**HAMPSHIRE COUNTY COUNCIL**

**Decision Report**

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| **Decision Maker:** | Pension Fund Panel and Board |
| **Date:** | 28 July 2022 |
| **Title:** | Governance – Triennial valuation |
| **Report From:** | Director of Corporate Operations |


**Contact name:** Lois Downer

**Tel:** 0370 779 4396 **Email:** lois.downer@hants.gov.uk


## 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 2022 valuation.

## Recommendations

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 2022. Membership data will be supplied to the Fund Actuary by 21 July 2022 and initial whole of Fund results will be presented to the Panel and Board by the Actuary at their meeting on 30 September 2022 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 2022, with the rates and adjustments certificate being finalised by 31 March 2023. New contribution rates are payable from 1 April 2023.

5. Initial financial and demographic assumptions have been agreed with the Fund Actuary to feed into the 2022 valuation calculations.

**Purpose of the triennial valuation**

6. 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.

7. 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.

8. 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**

9. 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 2022 with new contribution rates applying from 1 April 2023.

10. 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 23 to 30.

11. 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.

12. 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 30 September 2022 before being shared with employers at the AEM in October.

13. The Actuary will then calculate individual employer results and these will be sent to employers by the end of December 2022. 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 2023.

**Structure of the Fund for the valuation**

14. The structure of the Fund for valuation purposes remains unchanged from the 2019 valuation.

    Scheduled Bodies

15. The Actuary will calculate an individual contribution rate for each Scheduled body employer based on their own liabilities and notional share of the assets. The exceptions to this are academies and Town and Parish Councils. Academies are treated as part of 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 are also 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 mid August to do so, may choose not to participate in the pool but instead have an individual contribution rate calculated.

    Admitted Body Group

16. Employers in the Admitted Body Group now all have a commitment from an associated local council to subsume liabilities on exit. The Group operates with different recovery periods reflective of each employer's likely future participation in the Fund.

    HE and FE sector

17. Employers in the HE and FE sector 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.

18. 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.

19. 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 2022 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.

20. Aon also considers wider geographical comparisons where they have similar information for LGPS employers in the sector which are operating in different geographical locations.

21. In order to assess the risk in relation to an employer's LGPS pension liabilities in advance of the 2022 valuation date Aon has to base this on the employer's liabilities at the 2019 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.

22. 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 in advance of their contribution rate being certified by the end of March 2023.

**Initial financial and demographic assumptions**

23. One of the three aims of the Fund as set out in the Funding Strategy Statement is to enable primary contribution rates to be kept nearly constant as possible (subject to the administering authority not taking undue risk) at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies, while achieving and maintaining fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the Fund and employers, and the risk appetite of the administering authority and employers alike. It is with this aim in mind that the key assumptions used in the valuation are determined.

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

25. 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.

26. The Fund Actuary has determined that the latest version of the CMI mortality tables which was published in March 2022 is the best fit for use in the current valuation. This has been agreed by officers.

27. 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.

28. The secure scheduled body target is derived from three elements; solvency target, trajectory period and Probability of Funding Success (PoFS). Officers have agreed that these elements remain unchanged from the 2019 valuation, subject to a final review once the draft valuation results are known:

- Consistent with the 2019 valuation, the solvency target is based on a long term prudent investment return of CPI plus 2% per annum.
- The trajectory period was set at 25 years at the 2019 valuation, having been increased from 22 years at the 2016 valuation. It is appropriate to retain this at 25 years for the 2022 valuation.
- The PoFS was increased back to 75% at the 2019 valuation and officers have agreed it is appropriate to maintain this level of prudence for 2022.

29. The Actuary has recommended a CPI assumption of 2.3% which represents an increase of 0.2% from 2019 and is based on the long-term inflation

assumption from Aon's Capital Market Assumptions (CMAs). However because the April 2023 pensions increase will be based on the full year CPI from September 2021 to September 2022 Aon are also recommending a one off uplift of 5% on the scheduled body funding target for the short term inflation which is not fully reflected in CMAs. Short term inflation expectations are effectively priced into the ongoing orphan target due to this being connected to gilts.

