriate level to ensure both the solvency and the long term cost efficiency of the Fund.

This additional MHCLG oversight may have an impact on the strategy for setting contribution rates at future valuations.

5.2 Solvency

For the purposes of Section 13, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

(a) the rate of employer contributions is set to target a funding level for the Fund of 100%, over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds); and either

(b) 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

(c) there is an appropriate plan in place should there be, or if there is expected in future to be, a material reduction in the capacity of fund employers to increase contributions as might be needed.

5.3 Long Term Cost Efficiency

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long term cost efficiency if:

i. the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual,

ii. with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, MHCLG may have regard to various absolute and relative considerations. A relative consideration is primarily concerned with comparing LGPS pension funds with other LGPS pension funds. An absolute consideration is primarily concerned with comparing Funds with a given objective benchmark.

Relative considerations include:

1. the implied deficit recovery period; and
2. the investment return required to achieve full funding after 20 years.

Absolute considerations include:

1. the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;
2. how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy;
3. the extent to which contributions actually paid have been in line with the expected contributions based on the extant rates and adjustment certificate; and
4. the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual Fund experience.

MHCLG may assess and compare these metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

Appendix A – Regulatory framework

A1 Why does the Fund need an FSS?

The Ministry of Housing Communities and Local Government (MHCLG) has stated that the purpose of the FSS is:

- *"to establish a **clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;*
- *to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*
- *to take a **prudent longer-term view** of funding those liabilities."*

These objectives are desirable individually, but may be mutually conflicting.

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2016) and to its Statement of Investment Principles / Investment Strategy Statement.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to "consultation with such persons as the authority considers appropriate", and should include "a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers".

In practice, for the Fund, the consultation process for this FSS was as follows:

a) A draft version of the FSS was issued to all participating employers [DATE] for comment;

b) Comments were requested within [XX] days;

c) Following the end of the consultation period the FSS was updated where required and then published, on [DATE].

A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website, at [DATE];
- A copy sent by /e-mail to each participating employer in the Fund;
- Copies sent to investment managers and independent advisers;
- Copies made available on request.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. (which may move to every four years in future – see Section 2.8). This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Pensions Committee and would be included in the relevant Committee Meeting minutes.

A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Investment Strategy Statement, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at www.towerhamletspensionfund.org.

Appendix B – Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to each play their part.

B1 The Administering Authority should:-

- operate the Fund as per the LGPS Regulations;
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
- collect employer and employee contributions, and investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Investment Strategy Statement (ISS) and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the Fund's actuary;
- provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
- prepare and maintain a FSS and a ISS, after consultation;
- notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the fund's performance and funding and amend the FSS and ISS as necessary and appropriate.

B2 The Individual Employer should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

B3 The Fund Actuary should:-

- prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
- provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
- advise on the termination of employers' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties:-

- investment advisers (either internal or external) should ensure the Fund's ISS remains appropriate, and consistent with this FSS;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the ISS;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures;
- the Ministry of Housing Communities and Local Government (assisted by the Government Actuary's Department) and the Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

Appendix C – Key risks and controls

C1 Types of risk

The Administering Authority has an active risk management programme in place. The measures that it has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities and contribution rates over the long-term.	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc. Analyse progress at three yearly valuations for all employers. Inter-valuation roll-forward of liabilities between valuations at whole Fund level.
Inappropriate long-term investment strategy.	Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes. Chosen option considered to provide the best balance.
Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.
Effect of possible asset underperformance as a result of climate change	[ANYTHING EXPLICIT IN THE INVESTMENT STRATEGY? RISK REGISTER]
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions.

Risk	Summary of Control Mechanisms
Orphaned employers give rise to added costs for the Fund	The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future. If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 3.9).

C3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.
Deteriorating patterns of early retirements	Employers are charged the extra cost of non ill-health retirements following each individual decision. Employer ill health retirement experience is monitored, and insurance is an option.
Reductions in payroll causing insufficient deficit recovery payments	In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows: Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (b) to 3.3).

Risk	Summary of Control Mechanisms
	For other employers, review of contributions is permitted in general between valuations (see Note (f) to 3.3) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.

