Non-Executive Report of the: **Pensions Board & Pensions Committee** 05 & 07 December 2016	TOWER HAMLETS
Report of: Zena Cooke, Corporate Director of Resources	**Classification:** Unrestricted

31st March 2016 Triennial Valuation – Initial Results and Public Service Pensions Act - Section 13 Valuation

Originating Officer(s)	Bola Tobun, Investment and Treasury Manager
Wards affected	All wards

Summary

This report provides the Committee with a summary of progress to date on the 2016 actuarial valuation. Whilst a full report is not yet available for distribution, preliminary work gives a guide to the outcome of the valuation. The result of this preliminary work was presented at the Committee by the Fund's actuary, Hymans Robertson. The Actuarial Valuation is undertaken every three years and is an assessment of the assets and liabilities of the pension fund, which then determines the funding level. The final valuation will determine the contribution rates payable by all employers participating in the Fund, which includes the Council.

An initial presentation of the provisional overall funding position was given by Hymans Robertson at the meeting of 22nd September. Members were updated with the initial results and presented with a range of discussion points. The initial outcome of the 2016 valuation was that the monetary deficit amount decreased from £365m to £235m, the Fund saw its funding level increase from 71.8% to 82.7%.

This report also provides Members with information on the 'dry run' Section 13 analysis completed by the Government Actuary's Department (GAD) using the 2013 valuations.

The Government Actuary has been appointed by the Department of Communities and Local Government (DCLG) to report under section 13 of the Public Service Pensions Act 2013 in connection with the Local Government Pension Scheme ("LGPS" or "the Scheme") in England and Wales.

Recommendations:

The Pensions Committee is recommended to:

1) Agree the assumptions and methodology used by the Actuary to determine the actuarial funding level and a standardised basis for setting employer contribution rates.
2) Note the content of this report and the draft results of the triennial valuation of the Fund.

1. REASONS FOR THE DECISIONS

1.1 The Council is required by law to undertake an actuarial valuation of the Fund's assets and liabilities. The Pensions Committee under delegated authority should agree the underlying assumptions of the valuation with the actuary.

1.2 The understanding of the Pension Fund in terms of its investments, the Fund's liabilities both short and long term and the profile of its members between actuarial valuations determines the financial status of the pension fund, its funding level and the contributions that employers need to make into the Fund for the following three years.

1.3 The level of funding for the Pension Fund and the requirement to fund employee pension benefits, both past and current can directly impact on the level of resources available for other Council services. The valuation outcome is sensitive to both the actuarial and financial assumptions made within the valuation and any significant variations to those assumptions could impact upon Fund's financial position.

1.4 The contribution rate currently paid by the Council is 35.5% of payroll; this applies equally to the Council and to its schools.

2. ALTERNATIVE OPTIONS

2.1 There are no alternative options.

3. DETAILS OF REPORT

3.1 The Pension Fund is required to undertake a formal actuarial valuation of the Fund's assets and liabilities every three years to establish its funding position and to set the contribution rate for the following three years. The Pensions Committee under delegated authority should agree the underlying assumptions of the valuation with the actuary.

3.2 The last formal actuarial valuation of the London Borough of Tower Hamlets Pension Fund was carried out as at 31st March 2013, which showed a slight improvement in the funding level from 71.2% to 71.8% and set the contribution rates for the three years commencing 1st April 2014.

3.3 The Fund's actuary, Hymans Robertson, has been reviewing the data supplied to them by the Administering Authority, Tower Hamlets, over the summer and is in the process of assessing the current funding position and contributions payable by both the Council and other employers in the Fund.

3.4 The actuary has produced an initial overall fund results; however, issues around the quality of data provided by employers have meant that a number of assumptions have been required to produce these. These assumptions are not believed to have a material impact on the whole fund results, but do mean that additional work is likely to be required for some individual employers. Data quality is an important issue which has been raised by the Pensions

Regulator (tPR); the Fund has been working hard to improve the quality of data provided but this work remains ongoing.

