Non-Executive Report of the: **Pensions Committee** Monday, 27 June 2022	TOWER HAMLETS
Report of: Corporate Director, Resources	**Classification:** Open (Unrestricted)
Draft Pension Fund Triennial Valuation Assumptions	

Originating Officer(s)	Miriam Adams
Wards affected	(All Wards)

Executive Summary

This report and appendix provide the Committee with a summary of recommended valuation assumptions and valuation process progress to date. The London Borough of Tower Hamlets Pension Fund in accordance with the 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 employer within the Fund for the following three years which includes the Council.

The valuation is an assessment of the assets and liabilities of the pension fund which then determines the funding level.

Recommendations:

The Pensions Committee recommended to:

1. Consider and approve the triennial valuation assumptions recommended by the scheme actuary Hymans Robertson.

1. REASONS FOR THE DECISIONS

1.1 The Council as administering authority of the Fund 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 (from 1 April 2023 to 31 March

2026 at which point rates will be reassessed at the 2025 valuation).

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.

2. ALTERNATIVE OPTIONS

2.1 There are no alternatives because the requirements to carry out the triennial revaluation are prescribed in regulations.

3. DETAILS OF THE REPORT

3.1 The LGPS Regulations require administering authorities to complete an actuarial valuation of their Pension Fund on a three yearly cycle.

3.2 This report and appendix summarise the valuation assumptions which have been recommended by the scheme actuary, Hymans Robertson. It is good governance to review all actuarial assumptions as part of each triennial valuation to ensure they all reflect current expectations of the future.

3.3 Members will recall that a report was submitted to the Committee on 23rd September 2021, setting the timetable for the Pension Fund's valuation based on the membership at 31 March 2022.

3.4 Actuarial valuation aim is to set a suitable level of employer contributions to ensure that the Fund achieves its long-term solvency objective. The valuation also provides a much more comprehensive review of the funding level, which includes a review of the full range of assumptions looking forward (this report). The key output of the valuation is the schedule of employer contributions for the next 3 financial years.

3.5 To determine the required level of future employer contributions two main projections:

- Benefit projection: projects the benefits that will be paid to scheme members in each future year (taking into account benefits accrued up to the valuation date and those that will continue to be accrued after the valuation date).
- Asset projection: this projects the amount of the Fund's assets in each future year, taking into account future employer and employee contributions, future benefit payments (from the benefit projection) and the investment returns that will be earned on the assets.

3.6 The contribution rates are then set such that, at the end of an agreed period (the funding rime horizon), there are enough assets (from the asset projection) to meet the future benefit payments (from the benefit projections) in a sufficiently high number of possible future economic outcomes. This is the funding objective. The actuary uses an economic scenario generator to simulate a number of outcomes (5,000).

3.7 What Assumptions are needed

To carry out the valuation assumptions need to be made about the magnitude and timing of both the future benefits that will be paid out of the Fund and the future investment returns generated by the Fund's assets. The assumptions fall into two broad categories – financial assumptions and demographic assumptions. The table below sets out the valuation assumptions and why.

Assumption	Description	Required for
	Financial assumptions	
Future investment return	Projected annual returns and volatility on asset classes invested by the Fund e.g. UK equities, property etc.	**Asset projection** – to project employers' asset shares to the end of the funding time horizon
Discount rate	Annual rate of future investment return that will be earned on the Fund's assets after the end of the funding time horizon	**Funding objective** – to place a present value at the end of the funding time horizon of the future benefit payments
CPI inflation (benefit increases / CARE revaluation)	Future Consumer Price Index inflation	**Benefit projection** – to determine the size of future benefit payments (LGPS benefits are index-linked to CPI inflation)
Salary increases	Future inflationary salary awards	**Benefit projection** – to determine the size of future benefit payments (the pre-2014 final salary benefits are linked to salary) **Asset projections** – to determine future payroll values (and hence contribution income)
	Demographic assumptions	
Baseline longevity	How long we expect members to live based on current observed death rates	**Benefit projection** – to determine how long each member's benefits are paid for
Future improvements in longevity	How death rates are expected to change in the future (historically life expectancy has improved over time)	**Benefit projection** – to determine how long each member's benefits are paid for
Other demographic events	Events such as retirement age, rate of ill health retirement, level of commutation and 50:50 take up	**Benefit projection** – to determine the size and timing of future benefit payments

