HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Panel:	Pension Fund Panel and Board
Date:	26 July 2019
Title:	Governance: 2019 triennial valuation
Report From:	Director of Corporate Resources

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Purpose of this Report

1. The purpose of this report is to provide the Panel and Board with information about the valuation process in the LGPS, and to give an update on progress for the 2019 valuation.

Recommendation(s)

2. It is recommended that the Panel and Board note the information contained in this report.

Executive Summary

3. LGPS funds have to obtain an actuarial valuation every three years. The main output from the valuation is a rates and adjustments certificate which certifies the contributions each employer must pay into the Fund over the following three years.

4. Work is underway for the current valuation which is as at 31 March 2019. Membership data will be supplied to the Fund Actuary by 26 July and initial whole of Fund results will be presented to the Panel and Board at their meeting on 27 September before being shared with employers at the Annual Employer meeting in October. Initial individual employer results will be provided to all employers by the end of December 2019, with the rates and adjustments certificate being finalised by 31 March 2020. New contribution rates are payable from 1 April 2020.

5. Following the Panel and Board’s approval of proposals to change the way in which employers are grouped for funding purposes, the 2019 valuation will see individual rates calculated for the main scheduled bodies in the Fund. A new academies pool and Town and Parish Council pool will be created.

6. Initial financial and demographic assumptions have been agreed with the Fund Actuary to feed into the 2019 valuation calculations.

Purpose of the triennial valuation

7. Each administering authority needs to ensure that the cost of pension promises in its fund can be met over the long term and is required by the LGPS regulations to obtain an actuarial valuation of the assets and liabilities of its fund as at 31 March every three years. The main output from the valuation is a rates and adjustments certificate, which certifies the contributions payable by each employer in the fund for the following three years. The valuation also provides an opportunity to review the Funding Strategy Statement and is a formal measure of the health of the fund.

8. In order to compare the assets and liabilities of the fund and calculate required employer contribution rates, the Fund Actuary must place a value on them. Assets are usually taken at market value, but to place a value on liabilities, the Actuary needs to:
   - make use of Fund specific data
   - make some assumptions about the future
   - carry out some calculations.

9. Consequently, the Pensions team has to provide full membership data to the Actuary in order that she can analyse fund experience over the past 3 years and to estimate benefits that will be payable. The Actuary can then set appropriate financial and demographic assumptions which are a best fit for the fund and build these into the valuation calculations.

Valuation timetable

10. Although the formal valuation is only carried out every 3 years, work is undertaken throughout the interim period to ensure that there are no surprises and that the fund continues to be able to pay its obligations. The current triennial valuation date is 31 March 2019 with new contribution rates applying from 1 April 2020.

11. Initial decisions about financial and demographic assumptions to be used in the valuation are made shortly after the valuation date so that the Actuary has

time to build them into the valuation model. These are discussed in more detail in paragraphs 24 to 32.

12. Details about all members for the three year period is provided to the Actuary by mid July following the valuation date. This data is extracted from the pension administration system, following the upload and validation of the annual returns submitted by scheme employers and the application of annual increases to benefits in payment and deferment and to CARE amounts held for members with membership after 1 April 2014.

13. Any data queries are resolved by the end of July so that the Actuary can then carry out the necessary calculations to produce whole of fund results by early September. These initial results are then discussed with officers and will be brought to the Panel and Board for discussion and agreement on the 27th September before being shared with employers at the AEM in October.

14. The Actuary will then calculate individual employer results and these will be sent to employers by the end of December 2019. There may be some discussion with employers about these rates but in the main, these initial results will be formalised in the rates and adjustments certificate which has to be signed by the Actuary by 31 March 2020.

Structure of the Fund for the valuation

15. Following approval by the PFPB at their meeting on 12 July, there will be changes to how contribution rates are calculated for employers at the 2019 valuation, compared with 2016.

    Scheduled Body Group

16. The Scheduled Body Group will be dismantled and instead the Actuary will calculate an individual contribution rate for each employer based on their own liabilities and notional share of the assets. The exceptions to this are academies and Town and Parish Councils. Academies who will be put into an academy pool and pay a common contribution rate based on the group's future service and share of the group's deficit . Town and Parish Councils who will be grouped together and pay a common future service contribution and an individual deficit contribution based on their own liabilities and likely future participation in the fund. Any TPC who elects by 15 August to do so, may choose not to participate in the pool but instead have an individual contribution rate calculated.

Admitted Body Group

17. The Admitted Body Group will continue with a refinement to its operation to allow different recovery periods more reflective of each employer’s likely future participation in the Fund. The two employers without a commitment from an associated local council to subsume liabilities on exit will be removed from the ABG and placed on the ongoing orphan funding target.

HE and FE sector

18. Employers in the HE and FE sector will continue to have an individual contribution rate calculated based on their own liabilities in the fund. The funding target for these employers will be the intermediate one on either a high, medium or low risk basis. This rating has been determined through AON’s financial analysis assessment that was carried out earlier in the year.

19. Broadly speaking this analysis tests the employer's:
    - ability to meet ongoing pension contributions out of operating income,
    - ability to meet interest payments on loans out of cashflow, and
    - capacity to meet an exit debt out of net assets.