3.5 The assets are the amalgamation of all the asset classes which the Fund manages, including equities, bonds, property, etc. valued as at 31st March 2016. The liabilities are a summation of all the pension payments which are due to all scheme members, pensioners, deferred members and active members over the remaining lifetime of all members, which could stretch out beyond 60 years. The actuary then calculates the contributions which would be required in order for the Fund to meet its liabilities and to recover any deficit which has arisen. The actuary is looking at different options whereby the Committee has to make a decision to either continue with a relatively cautious approach or to reduce the deficit recovery period from 20 to 17 years.

3.6 The background to other employers varies significantly depending on what their formal status is within the fund – this will depend on their contract lifespan and funding position. Some employers arise from TUPE transfer situations when the Council outsources contracts which involve the transfer of staff. These are either Community Admission Bodies or Transferee Admission Bodies. As a general rule, when staff are TUPE'd across to new admission bodies, any historic deficit remains with the Council and the new employer is set up with a 100% funding position i.e. it has sufficient assets to cover any liabilities as at the date of transfer. Scheduled bodies, such as academies, receive a share of the deficit on transfer where these arise as a result of TUPE. A number of the earlier academies in Tower Hamlets were established as completely new entities and therefore did not result in TUPE transfers; hence the contribution rates can vary significantly between academies. The contribution rate which is set for such an employer is such that it should be sufficient to ensure that at the end of the contract life, the employer is 100% funded. Any deficit which arises during the contract life should therefore be met during the period of the contract, however, if at the end of the contract a deficit position has arisen then an admitted body employer is expected to make good that deficit.

3.7 The triennial valuations adjust contribution rates that employers are required to pay to try to ensure that any deficit at end of contract is kept to a minimum and employers will be informed of indicative contribution rates payable during the month of December. Employers will also be given the opportunity to meet with the Fund actuary to discuss the valuation following the Employer Forum to be held in December.

3.8 At the time of writing, the actuarial work is still underway but it is anticipated that the contribution rates will be available to discuss with Members at the Committee meeting itself.

Overall Fund Initial Results

3.9 A summary of the results are shown as Appendix 1. The highlights are:

- The funding level has improved from 71.8% to 82.7%.

- In monetary terms the deficit has reduced by £130m to £235m from £365m as at March 2013. This funding position was based on the Fund having assets of £1,126m and liabilities of £1,361m

3.10 The table shown below analyses the change in deficit. This table is in Page 7 of Appendix 1 of the actuarial report. The main reasons 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 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)

3.11 It is noticeable from above table, that the outcomes for 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.

Future Contribution Rates

3.12 The Actuary determines contribution rates separately and specifically for each employer, including the Council. For 2013 valuation, the Council's rate was 15.8% of payroll for future service rate contribution. Other employers, pay rates ranged between 15.9% and 41.4% and in most cases also paid annual lump sums to cover past service deficits. The Council is paying £22m in 2016/17 to cover the past service deficit. The employer risk profile analysis will assist the actuary in determining the appropriate recovery period and consequently contribution rate for each of the employer in the Fund.

3.13 Following consultation with other employers, the Actuary may be asked to undertake additional modelling to test the impact of changing the contribution rates that they pay during the next valuation cycle.

Next Steps

3.14 The subsequent steps in the valuation process are summarised below.

December 2016

- Receive feedback from individual employers on their estimated funding level and contribution rates.
- Carry out any additional contribution rate modelling.
- Finalise Funding Strategy Statement ("FSS").

March 2017

- Present final Actuarial report including schedule of contributions from April 2017 to March 2020 together with the FSS to the Pensions Committee.

3.15 **Section 13 Valuation**

1. This piece of primary legislation requires that an appointed person, in this case, the Government Actuary's Department ("GAD"), reports on whether the LGPS formal funding valuations adhere to the following criteria:

    a. **Compliance**
    b. **Consistency**
    c. **Solvency**
    d. **Long term cost efficiency**

2. GAD will calculate a number of metrics for each of the LGPS funds using consistent actuarial assumptions. Funds will be ranked in a league table based on these metrics and assigned a RAG (Red/Amber/Green) status against each metric to identify those funds that may need to take action. The absolute value of the assumptions in the chosen actuarial basis is not important – the important fact is that all LGPS funds are measured on the same assumptions, allowing comparison across funds.

