Non-Executive Report of the: **PENSIONS COMMITTEE** **16 March 2017**	
Report of: Zena Cooke, Corporate Director, Resources	**Classification:** Unrestricted
Pension Fund Triennial Valuation Outcome and Funding Strategy Statement for 2017/18	

Originating Officer(s)	Bola Tobun, Investment and 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 current actuarial valuation is based upon investment, cash flow and member information as at 31 March 2016 with contributions set to cover the period from April 2017 – March 2020.

This report brings the final actuarial valuation outcome to the Committee for adoption and also the Funding Strategy Statement (FSS) to the Committee for approval. This statement sets out how the Pension Fund aims to become fully funded over the long term, whilst considering affordability, transparency, stability and prudence.

Employees contributions are set by the Government, so employers must pay the balance of any cost in delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded, and, insofar as is practical, the measures to ensure that employers or pools of employers pay for their own liabilities. The final agreed contribution rates for employers are shown in Appendix 3.

The Funding Strategy Statement has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) as attached in Appendix 4, which provides the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS).

The FSS was circulated in draft to all employers who participate in the Tower Hamlets Pension Fund to allow comments to be made prior to its finalisation. Employers were invited to respond with any comments by Monday 6th March 2017.

Following the consultation, the FSS will be considered and approved by the Pensions Committee on 16th March 2017. Comments received from consultation will be brought to the attention of the Committee.

Recommendations:

Pensions Committee is recommended to:

- Note and adopt the 31st March 2016 actuarial valuation report as set out in Appendix 1;
- Approve the Funding Strategy Statement as set out in Appendix 2;
- Note and adopt the draft rates and adjustments schedule/certificate prepared by the Fund Actuary listing all employers' in the Tower Hamlets Pension Fund, primary and secondary contributions payable from April 2017 to March 2020 as set out in Appendix 3;
- Approve the sign off of the Rates and Adjustments Certificate and the implementation of the Funding Strategy Statement.

Commented [NA1]: There is currently no power for the Committee to pass this function to the Director. I think if the wording is left at for the Committee to approve the sign off and implementation this should be ok.

1. REASONS FOR THE DECISIONS

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 Following consultation with such persons as it considers appropriate, prepare, maintain and publish a written statement setting out its funding strategy with all relevant interested parties involved with the fund – for example, local authority employers, admitted bodies, scheduled/resolution bodies.

1.3 The administering authority will prepare and publish its funding strategy by having have regard to:-

a. the guidance issued by CIPFA for this purpose; and

b. the Statement of Investment Principles (SIP) or investment strategy statement (ISS), whichever is appropriate;

1.4 The FSS will be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the statement of investment principles or investment strategy statement.

1.5 The revised FSS should be completed and approved by the Pension Committee (or equivalent) prior to the completion of each valuation.

1.6 The Fund actuary must have regard to the FSS as part of the fund valuation process.

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 Results: Deficit and Funding Level

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 2013:

- The funding level has improved from 71.8% to 82.7%.
- In monetary terms the deficit has reduced by £130m from £365m (at March 2013) to £235m (March 2016). This was based on the Fund having assets of £1,126m and liabilities of £1,361m as shown below.

Valuation Date	31 March 2013	31 March 2016
Past Service Liabilities	**(£m)**	**(£m)**
Employees	451	414
Deferred Pensioners	297	320
Pensioners	546	627
Total Liabilities	**1,293**	**1,361**
Assets	**928**	**1,126**
Surplus / (Deficit)	**(365)**	**(235)**
Funding Level	**71.8%**	**82.7%**

3.2 The table shown below analyses the change in the deficit. The main reason for the reduced deficit are as follows; contributions greater than cost of accrual, better than expected performance of the markets/return on investments and membership experience (new members, number of deaths and leavers, etc.) being better in terms of financial impact on the Fund.

Analysis		(£m)
Surplus / (deficit) at 31 March 2013		**(365)**
Interest on surplus / (deficit)	(53)	
Investment returns greater than expected	46	
Contributions greater than cost of accrual	38	
Membership experience over the period	66	
Change in demographic assumptions	6	
Change in base mortality assumption	16	
Change in longevity improvements assumption	1	
Change in financial assumptions	33	
Impact of LGPS 50/50 take up	(7)	
Other experience items	(16)	
Surplus / (deficit) at 31 March 2016		**(235)**

3.3 It is noticeable from above table, that the elements of the valuation assumptions that are controllable by the Council (investment returns, retirements & salary increases) have positively impacted the results; whereas the assumptions that are outside the Council's control (gilt yields and inflation during the valuation period) have had a negative impact on the results. For the first time in recent times, mortality rate has trended downwards – this has had a positive impact on Fund liabilities.