3.8 The table below compared 2019 valuation financial assumptions against recommended assumptions for 2022.

Financial Assumption	2019 Assumption	Proposed for 2022	Reason for change
Future Investment return	Based on Hymans ESS model. CPI inflation 2.2% Global equity returns 5.8% Index-linked gilt returns 0.3% Corporate bond returns 1.9%	As per 2019 but updated to latest market calibration CPI inflation 2.7% Global equity returns 6.3% Index-linked gilt returns 0.1% Corporate bond returns 2.1%	Projections allow for different levels of inflation and returns across all asset classes.
Discount Rate	2.0% p.a. above the risk-free rate	Increase discount rate assumption to 2.2% p.a. above risk-free rate 65% prudence level	Increasing assumed discount rate by 0.2% p.a. will reduce

			assets the Fund is aiming to hold, by around 4-6%
Pension Benefit Increases	Based on CPI projections from Hymans ESS model	No change in approach but use latest market calibration	Increase in assumed future inflation will increase inflation linked liabilities
Salary Increases	CPI plus 0.2% pa, plus a promotional salary scale	No change from 2019 long term valuation assumption of CPI (plus a promotional salary scale)	Less significant than in previous years

3.9 The table below compared 2019 valuation demographic assumptions against recommended assumptions for 2022.

Demographic Assumptions	**2019 Assumption**	**Proposed for 2022**	**Reason for change**
Baseline Longevity	Based on Club Vita analysis and tailored to fit each individual member of the Fund	Based on Club Vita but adjusted to avoid being skewed by covid. Captures the unique mix of people in the scheme	Small change in base table to reflect up-to-date experience
Future Improvements in Longevity	CMI 2018 model Smoothing applied to recent experience Long-term rate of improvement = 1.25%	CMI 2021 model No weight placed on 2020 data	Latest version of CMI model used
Withdrawals (excluding ill health)	Based on analysis of experience at a national level, Hymans have increased their national assumption on the likelihood of withdrawals at each age. Hymans's recommendation is to scale the default assumption by 150% for full time males, 160% for full time females, 140% for part time-time males and 110% for part-time females.		
50:50 option	Fund assumption was 0.5% of members	Keep assumption unchanged at 0.5% of members	Take up in fund date was 0.9%. However, it is not clear how take up will change in the future
Cash commutation	50% pre-2008 75% post-2008	Based on the Fund's own experience, Hymans propose to update this assumption to 60% of maximum tax-	

		free cash	
Ill health early retirements	No change from the 2019 valuation assumption. Although fund specific shows a slightly higher rate of ill-health retirements than expected. As there are only a small number of data points, Hymans do not believe there is evidence to adjust the assumption.		
Promotional salary scale	Hymans's analysis of the Fund's membership do not suggest any change is required to the default salary scale used in the 2019 valuation. Recommendation is to continue to use LGPS wide analysis, adjusted for local experience where appropriate.		
Death in service	Incidence of death in service is very low and less than expected at 2019. Although there has been an increase in the period from 2019 to 2022, Hymans believe this is temporary.		
Retirement age	Assumed members retired in the years up their state pension age, with a chance of retiring at each age from age 55 based on historical data	The assumption will reflect the earliest age at which a member can retire with their benefit unreduced. Hymans estimate this change to reduce liabilities by around 1%.	It is expected that by 2022, many of the members with complex retirement ages will have retired and therefore the assumptions can be simplified.
Proportion leaving a dependant	Based on Club Vita analysis of our Fund		

3.10 Demographic assumptions impact the timing of payments, and financial assumptions impact the amount of payments. The value placed on the liabilities is sensitive to these assumptions, so the choice of assumptions has to be reasoned and robust. While any assumption about the future is subjective by nature.

3.11 Other factors like climate change, McCloud, cost sharing mechanism, guarantee minimum pension equalisation and revaluation as well as legal factors are considered.

3.12 Officers have received proposals from the Fund Actuary, Hymans Robertson, setting out recommended approach and assumptions chosen. Full details are set in the actuary's report enclosed here as appendix A giving further information on these assumptions.