3. If GAD has concerns about LGPS funds under any of these measures then they can recommend remedial actions which may ultimately be enforced by DCLG using powers granted under this legislation. That is the resulting report may recommend remedial action where appropriate; the scheme manager (in this case the administering authority) must take and report on any remedial action they consider appropriate, although the law does provide for the Government to direct the scheme manager if they consider it necessary.
4. Six months to 31st August 2016, all the four LGPS actuaries (AON, Hymans Robertson, Barnett Waddingham and Mercer) have been engaging with GAD as they have carried out a review of LGPS 2013 valuations against the above listed criteria. This exercise is now complete. GAD has published their report and hosted a series of seminars to discuss their findings and recommendations. The 2013 valuations pre-date the effective date of the legislation. As such, the work on the 2013 valuations has no legal force but serves as a "dry run" to familiarise all parties with the process and sets expectations as to how the 2016 valuation review might be implemented.

<u>The 'dry run' report found:</u>

5. The analysis identified no evidence of material non-compliance

6. There are some inconsistencies between the LGPS local valuations in terms of approach taken, assumptions used and disclosures. These made meaningful comparison of local valuations difficult. Issues highlighted include differences of approach in terms of the derivation of discount rates, and the interpretation of the common contribution rate.

7. From the 2013 local valuation data, the funding level of the Tower Hamlets Fund improves considerably when presented on a SAB standardised basis, ***from 2013 formal valuation funding level of 72% to 85% under Section 13 SAB valuation*** is attached as appendix Z of this report.

8. **Long Term Cost Efficiency Measures** - A small number of flags (as shown in table below) triggered on the metrics used to assess long term cost efficiency. These are split into relative considerations, that compare funds to other LGPS funds (Deficit repaid, deficit period, required return and repayment shortfall) and absolute considerations, which are concerned with funds on a standalone basis (return scope, deficit extension and interest cover). ***The Tower Hamlets Fund did not trigger any flags on this measure.***

Table 6.2: Open funds with amber or red long term cost efficiency measures

PENSION FUND	MATURITY (RANK)	LONG TERM COST EFFICIENCY MEASURES						
		RELATIVE CONSIDERATIONS				ABSOLUTE CONSIDERATIONS		
		DEFICIT REPAID	DEFICIT PERIOD	REQUIRED RETURN	REPAYMENT SHORTFALL	RETURN SCOPE	DEFICIT EXTENSION	INTEREST COVER
BERKSHIRE	5.9 (78)	4%	34	6%	-2%	-0.5%	-3	No
BROMLEY	6.8 (33)	>50%	2	3%	13%	3.1%	3	Yes
ENVIRONMENT AGENCY ACTIVE[21]	5.8 (85)	IN SURPLUS	IN SURPLUS	N/A	N/A	N/A	3	N/A
GWENT	5.9 (79)	13%	8	5%	5%	1.5%	5	Yes
SOMERSET	5.9 (80)	5%	24	6%	-1%	0.0%	0	No
STAFFORDSHIRE	6.2 (59)	23%	5	4%	9%	2.4%	5	Yes
WORCESTERSHIRE	6.3 (57)	14%	7	4%	7%	2.0%	2	Yes

9. **Solvency Measures** - a series of 6 solvency measures were used to analyse funds and there were some possible risks to sponsoring employers. This solvency measures are split into ***risks already present*** (SAB funding level, open fund and non-statutory employees) and ***emerging risks*** (liability shock, asset shock and employer default). A fund is allocated a red colour code if its result is greater than 7.5%, an amber colour code if it's between 5% and 7.5% and a green colour code otherwise.