C4 Regulatory risks

Risk	Summary of Control Mechanisms
Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. The Administering Authority is monitoring the progress on the McCloud court case and will consider an interim valuation or other appropriate action once more information is known. The government's long term preferred solution to GMP indexation and equalisation - conversion of GMPs to scheme benefits - was built into the 2019 valuation.
Time, cost and/or reputational risks associated with any MHCLG intervention triggered by the Section 13 analysis (see Section 5).	Take advice from Fund Actuary on position of Fund as at prior valuation, and consideration of proposed valuation approach relative to anticipated Section 13 analysis.
Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.

C5 Governance risks

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data. The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions between triennial valuations Deficit contributions may be expressed as monetary amounts.
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way	The Administering Authority maintains close contact with its specialist advisers. Advice is delivered via formal meetings involving Elected Members, and recorded appropriately. Actuarial advice is subject to professional requirements such as peer review.
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.	The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes. Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see Notes (h) and (j) to 3.3). Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. Vetting prospective employers before admission.

Risk	Summary of Control Mechanisms
	Where permitted under the regulations requiring a bond to protect the Fund from various risks. Requiring new Community Admission Bodies to have a guarantor. Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to 3.3). Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to 3.3).
An employer ceasing to exist resulting in an exit credit being payable	The Administering Authority regularly monitors admission bodies coming up to cessation The Administering Authority invests in liquid assets to ensure that exit credits can be paid when required.

Appendix D – The calculation of Employer contributions

In Section 2 there was a broad description of the way in which contribution rates are calculated. This Appendix considers these calculations in much more detail.

As discussed in Section 2, the actuary calculates the required contribution rate for each employer using a three-step process:

- Calculate the funding target for that employer, i.e. the estimated amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;
- Determine the time horizon over which the employer should aim to achieve that funding target. See the table in 3.3 and Note (c) for more details;
- Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon, allowing for various possible economic outcomes over that time horizon. See the table in 3.3 Note (e) for more details.

The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

a) the estimated cost of ongoing benefits being accrued, referred to as the "Primary contribution rate" (see D2 below); plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "Secondary contribution rate" (see D3 below).

The contribution rate for each employer is measured as above, appropriate for each employer's assets, liabilities and membership. The whole Fund position, including that used in reporting to MHCLG (see section 5), is calculated in effect as the sum of all the individual employer rates. MHCLG currently only regulates at whole Fund level, without monitoring individual employer positions.

D2 How is the Primary contribution rate calculated?

The Primary element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members' **future** service in the Fund. This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

The Primary rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The Primary rate is calculated such that it is projected to:

1. meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets,

2. within the determined time horizon (see note 3.3 Note (c) for further details),
3. with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

* The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund's actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. Further information about this model is included in Appendix E. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

The approach includes expenses of administration to the extent that they are borne by the Fund, and includes allowances for benefits payable on death in service and on ill health retirement.

D3 How is the Secondary contribution rate calculated?
The Secondary rate is calculated as the balance over and above the Primary rate, such that the contribution rate is projected to:

1. meet the required funding target relating to combined past and future service benefit accrual, including accrued asset share (see D5 below)
2. at the end of the determined time horizon (see 3.3 Note (c) for further details)
3. with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

The projections are carried out using an economic modeller developed by the Fund Actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes with at least 100% solvency (by the end of the time horizon) is equal to the required likelihood.

The Administering Authority, after taking advice from the Fund's actuary, may choose to calculate Primary and Secondary contribution rates differently if particular circumstances apply to an employer.

D4 What affects a given employer's valuation results?
The results of these calculations for a given individual employer will be affected by:

1. past contributions relative to the cost of accruals of benefits;
2. different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
3. the effect of any differences in the funding target, i.e. the valuation basis used to value the employer's liabilities at the end of the time horizon;
4. any different time horizons;
5. the difference between actual and assumed rises in pensionable pay;

6. the difference between actual and assumed increases to pensions in payment and deferred pensions;
7. the difference between actual and assumed retirements on grounds of ill-health from active status;
8. the difference between actual and assumed amounts of pension ceasing on death;
9. the additional costs of any non ill-health retirements relative to any extra payments made; and/or
10. differences in the required likelihood of achieving the funding target.

