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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