PENSION FUND	MATURITY (RANK)	SOLVENCY MEASURES					
		RISKS ALREADY PRESENT			EMERGING RISKS		
		SAB FUNDING LEVEL	OPEN FUND	NON-STATUTORY EMPLOYEES	LIABILITY SHOCK	ASSET SHOCK	EMPLOYER DEFAULT
LONDON PENSIONS FUND	9.6 (4)	92%	YES	0%	+6%	+4%	+0%
MERSEYSIDE	7.3 (17)	92%	YES	13%	+4%	+5%	+0%
MERTON	7.1 (25)	91%	YES	3%	+4%	+4%	+0%
NEWHAM	7.3 (19)	75%	YES	N/A	+4%	+4%	N/A
NORFOLK	6.6 (40)	91%	YES	9%	+4%	+4%	+0%
NORTH YORKSHIRE	5.3 (89)	87%	YES	3%	+3%	+3%	+0%
NORTHAMPTONSHIRE	6.2 (60)	85%	YES	4%	+4%	+4%	+0%
NORTHUMBERLAND	8.2 (8)	84%	YES	6%	+5%	+5%	+0%
NOTTINGHAMSHIRE	6.3 (54)	85%	YES	6%	+4%	+4%	+0%
OXFORDSHIRE	5.9 (75)	85%	YES	36%	+3%	+4%	+2%
POWYS	6.4 (46)	82%	YES	3%	+4%	+3%	+0%
REDBRIDGE	6.3 (51)	83%	YES	9%	+4%	+3%	+0%
RHONDDA CYNON TAF	6.1 (68)	77%	YES	5%	+3%	+3%	+0%
RICHMOND	7.1 (24)	97%	YES	3%	+4%	+5%	-0%
SHROPSHIRE	6.5 (43)	88%	YES	10%	+4%	+4%	+0%
SOMERSET	5.9 (80)	74%	YES	13%	+3%	+3%	+1%
SOUTH YORKSHIRE	6.4 (47)	94%	YES	10%	+4%	+4%	+0%
SOUTH YORKSHIRE PTA	25.2 (1)	114%	NO	100%	+5%	+3%	N/A
SOUTHWARK	7.3 (20)	84%	YES	2%	+4%	+4%	+0%
STAFFORDSHIRE	6.2 (59)	87%	YES	6%	+4%	+4%	+0%
SUFFOLK	6.2 (62)	93%	YES	19%	+4%	+3%	+0%
SURREY	5.9 (81)	86%	YES	5%	+3%	+4%	+0%
SUTTON	6.5 (42)	81%	YES	3%	+4%	+3%	+0%
SWANSEA	6.2 (61)	80%	YES	4%	+4%	+4%	+0%
TEESSIDE	6.8 (29)	103%	YES	13%	+4%	+5%	-0%
TOWER HAMLETS	8.1 (9)	85%	YES	0%	+5%	+5%	+0%
TYNE AND WEAR	7.1 (23)	87%	YES	11%	+4%	+4%	+0%
WALTHAM FOREST	7 (26)	73%	YES	5%	+4%	+4%	+1%

10. ***Tower Hamlets raised two amber flags under this assessment*** as shown in the table above for:

a. Liability shock – This a change in average employer contribution rates as a percentage of payroll after a 10% increase in liabilities. As a continued solvency of a fund depends on the ongoing ability of employers to pay the required contributions into the fund.
b. Asset shock – this a potential change in employer contribution rates required after a 15% fall in the value of return seeking assets. In effect a one-off decrease in asset values results in an increase fund deficits.

11. GAD reported that they had found both presentational and evidential inconsistencies in the valuation approach adopted by LGPS funds, and in assumptions used and disclosure of results. GAD named two funds with whom they would have wanted to have further discussion over the long term cost efficiency of their funding plans. GAD clarified that meeting solvency and long term cost-efficiency requirements takes precedence in the regulatory framework over the desirability of stable contributions.

12. The S13 report can be used to provide stakeholders with reassurance that the LGPS as a whole is able to meet the liabilities owed to its members, and to highlight where individual funds appear to be outliers from the main pack. On the basis of the 2013, the Tower Hamlets Fund has not raised any concerns which GAD felt would justify an engagement with the Fund and compares well with its peers when its funding level is considered on a standardised basis.