Contributions Rates

3.4 The rates that are certified in the Rates and Adjustment Certificate ("R and A"), as shown at Appendix 3, which result from calculations carried out by the Fund Actuary (Hymans Robertson) at the valuation, 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.

3.5 ***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.

3.6 The actuary's final report is set out in Appendix 1. The Pension Fund is required by statute to publish a Funding Strategy Statement (FSS), to keep the Statement under review and to revise it whenever there is a material change in the policy set out within it.

3.7 The Council, as an employer in the Fund, like the Fund as a whole, is in deficit and has been for a significant period of time. Therefore, the rates previously and currently paid have included a Secondary Rate to help recover the deficit. This deficit amount helps to meet the objective of the Fund, and ensure the Council can become fully funded over a suitable period of time.

3.8 Historically, the schools within the London Borough of Tower Hamlets, have paid the Primary Rate only, i.e. the cost of future accrual, and have not been contributing towards the deficit repayment. This has led to the Council subsidising the schools to ensure that the Council, overall, pay the rate certified by the Fund Actuary.

3.9 The 2013 valuation the rates certified were as follows:

Payment Period	Primary	Secondary	Total % of pay	Subsidy (Difference between Total Rate and Primary Rate)
2014-15	15.8%	£18.5m	31%	15.2%
2015-16	15.8%	£20.5m	32%	16.2%
2016-17	15.8%	£22.0m	33%	17.2%

3.10 As stated above, schools have only been contributing towards the cost of future accrual, and have been paying 15.8% for the past 3 years. The Council has subsidised the difference in order to meet the deficit payment contributions. The amounts subsidised as a percentage of pay are shown in the table above.

Outlook - Primary Rate

3.12 The recent 2016 valuation results have been completed and the funding position of the Fund as a whole has improved. However, despite this improvement in funding position, which relates to the past service benefits accrued, the cost of future benefits has increased as a result of the change in market conditions.

3.13 This has resulted in a new primary rate of 19.9% of pay being required for the Council for the 3 years from 1 April 2017. This represents a 4% increase on current contributions towards the cost of new benefits accruing, and as noted above this is mainly due to the market expectations of future investment returns being lower.

3.14 The Council has made the decision not to pass this increase on to Schools immediately; however phased increases will apply over the next 3 years.

Outlook – Secondary Rate

3.15 As noted above, the funding position of the Council has improved, and this has resulted in lower deficit repayments. Overall however, with the primary rate increasing and secondary rate decreasing the Council's rate will remain the same as the current rate (i.e. 33% of pay) from 1 April 2017. This is the rate the schools should be paying. However, in order to ease budgetary pressure the Council has decided that Schools will have their contribution increased by 1.5% p.a. to meet the cost of future benefits and by 2019 their contribution rate will start to pay back some of the accumulated deficit.

3.16 This means that for the following 3 years the contribution rates for schools will be:

Payment Period	Total % of pay
2017-18	17.3%
2018-19	18.8%
2019-20	20.3%

3.17 These rates will be re-assessed as part of the 2019 valuation, from which point new contribution rates will be certified to come into payment from 1 April 2020. However, there is likely to be further upward pressure on the contribution rates, with the overall aim of schools paying a similar rate to the Council. This rate is currently certified at 33% of pay, but is expected to fall with subsequent valuations as the deficit decreases.

3.18 It is important to note that until 1 April 2019, schools will be contributing less than the cost of future benefits and the Council will continue to subsidise the schools until they are paying the same rate as the Council. For planning purposes, schools could assume the likely contribution rates will increase by 1.5% a year until they match the Council's overall contribution rate. This approach and basis for future planning has been communicated to the schools that are Fund members.

3.19 The strategy of amending contributions so that they contribution to deficit payments, as shown in the table above, and the more stable increase in the total contribution rate are in line with the objectives as stated in the FSS.

3.20 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 2013 valuation and this has been updated to reflect changes made for the 2016 valuation.

3.21 As set out in the FSS the objectives of the statement are to:

a) 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;

b) ensure that employer contribution rates are reasonably stable where appropriate;

c) 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);

d) 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

e) 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.