20. To make this assessment Aon generates accounting ratios using the information provided by the employers, together with any relevant external information, for example financial notices of concern. In determining the appropriate risk category for the 2019 valuation Aon took into account trend information, including forecasts, and compared metrics across employers operating within the same sector to obtain a relative view of their strength as well as an absolute one.

21. Aon does consider wider geographical comparisons where they have similar information for LGPS employers in the sector which are operating in different geographical locations.

22. In order to assess the risk in relation to an employer's LGPS pension liabilities in advance of the 2019 valuation date Aon has to base this on the employer's liabilities at the 2016 valuation. Employers can ask for an updated assessment of their assets and liabilities to be used in the risk assessment but are required to pay for the additional actuarial work involved.

23. Employers who are on the intermediate funding target but disagree with their financial risk assessment can choose to pay for a full covenant assessment at around £10,000. It is anticipated that a session on the detail of these assessments will be held for affected employers on the afternoon of the Annual Employers Meeting in October. This will still leave employers with

sufficient time to request a full assessment in advance of their contribution rate being certified by the end of March 2020.

Initial financial and demographic assumptions

24. Prior to the membership data being available, the Actuary does some initial work on the assumptions that will be used at the valuation. This includes:

- agreeing the best fit market data for demographic assumptions
- determining the likely funding target for different groups of employers
- agreeing the CPI and pay growth assumptions
- discussing any other likely factors that will need to be allowed for in the calculations

A starting point for each of these assumptions has been agreed in discussions with officers so that the Actuary can run the calculations through when the membership data is available and produce initial results for the fund. The assumptions will then be reviewed, and where necessary refined, to ensure that they are appropriate, and in line with expectations from the bodies which oversee the LGPS such as the Government Actuary's Department and the Scheme Advisory Board.

25. The Fund Actuary has determined that the latest version of the CMI mortality tables which was published in March 2019 is the best fit for use in the current valuation. This has been agreed by officers.

26. There are different funding targets for different groups of employers, based on the likely future participation in the fund:

- one for secure scheduled bodies
- an intermediate funding target for non tax payer backed scheduled bodies (differentiated for high medium and low risk employers within this sector)
- An ongoing orphan funding target for employers who still have active members but are likely to exit the scheme in the short term.

27. The secure scheduled body target is derived from three elements; solvency target, trajectory period and Probability of Funding Success (PoFS). It is proposed that this methodology remains unchanged from the 2016 valuation, but that the solvency target methodology is simplified and the PoFS is strengthened to reflect the improved funding levels. (The PoFS was pushed out to 71% following the market crash in 2008, so it is right to bring it back to its pre 2008 level of 75% now markets have recovered; increasing the POFS to 75% remains the aspiration for this valuation subject to affordability within the overall valuation results.

28. The intermediate funding target is set with the objective of maintaining affordability whilst targeting a gilts based exit position for these employers. The Actuary therefore used a ‘gilts plus’ figure at the 2016 valuation. As gilts yields have continued to fall since 2016, it is proposed that a greater allowance is made for asset outperformance in the investment strategy such that the impact of falling gilt yields on the discount rate is reduced. The impact of this proposed measure is to increase the difference between the discount rate for secure employers and those on the intermediate target but by less than would be required based purely on the change in gilt yields.

29. The Actuary has recommended a CPI assumption of 2.1% which represents no change in approach from 2016 and is based on the long-term RPI from Aon's Capital Market Assumptions (CMAs) of 3.2% less an allowance for an assumed RPI-CPI gap of 1.1%.

30. The pay growth assumption has become less important since the removal of the final pay link to future service. However the assumption will have an effect on the impact of the McCloud judgement, as any remedy could potentially increase the number of people for whom benefits are based on final pay instead of CARE. After discussions with officers, it was agreed that this should be reduced from the 2016 level of 3.6% to better reflect actual experience and likely future expectations now that the impact of the introduction of the living wage has worked through.

31. The Actuary will need to allow for the impact of the McCloud judgement. The Scheme Advisory Board has issued guidance to funds that if no further information is available by 31 August funds should value known benefits. However AON will provide advice on McCloud with a recommendation for the approach by 26 July (which ideally will be consistent across Aon-advised funds and more widely across the LGPS). Aon will show the impact of McCloud on contribution rate calculations for the Panel at the meeting in September, and at the AEM so that the implication of McCloud can be clearly seen.

32. From the work already carried out by the Actuary, it is anticipated that there will be a material improvement in the funding level at a whole of fund position. This results in a material reduction in the level of deficit contribution that will be required from each employer which should translate into stable contribution rates, and possibly reductions for employers who were part of the scheduled body group at the 2016 valuation. However, given the significant falls, employers with a funding target linked to gilts may see increases in their contributions at this valuation. The Actuary will work with the Administering Authority to ensure that any increases are stepped to allow continued affordability of the scheme to employers.

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	yes/no
People in Hampshire live safe, healthy and independent lives:	yes/no
People in Hampshire enjoy a rich and diverse environment:	yes/no
People in Hampshire enjoy being part of strong, inclusive communities:	yes/no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires the Pension Fund Panel and Board to note the information contained within it.	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document	Location
None	

EQUALITIES IMPACT ASSESSMENT:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionally low.

2. Equalities Impact Assessment:

Equality objectives are not considered to be adversely affected by the information in this report as it affects all scheme members.