13. The Fund will continue to conduct its local triennial valuation in a way that allows it to meet its specific liabilities given its own local circumstances; the S13 report is not intended to force a standardised basis for valuations or to be used as a minimum funding requirement.

Section 13 - 2016 SAB Valuation Result

14. Under Section 13, SAB valuation assumptions for 2016, Tower Hamlets funding ratio is 93.4%. And the Fund local formal triennial valuation indicates funding level of 83%. The reason for this is because the valuations were carried out under different assumptions.

15. The SAB basis is weaker and GAD has stated that this basis is not suitable for funding as it is a best estimate basis and the Regulations require a prudent assessment. The assumptions set out in the certificate are prescribed by the Scheme Advisory Board and will allow each Fund to be compared on a like for like basis.

16. The figures being requested by SAB will have no impact on the results of the 2016 formal valuation. They are being requested to allow comparisons on certain metrics between funds. They will lead to greater transparency and should help to improve the governance and performance of the LGPS.

17. The table below highlights the valuation assumptions used by the two different valuation methodologies.

Assumptions	2016 Local Valuation	2016 - Section 13 GAD Valuation
Discount Rate	4.20%	5.06%
Pensions Increases	2.10%	2.00%
Long Term Salary Grov	2.65%	3.50%
Longetivity	CMI 2013 + 1.25%	CMI 2015 + 1.5%

Conclusion

At the next meeting the Pension Committee will need to make a decision and approve the new contribution rates for employers to be effective from 1st April 2017 for the next three years up to 31st March 2020. The Committee has to bear in mind, when making this decision on employer contributions, the outcome of the 2013 Section 13 Valuation, which indicates the Fund funding level of 85% (13% more than the formal actuarial valuation for 2013). In spite of this significant improved position, the Fund had two amber flags on solvency measures on asset shock and liability shock which basically demonstrate the ability of employers to pay the required future contributions into the fund plus funding the deficits.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1 The comments of the Corporate Director of Resources have been incorporated into the report.

5. LEGAL COMMENTS

5.1 The Local Government Pension Scheme Regulations 2013, Regulation 62, requires an Administering Authority to obtain an actuarial valuation of its fund as at 31st March 2016, and as at 31st March every third year thereafter. The documents obtained by the administering authority must include a report by an actuary in respect of the valuation, and a rates and adjustments certificate provided by the actuary. The report must contain a statement of the demographic assumptions used in producing the valuation, and how these assumptions relate to events which have actually occurred in relation to the scheme membership. These documents must be received before the first anniversary of the valuation date.

5.2 Regulation 66 also requires the Administering Authority to supply copies of any valuation report, rates and contributions certificates to be supplied to the Secretary of State, employing authorities participating in the Fund and any other bodies liable to make payments to it.

5.3 There are no immediate legal implications arising from this report.

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1 The Pension Fund Accounts demonstrate financial stewardship of the fund's assets. A financially viable and stable pension fund is a valuable recruitment and retention incentive for the Council.

7. BEST VALUE (BV) IMPLICATIONS

7.1 The level of funding for the Pension Fund and the requirement to fund employee pension benefits, both past and current can directly impact on the level of resources available for other Council services. The valuation outcome is sensitive to both the actuarial and financial assumptions made within the valuation and any significant variations to those assumptions could impact upon Fund's financial position.

7.2 The understanding of the Pension Fund in terms of its investments, the Fund's liabilities both short and long term and the profile of its members between actuarial valuations determines the financial status of the pension fund, its funding level and the contributions that employers need to make into the Fund for the following three years.

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 The valuation outcome is sensitive to both the actuarial and financial assumptions made within the valuation and any significant variations to those assumptions could impact upon Fund's financial position. Therefore a prudent approach is crucial in minimising the key risks involved in managing the Pension Fund.

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 – 20160930 LBTH - 2016 Formal Funding Valuation
- Appendix 2 – Section 13 Dry Run

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

- As shown in appendices above.

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Appendix Z

Chart 4.6: Standardising local valuation results