Non-Executive Report of the: **PENSIONS COMMITTEE** **27 July 2020**	TOWER HAMLETS
Report of: Neville Murton, Corporate Director, Resources	**Classification:** Unrestricted
ACTUARIAL UPDATE, COVID-19 AND FUNDING RISKS	

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

Summary

The funding update is provided to illustrate the estimated development of the funding position from 31 March 2019 to 17 June 2020 as well as understanding the funding impact, risks and mitigation of such risks associated with the ongoing COVID-19 pandemic.

At the last formal valuation, the Fund assets was £1,552m and the liabilities were £1,525m. This represented a surplus of £27m and equated to a funding level of 102%. At June 2020 the actuarial estimate is that the funding level is unchanged at 102%.

Recommendations:

Pensions Committee is recommended to:

1. Note the whole Fund actuarial update at 31 March 2020 and 17 June 2020;
2. Note the impact of COVID-19 and funding risk; and
3. Note the risk mitigating measures

1. REASONS FOR THE DECISIONS

1.1 Tower Hamlets Council as the Fund’s administering authority recognises that effective risk management is an essential part of good governance.

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 This report serves as a monitoring tool for funding level as well as acting as a risk management tool.

3. DETAILS OF REPORT

17 June 2020 funding and risk

3.1 The funding update is provided to illustrate the estimated development of the funding position from 31 March 2019 to 17 June 2020. At the last formal valuation, the Fund assets were £1,552m and the liabilities were £1,525m. This represented a surplus of £27m and equated to a funding level of 102%. At 17 June 2020 the actuary estimated that the funding level is unchanged at 102% as detailed in the table below.

June 2020 funding and risk report

HEADLINE

17 June 2020	Ongoing Funding (£m)
Assets	1,789
Liabilities	1,752
Surplus/(deficit)	37
Funding level	102%

Surplus/(deficit)	£m
Surplus/(deficit) as at 31/03/2019	27
Contributions (less benefits accruing)	(8)
Interest on surplus/(deficit)	(0)
Excess return on assets	219
Change in inflation & expected future investment return	(201)
Surplus/(deficit) as at 17/06/2020	37

3.2 The method and assumptions used to calculate the updated funding position are consistent with those disclosed in the reported assumptions for the last actuarial valuation at 31 March 2019. The financial assumptions have been updated to reflect changes in market conditions. The calculations contain approximations and the accuracy of this type of funding declines with time from the valuation. There has been extreme volatility in investment markets in response to COVID-19 global pandemic. This may impact both asset and liability valuations, but in particular the estimate of future investment returns. Estimated investment returns of c10.6% over the period since the valuation have been higher than expected. However, the outlook for future investment returns over the next 20 years on the Fund's portfolio of assets has fallen (from 4% to 3%), increasing the value placed on liabilities. A full breakdown of the impact of these changes on the funding surplus/deficit is included in the table below.

	31 March 2019	17 June 2020
Market yields (p.a.)		
Fixed interest gilts	1.49%	0.51%
Index-linked gilts	-1.81%	-2.37%
Implied inflation	3.36%	2.95%
AA corporate bond yield	2.36%	1.40%
Price Index		
FTSE All Share	3,978	3,465
FTSE 100	7,279	6,253
Expected future investment return (p.a.)		
20yr annualised return on Fund's asset portfolio*	4.0%	3.0%

*There is at least a 70% likelihood of the Fund's investments achieving a return of at least 3.0% p.a. over the next 20 years

*There was some extreme volatility in investment markets around the date of 31 March 2020, which may impact the likelihood estimates of expected future investment returns in this report.

COVID-19 and funding risks

3.3 COVID-19 has led to a worldwide increase in deaths and a significant shock to the global economy with large movements and increased volatility in stock market values and financial difficulties for some employers.

Whilst the short-term impact on the number of deaths and the economy is significant, it is unclear at this stage what will be the medium- and longer-term impact to be considered for example:

- The impact of recent market movements on the funding level since the 2019 actuarial valuation
- Impact of economic lockdown on employer covenant and risks
- The impact of higher death rates.