30. The intermediate funding target is set with the objective of maintaining affordability whilst targeting a gilts based exit position for these employers. As gilts yields have continued to fall a greater allowance was made for asset outperformance in the investment strategy such that the impact of falling gilt yields on the discount rate is reduced. This then increased 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. For the 2022 valuation, this approach is likely to be maintained, with the inflation assumptions for the intermediate funding target being linked to those for secure scheduled bodies, rather than tied to that of gilts.

31. The pay growth assumption has become less important since the removal of the final pay link to future service. However the assumption does 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. The assumption was reduced from 3.6% to 3.3% at the 2019 valuation, and it is recommended that this is retained for 2022.

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 compared with 2019, due to the higher than assumed asset returns. This means that secure scheduled bodies should be able to bank the deficit contribution reduction from the 2019 valuation and still see stable contribution rates at the 2022 valuation; this of course is a provisional view at this stage subject to confirmation once the valuation work is complete.

33. However, given the significant falls, employers with a funding target linked to gilts such as the HE/FE sector may see increases in their contributions at this valuation; as above, this is a provisional view subject to confirmation. The Actuary will work with the Administering Authority to ensure that any increases are stepped to allow continued affordability of the scheme to employers.

**Climate change**

34. The potential impact of climate change needs to be quantified and documented in the 2022 valuation. Aon have been commissioned to provide analysis on different climate change scenarios which will:

- test the resilience of the Fund's investment and funding strategies to climate change shocks
- assess the potential impact of the future global economy and therefore the impact to the assets and liabilities of the Fund
- meet regulatory requirements in relation to climate change related reporting and expectations such that the Fund can evaluate the way in which climate-related risks may affect the strategies and plans of the Fund and report on this activity in a consistent and transparent manner

35. Aon's analysis will cover three scenarios:

- Orderly transition; the Paris-aligned scenario with immediate and co-ordinated action to tackle climate change taken using carbon taxes and environmental regulation
- Disorderly transition; delayed and limited action taken and insufficient consideration given to sustainable long-term policies to manage global warming
- No transition; no new climate policies are implemented leading to significant global warming and dramatic long term impacts.

36. As part of their work, Aon will provide statistics required for TCFD reporting, summaries of the impact on expected investment returns under each scenario over the short, medium and long term as well as the impact on future overall employer contribution rates. The valuation report will cover the basic requirements to meet the Government's Actuary's Department's expectations with the additional analysis provided in a separate report for the Fund.

**Climate Change Impact Assessments**

1. Hampshire County Council utilises two decision-making tools to assess the carbon emissions and resilience of its projects and decisions. These tools provide a clear, robust, and transparent way of assessing how projects, policies and initiatives contribute towards the County Council's climate change targets of being carbon neutral and resilient to the impacts of a 2℃ temperature rise by 2050. This process ensures that climate change considerations are built into everything the Authority does.

2. The Pension Fund itself has a negligible carbon footprint, but it recognises that the companies and other organisations that it invests in will have their own carbon footprint and a significant role to play in the transition to a lower carbon economy. Therefore the Pension Fund recognises the risk that environmental, social and governance (ESG) factors including the impact of climate change can materially reduce long-term returns. The Pension Fund has a role to play as an investor, in ensuring that its investment managers are suitably considering the impact and contribution to climate change in their investment decisions and acting as a good steward to encourage these companies to play their part in reducing climate change. This is explained

further in the Pension Fund's RI policy
InvestmentStrategyStatementincludingRIpolicy.pdf (hants.gov.uk).

**REQUIRED CORPORATE AND LEGAL INFORMATION:**

**Links to the Strategic Plan**

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| **Hampshire maintains strong and sustainable economic growth and prosperity:** | no |
| **People in Hampshire live safe, healthy and independent lives:** | no |
| **People in Hampshire enjoy a rich and diverse environment:** | no |
| **People in Hampshire enjoy being part of strong, inclusive communities:** | no |
| **OR** | |
| **This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because:**<br>For the ongoing management of the Hampshire Pension Fund. | |

**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 proposals in this report as the proposals do not directly affect scheme members.