D5 How is each employer's asset share calculated?

The Administering Authority does not operate separate bank accounts or investment mandates for each employer. Therefore it cannot account for each employer's assets separately. Instead, the Fund Actuary must apportion the assets of the whole Fund between the individual employers. There are broadly two ways to do this:

A technique known as "analysis of surplus" in which the Fund actuary estimates the surplus/deficit of an employer at the current valuation date by analysing movements in the surplus/deficit from the previous actuarial valuation date. The estimated surplus/deficit is compared to the employer's liability value to calculate the employer's asset value. The actuary will quantify the impact of investment, membership and other experience to analyse the movement in the surplus/deficit. This technique makes a number of simplifying assumptions due to the unavailability of certain items of information. This leads to a balancing, or miscellaneous, item in the analysis of surplus, which is split between employers in proportion to their asset shares.

A 'cashflow approach' in which an employer's assets are tracked over time allowing for cashflows paid in (contributions, transfers in etc.), cashflows paid out (benefit payments, transfers out etc.) and investment returns on the employer's assets.

Until 31 March [2016] the Administering Authority used the 'analysis of surplus' approach to apportion the Fund's assets between individual employers.

Since then, the Fund has adopted a cashflow approach for tracking individual employer assets.

The Fund Actuary tracks employer assets on an annual basis. Starting with each employer's assets from the previous year end, cashflows paid in/out and investment returns achieved on the Fund's assets over the course of the year are added to calculate an asset value at the year end. The approach has some simplifying assumptions in that all cashflows and investment returns are assumed to have occurred uniformly over the course of the year. As the actual timing of cashflows and investment returns are not allowed for, the sum of all employers' asset values will deviate from the whole fund asset total over time (the deviation is expected to be minor). The difference is split between employers in proportion to their asset shares at each triennial valuation.

The Fund is satisfied that this new approach provides the most accurate asset allocations between employers that is reasonably possible at present.

D6 How does the Fund adjust employer asset shares when an individual member moves from one employer in the Fund to another?

Under the cashflow approach for tracking employer asset shares, the Fund has allowed for any individual members transferring from one employer in the Fund to another, via the transfer of a sum from the ceding employer's asset share to the receiving employer's asset share. This sum is equal to the member's Cash Equivalent Transfer Value (CETV) as advised by the Fund's administrators.

Appendix E – Actuarial assumptions

E1 What are the actuarial assumptions used to calculate employer contribution rates?
These are expectations of future experience used to place a value on future benefit payments ("the liabilities"). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, likelihoods of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

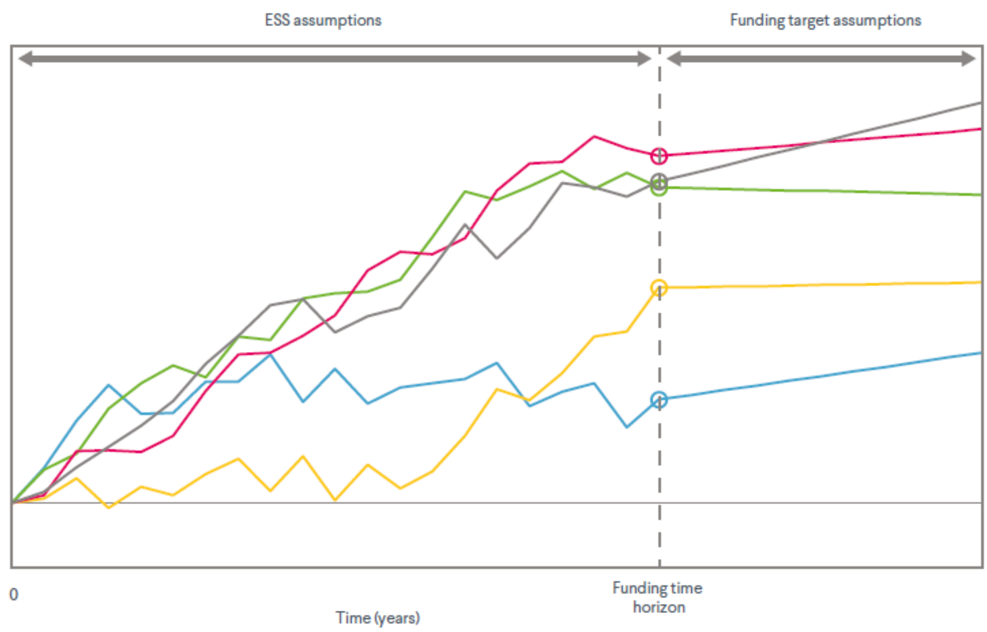
Changes in assumptions will affect the funding target and required contribution rate. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The actuary's approach to calculating employer contribution rates involves the projection of each employer's future benefit payments, contributions and investment returns into the future under 5,000 possible economic scenarios. Future inflation (and therefore benefit payments) and investment returns for each asset class (and therefore employer asset values) are variables in the projections. By projecting the evolution of an employer's assets and benefit payments 5,000 times, a contribution rate can be set that results in a sufficient number of these future projections (determined by the employer's required likelihood) being successful at the end of the employer's time horizon. In this context, a successful contribution rate is one which results in the employer having met its funding target at the end of the time horizon.