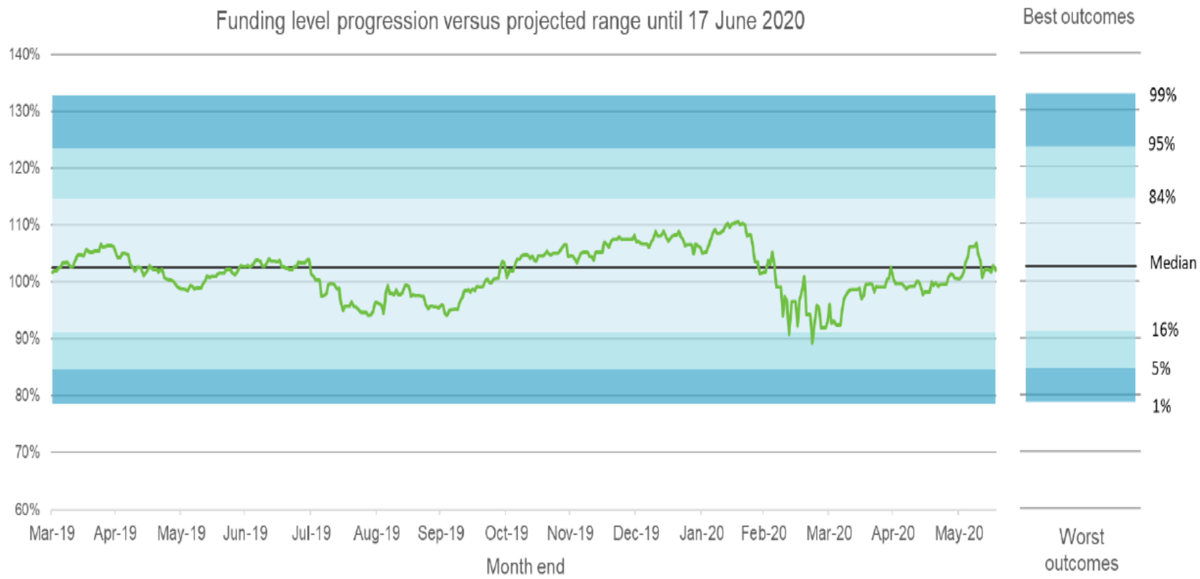
The focus of the funding strategy is to take a long-term view and ensure the circumstances of each employer in the Fund is taken into account.

Market movement impact

3.4 The chart below shows that at 26 June, the funding level remains within the 'corridor' of outcomes predicted by the actuary in the 2019 valuation. For the majority of the period of COVID-19 volatility, the funding level remained within the band consisting of two thirds of the outcomes (with a very short period when the level fell to having just lower than a 1 in 6 chance of occurring).

Employer covenant and risks

3.5 Many businesses and institutions in all sectors have been affected significantly by COVID-19. The impact will vary by sector and by source of funding. The main funding risks posed to the Fund by its participating employers are the inability to make contributions when thy fall due and or insolvency resulting in an employer ceasing in the Fund whilst a deficit exists, and that deficit therefore passing to remaining employers to Fund.



Employers in the Fund

3.6 Majority of employers in the Tower Hamlets Fund are public sector bodies, such as the council and academies where the covenant is strong and backed by statute or the Department of Education (DFE). These kinds of employers are unlikely to pose an insolvency risk to the Fund. Similarly, they are likely to make contributions when they fall due although some may face cash flow challenges.

Other employers like contractors tend to only participate in the Fund for a number of years depending on their contract duration. Most are closed to new entrants. Charities and other third sector employers may be the group most impacted although some may have reserves to call upon. Employers like leisure centres will be badly hit by lockdown although ceding council support may be available.

Future monitoring position of employers

3.7 The Fund will monitor the position of all employers, most importantly employers who are expected to cease in the near future and those whose revenue has been hard hit by COVID-19.

4. <u>RISK MITIGATION MEASURES</u>

4.1 The Fund will apply the following measures to mitigate risks outlines above.

- Market movements – monitor funding level, outlook for the long-term economy and asset returns on a regular basis, avoid revisiting contribution rates for long term employers and avoid reworking the 2019 valuation results.

- Employer covenant and risks – the policy for contribution deferral policy, ensure contracts, bonds and guarantees are in place and up to date. Seek to understand impact of covenant through sector analysis or direct engagement with employers, review funding position for employers likely to cease before 2023.

- Higher death rates - the Fund will ensure liquidity availability to pay increased death benefit payments. The Committee is asked to agree to £20m cash from Equity Protection for operational cash use. Communicate possibility of death in service strain to small employers

- Continue to monitor scheme longevity via Club Vita.

5. COMMENTS OF THE CHIEF FINANCE OFFICER

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

5.2 The employers' contribution rate for the London Borough of Tower Hamlets 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.

6. LEGAL COMMENTS

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

6.2 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.

6.3 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.

7. ONE TOWER HAMLETS CONSIDERATIONS

7.1 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.

7.2 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.

8. BEST VALUE (BV) IMPLICATIONS

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

8.2 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.

9. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

10. RISK MANAGEMENT IMPLICATIONS

10.1 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.

11. CRIME AND DISORDER REDUCTION IMPLICATIONS

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

Linked Reports, Appendices and Background Documents

Linked Report - NONE

Appendices
None

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

Officer contact details for documents:
Miriam Adams, Interim Pensions & Investment Manager
Email: miriam.adams@towerhamlets.gov.uk
Tel: 0207 364 4248