3.13 Financial assumptions – Hymans use a "risk-based" approach to calculate the benefit and asset projections and setting the underlying financial assumptions. The assumptions in each scenario vary by year so they are not "flat".

Summary of Recommended Assumptions

Assumption	Recommended approach	Comments
Future investment return assumption	Based on Hymans Robertson ESS model updated to latest market calibration	Asset class return expectations are generally slightly better than in 2019.
Discount rate	Can be increased from 2.0% to 2.2% above the risk-free rate at the same level of prudence	No significant change in environment to suggest an increase or decrease in prudence levels Would reduce contributions by 1% to 1.5% of pay. However in 20 years time the Fund would be aiming to hold around 4-6% less assets (all other things being equal).
CPI inflation (benefit increases / CARE revaluation)	Based on Hymans Robertson ESS model	Inflation expectations are slightly higher (c.0.2-0.3% p.a.) than 2019 due to current economic outlook.
Salary increases	CPI inflation (was 0.2% above CPI at 2019)	2022 proposed assumption in line with 2019 long-term salary increase expectations. However, at 2019, allowance was made for short-term expected pay restraint. Given recent increases in National Living Wage and reduced impact on pension liabilities from short-term pay expectations, recommend that no allowance is made for any short-term pay restraint.
Baseline longevity	Based on Club Vita analysis updated to reflect non-Covid related experience	Longevity assumptions are tailored to the Fund's experience and membership.
Future improvements in longevity	Updated to CMI 2021 model with no weight on 2020/21 data with long term improvement of 1.5%	Latest version of CMI model is best practice but avoid projections being affected by short-term Covid-19 experience.
Demographic assumptions (excluding longevity)	Adopt Hymans proposed demographic assumptions	All demographic assumptions have been reviewed against LGPS wide experience with some adjustment to reflect Fund's own experience.

3.14 Investment return and discount rate assumptions – the actuary recommends an increase of discount rate assumption from 1019 values of 2.0% to 2.2% p.a. above risk-free rate.
Benefit projections were assumed to be in line with CPI projections from the Hymans ESS model.
Salary increases – no allowance was made for short-term restraint with no change from 2019 long-term assumption of CPI (plus a promotional salary scale).

3.15 In 2019, the funding level was reported using an assumed investment return assumption of 4.0% which had an associated prudence level of 70%. In this valuation a prudence level of 65% for the assumed investment return has been used and assumed pension increases in line with the Hymans median projected CPI inflation of 2.7% p.a. over the next 20 years.

In terms of longevity assumptions (life expectancy), the actuary has used their Club Vita mortality tables which has been adjusted for covid19.
Next Steps

3.11 The subsequent key steps in the valuation process are summarised below:

- Assumption advice (this report)
- Employer risk management
- Data submission
- Funding Strategy Statement review (September Committee)
- Whole fund results (September Committee)
- Employer results (December Committee
- Employer discussions (December Committee)

- Valuation sign off (March Committee)

4. EQUALITIES IMPLICATIONS

4.1 There are no direct equality impact.

5. OTHER STATUTORY IMPLICATIONS

5.1 This section of the report is used to highlight further specific statutory implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration. Examples of other implications may be:

- Best Value Implications,
- Consultations,
- Environmental (including air quality),
- Risk Management,
- Crime Reduction,
- Safeguarding.
- Data Protection / Privacy Impact Assessment.

Risk Management

5.2 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.

6. COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 The comments of the Corporate Director of Resources have been incorporated as required, throughout this report.

7. COMMENTS OF LEGAL SERVICES

7.1 The Local Government Pension Scheme Regulations 2013, Regulation 62, requires an Administering Authority to obtain an actuarial valuation of its fund at 31 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 adjustment 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.

7.2 Regulation 66 also requires the Administering Authority to supply copies of any valuation report, rates and contributions certificates to the Secretary of

State, employing authorities participating in the Fund and any other bodies liable to make payments to it.

Linked Reports, Appendices and Background Documents

Linked Report
- 2022 Triennial Valuation Plan (September 2021)

Appendices
- Draft Fund Triennial Valuation Assumptions by Hymans Robertson

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report
List any background documents not already in the public domain including officer contact information.
- These must be sent to Democratic Services with the report
- State NONE if none.

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