Setting employer contribution rates therefore requires two types of assumptions to be made about the future:

1. Assumptions to project the employer's assets, benefits and cashflows to the end of the funding time horizon. For this purpose the actuary uses Hymans Robertson's proprietary stochastic economic model - the Economic Scenario Service ("ESS").

2. Assumptions to assess whether, for a given projection, the funding target is satisfied at the end of the time horizon. For this purpose, the Fund has three different funding bases.



Details on the ESS assumptions and funding target assumptions are included below (in E2 and E3 respectively).

E2 What assumptions are used in the ESS?

The actuary uses Hymans Robertson's ESS model to project a range of possible outcomes for the future behaviour of asset returns and economic variables. With this type of modelling, there is no single figure for an assumption about future inflation or investment returns. Instead, there is a range of what future inflation or returns will be which leads to likelihoods of the assumption being higher or lower than a certain value.

The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2019. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the simulated yields at that time horizon.

		Annualised total returns									
		Cash	**Index Linked Gilts (medium)**	**Fixed Interest Gilts (medium)**	**UK Equity**	**Overseas Equity**	**Property**	**A rated corporate bonds (medium)**	**RPI inflation expectation**	**17 year real govt bond yield**	**17 year govt bond yield**
5 years	16th %'ile	-0.4%	-2.3%	-2.9%	-4.1%	-4.1%	-3.5%	-2.7%	1.9%	-2.5%	0.8%
	50th %'ile	0.7%	0.5%	0.3%	4.0%	4.1%	2.4%	0.8%	3.3%	-1.7%	2.1%
	84th %'ile	2.0%	3.3%	3.4%	12.7%	12.5%	8.8%	4.0%	4.9%	-0.8%	3.6%
10 years	16th %'ile	-0.2%	-1.8%	-1.3%	-1.5%	-1.4%	-1.5%	-0.9%	1.9%	-2.0%	1.2%
	50th %'ile	1.3%	0.0%	0.2%	4.6%	4.7%	3.1%	0.8%	3.3%	-0.8%	2.8%
	84th %'ile	2.9%	1.9%	1.7%	10.9%	10.8%	7.8%	2.5%	4.9%	0.4%	4.8%
20 years	16th %'ile	0.7%	-1.1%	0.1%	1.2%	1.3%	0.6%	0.7%	2.0%	-0.7%	2.2%
	50th %'ile	2.4%	0.3%	1.0%	5.7%	5.8%	4.3%	1.9%	3.2%	0.8%	4.0%
	84th %'ile	4.5%	2.0%	2.0%	10.3%	10.4%	8.1%	3.0%	4.7%	2.2%	6.3%
	Volatility (Disp) (1 yr)	1%	7%	10%	17%	17%	14%	11%	1%		

E3 What assumptions are used in the funding target?

At the end of an employer's funding time horizon, an assessment will be made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). Valuing the cost of future benefits requires the actuary to make assumptions about the following financial factors:

- Benefit increases and CARE revaluation
- Salary growth
- Investment returns (the "discount rate")

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is unlikely to be appropriate for every projection. For example, a high assumed future investment return (discount rate) would not be prudent in projections with a weak outlook for economic growth. Therefore, instead of using a fixed value for each assumption, the actuary references economic indicators to ensure the assumptions remain appropriate for the prevailing economic environment in each projection. The economic indicators the actuary uses are: future inflation expectations and the prevailing risk free rate of return (the yield on long term UK government bonds is used as a proxy for this rate).