3.22 In addition to the objectives set out above, 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.

3.23 The FSS also covers the links to investment strategy which are set out in the Statement of Investment Principles now Investment Strategy Statement. The investment strategy for the Pension Fund is set for the longer term. The investment strategy is an important and time consuming activity that the Committee needs to devote its time to. This may include dedicated strategy meetings to consider the longer term investment strategy for the Fund as well as looking at options for risk reduction over the longer term, should the funding level improve.

3.24 The FSS includes a number of detailed appendices covering key points around responsibilities, risks and regulations and the following points set these out in more detail.

3.25 Appendix A – Regulatory Framework for the FSS which sets out the purpose of the Statement as defined by The Department for Communities and Local Government (DCLG):

- "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."

3.26 Appendix B – Responsibilities of the key parties, i.e. the Administering Authority, individual employers, the Fund Actuary and other parties such as the investment advisers, investment managers, legal advisers, etc.

3.27 Appendix C – Key Risks and Controls:

- **Financial Risks** – includes assets failing to deliver returns in line with anticipated returns, inappropriate long term investment strategy, falls in risk-free returns on Government bonds giving rise to value placed on liabilities, underperformance relative to benchmark by the Fund's investment managers, pay and price inflation significantly higher than anticipated, impact of increased employer contributions on service delivery and ceased employers giving rise to additional costs. **Controls** – includes prudent longer term return assumptions, taking specialist advice, inter-valuation monitoring, reviewing investment strategy options, measuring performance relative to bond targets, stabilisation modelling, quarterly investment and funding monitoring, making employers aware of possible consequences of decision, stabilisation for some employer, phased contribution increases, guarantees, cessation calculations and recovery of deficit amounts.
- **Demographic Risks** - includes pensioners living longer, fund maturity i.e. declining active membership, deteriorating patterns of early retirements and reductions in payroll leading to insufficient deficit payments,. **Controls** – include setting mortality assumptions which allow for some increased longevity, specific fund mortality monitoring, ongoing monitoring of cashflows and maturity profiling of the Fund, monitoring ill health experience, charging employers for non ill-health retirements and seeking deficit contributions paid as lump sums rather than percentage of payroll.
- **Regulatory Risks** – includes changes to national pension requirements and/or HMRC rules, time/cost/reputational risk associated with DCLG intervention triggered by Section 13 and changes by Government to particular employer participation in the LGPS. **Controls** – include ensuring that the Administering Authority considers consultations issued by Government and comments where appropriate and taking advice from the Fund Actuary re: Section 13.
- **Governance Risk** – Administering Authority unaware of structural changes in employer membership, actuarial advice not sought, noted or proves to be insufficient, failure to carry out termination valuations on a cessation of an employer or employers ceasing with insufficient reserves to meet liabilities at cessation. **Controls** – include monitoring employer membership and any changes to the employer that may impact on it, collecting deficit contributions as lump sums, Administering Authority maintaining a close working relationship with its advisers, seeking guarantees from another

scheme employer and being alert to possible financial problems facing employers.

3.28 Appendix D – The calculation of Employer contributions covering the difference in the calculation at a whole Fund level compared to individual employer level, how the Primary and Secondary contribution rates are calculated and the treatment of different types of employers, how the Funding level is calculated and what affects the results for individual employers

3.29 Appendix E – Actuarial Assumptions, sets out the actuarial assumptions used and the standard funding basis (ongoing), as well as the assumptions behind this (investment returns/discount rate, expected salary growth, pensions increase, life expectancy and other wider assumptions.)

3.30 Appendix F – Glossary - sets out key terms used in both the FSS and the Actuarial Valuation.

3.31 The Committee are asked to approve the draft Funding Strategy Statement and to delegate final sign off of FSS to the Corporate Director, Resources following the consultation period.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The budget for the formal actuarial work was £30k however additional work required has resulted in additional expenditure and a total spend of £46k is forecast. The total cost of the actuarial work will be met through the pension fund.

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

4.3 The employers' contribution rate for the London Borough of Tower Hamlets is currently set at 15.8% for 2016/17. This will increase to 19.9% as a result of the 2016 triennial review. However, following the 2013 triennial valuation the total implied employer's contribution rate (based on current pensionable pay) for the Council for 2016/17 was 33% and this will not change as a result of the 2016 triennial review. The Council will still continue to pay this rate for the next three years up until 31 March 2020. The next valuation exercise will occur in March 2019 with the results taking effect from 1 April 2020.

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
Appendix 2 – Funding Strategy Statement
Appendix 3 – Rates & Adjustments Certificate
Appendix 4 – CIPFA FSS Guidance

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

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