The Fund has three funding bases which will apply to different employers depending on their type. Each funding basis has a different assumption for future investment returns when determining the employer's funding target.

Funding basis	Ongoing participation basis	Contractor exit basis	Low risk exit basis
Employer type	All employers except Transferee Admission Bodies and closed Community Admission Bodies	Transferee Admission Bodies	Community Admission Bodies that are closed to new entrants
Investment return assumption underlying the employer's funding target (at the end of its time horizon)	Long term government bond yields plus an asset outperformance assumption (AOA) of 2.0% p.a.	Long term government bond yields plus an AOA equal to the AOA used to allocate assets to the employer on joining the Fund	Long term government bond yields with no allowance for outperformance on the Fund's assets

E4 What other assumptions apply?

The following assumptions are those of the most significance used in both the projection of the assets, benefits and cashflows and in the funding target.

a) Salary growth

After discussion with Fund officers, the salary increase assumption at the 2019 valuation has been set to be a blended rate combined of:

- 4%, 2.5%, 2.5% each year until 31 March 2022, followed by
- 1% below the retail prices index (RPI) p.a. thereafter.

This gives a single “blended” assumption of CPI plus 0.2%. This is a change from the previous valuation, which assumed a blended assumption of CPI less 0.1% per annum. The change has led to an increase in the funding target (all other things being equal).

b) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

At this valuation, we have continued to assume that CPI is 1.0% per annum lower than RPI. (Note that the reduction is applied in a geometric, not arithmetic, basis).

c) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of “VitaCurves”, produced by the Club Vita’s detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

Allowance has been made in the ongoing valuation basis for future improvements in line with the 2018 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.25% per annum minimum underpin to future reductions in mortality rates. This updated allowance for future improvements will generally result in lower life expectancy assumptions and hence a reduced funding target (all other things being equal).

The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members’ benefits.

d) General

The same financial assumptions are adopted for most employers (on the ongoing participation basis identified above), in deriving the funding target underpinning the Primary and Secondary rates: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer’s circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

Appendix F – Glossary

Administering Authority	The council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
Admission Bodies	Employers where there is an Admission Agreement setting out the employer's obligations. These can be Community Admission Bodies or Transferee Admission Bodies. For more details (see 2.3).
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Designating Employer	Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund.
Employer	An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **funding target** values for each employer are individually tracked, together with its **Primary rate** at each **valuation**.
Funding Basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of the funding target at the end of the employer's time horizon. The main assumptions will relate to the level of future investment returns, salary growth, pension increases and longevity. More prudent assumptions will give a higher funding target, whereas more optimistic assumptions will give a lower funding target.
Gilt	A UK Government bond, i.e. a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but are also used in funding as an objective measure of a risk-free rate of return.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's.
Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local

	authority, but can sometimes be another type of employer such as an Academy.
LGPS	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 100 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Maturity	A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.
Members	The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).
Primary contribution rate	The employer contribution rate required to pay for ongoing accrual of active members' benefits (including an allowance for administrative expenses). See Appendix D for further details.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's **members**, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also.
Rates and Adjustments Certificate	A formal document required by the LGPS Regulations, which must be updated at the conclusion of the formal **valuation**. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the period until the next valuation is completed.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employees must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).

Secondary contribution rate	The difference between the employer's actual and **Primary contribution rates**. See Appendix D for further details.
Stabilisation	Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund.
Valuation	A risk management exercise to review the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too.

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Non-Executive Report of the: **Pensions Committee** 18 June 2020	TOWER HAMLETS
Report of Neville Murton, Corporate Director, Resources	**Classification:** Unrestricted Appendix to this report is restricted

Proposed Changes to Retail Price Index (PRI)

Originating Officer(s)	Miriam Adams, Pensions & Investments Manager
Wards affected	All wards

SUMMARY

The UK Government is to undertake a consultation into the calculation and use of RPI with reference to Index Linked Gilts, the effect on public finances and the integrity for the statistical system.
The result could see RPI no longer used as a statistic used by Index Linked government bonds and the Consumer Prices Index including owner occupier housing costs (CPIH). Thereby reducing the future change in RPI by around 1% per annum.

This could have a potentially major effect on the market and could cause a huge sell off-off in market.

RECOMMENDATIONS

The Pensions Committee is recommended to:

1. Consider the paper prepared by Mercer (Appendix A);
2. Consider the options presented by Mercer (Appendix A page 12)
3. Consider the advice put forward by Mercer to switch to fixed index gilts as soon as possible using LGIM or Schroders;
4. Note the need to consider procurement implications of the above recommendations; and
5. Agree on a way forward.

1. <u>REASONS FOR THE DECISION</u>

1.1 This change could have significant and immediate financial consequences for investors in RPI-linked assets such as index-linked gilts. The Fund's assets are linked to RPI while its liabilities are linked to CPI. The Fund's investment adviser Mercer is of the opinion that following a RPI reform consultation, RPI is expected to fall while CPI will remain unchanged, which could lead to a possible deterioration of the Funding level.

1.2 However, Insight investment, one of the Fund's fixed income manager is of the view that they would recommend in the consultation that RPI be amended to align with CPIH plus a margin to avoid potential losses.

2. DETAILS OF REPORT

2.1 RPI has consistently risen at a faster pace than the recommended index CPIH, so to align the indices will reduce the value of future cash flows and the price of bonds will fall. It is anticipated that the market price of the Longest dated bonds will suffer the biggest price falls. That the market price of the longest bond in the market, maturing in 2068, could fall as much as 30% should the consultation rule that the change should occur.

2.2 It should be noted that these are all based on estimates and uncertainties, the consultation was due to commence in January 2020 and report by the end of the current financial year but this timeline has slipped to March with the results expected at the end of April. The current estimated timescales for any switch to take place in 2025 could change.

2.3 When investors invest in index-linked gilts they do so with the knowledge of the difference between RPI and CPI. Investors invest in RPI-related gilts, they factor in the fact that RPI is likely to rise more quickly than CPI.

2.4 In addition to Index-linked gilts held by the Fund (6%), other assets with exposure to RPI are property managed by Schroders (12% of portfolio), Baillie Gifford DGF (10%) and Ruffer Absolute Return (10%).

2.5 Mercer is of the opinion that given other price sensitivities of these assets and cost/practicalities of change as well as the flexibility in DGF, the Fund should limit any changes to the index linked portfolio.

3. COMMENTS OF THE CHIEF FINANCE OFFICER

3.1 The full impact of this legislative change is not fully understood at this point. On 12 March, the Chancellor launched a consultation to understand the impact of the potential changes and what then will be required.

4. LEGAL COMMENTS

4.1 All regulatory matters concerning the operation of the mandate would be managed by the fund manager. One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate having regard to these matters, for the Committee to receive information about asset allocation and ensure that funds are being managed in accordance with the Council's statutory obligations.

4.2 Recommendation 3 refers to changing index linked gilts to fixed index gilts. This is financial activity which is exempt under the Public Contracts Regulations 2015. Therefore, the committee is free to follow this recommendation should it so choose without the need for any further competitive exercise.

5. ONE TOWER HAMLETS CONSIDERATIONS

5.1 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.

6. BEST VALUE (BV) IMPLICATIONS

6.1 The Pension Fund accounts demonstrate the financial stewardship of the scheme members and employers' assets.

7. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

7.1 There is no direct Sustainable Action for a Greener Environment implication arising from this report.

8. RISK MANAGEMENT IMPLICATIONS

8.1 Any form of investment inevitably involves a degree of risk. The rigorous robust management of LBTH Pension Fund results in better performance ad reduction in the contribution required from the Council towards the Fund.

8.2 To minimise risk, the Pensions Committee attempts to achieve a diversified portfolio.

9. CRIME AND DISORDER REDUCTION IMPLICATIONS

9.1 There are no crime and disorder reduction implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report
- None

Appendices
Appendix A – Tower Hamlets RPI and ILG considerations (restricted)

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report

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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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