Committee:	Date:
Finance Committee	18 February 2020
Subject: Pension Fund – Actuarial Valuation as at 31 March 2019	**Public**
Report of: The Chamberlain	**For Decision**
Report author: Kate Limna – Chamberlain's Department	

Summary

Administering Authorities of the Local Government Pension Scheme (LGPS) are required to arrange triennial valuations of the Pension Fund in order to establish appropriate employer contribution rates for the following three-year period (i.e. from 1 April 2020 to 31 March 2023). The preliminary results of the Pension Fund Actuarial Valuation as at 31 March 2019, undertaken by the Fund's Actuary, Barnett Waddingham LLP, have now been received and is appended (Appendix A).

The overall funding level of the Pension Fund has increased from 84% as at 31 March 2016 to 90% as at 31 March 2019 and the deficit has decreased from £149m to £113m. This has primarily resulted from better than expected investment returns as well as prudent changes to financial and demographic assumptions used by the Actuary in valuing the Fund's liabilities (promised benefits to be paid in future).

Six years ago, a 20 year deficit recovery plan was established; and the City Corporation is on track to recover the deficit over the remaining period. Setting the employer contribution rates to fund the deficit over the next 14 years results in the average employer's contribution rate remaining at 20.7%. Because the Actuary assesses each employer's funding position on an individual basis, the actual contribution levels due from individual employers will vary. The City of London Corporation and most admitted bodies will pay 21.0% per annum. Contribution rates for four employers (the Museum of London, City Academy, City of London Academies Trust and the London CIV) will differ.

The Government Actuary's Department will be scrutinising the assumptions used by LGPS actuaries to ensure that employers are taking a sufficiently prudent approach to financing LGPS benefits and results will be published.

Recommendations

Members are asked to agree that:

- The Pension Fund deficit recovery period is set at 14 years from 2020/21 and:
- The employers' overall contribution rate remains at 20.7% with the City of London Corporation's contribution rate remaining at 21.0% for the financial years 2020/21, 2021/22 and 2022/23.

Main Report

Background

1. The City of London Pension Fund (the Pension Fund) is part of the Local Government Pension Scheme. The Pension Fund is administered in-house by the City of London Corporation on behalf of the participating employers. At the end of March 2019, the Pension Fund had ten active employers the largest of which is the City of London, followed by the Museum of London. Teachers, judges and police officers have their own pension schemes and are not included in the Pension Fund.
2. Under Regulation 62 of the Local Government Pension Scheme Regulations 2013 (the Regulations), Administering Authorities are required to arrange triennial valuations of the Pension Fund in order to establish appropriate employer contribution rates for the following three year period i.e. from 1 April 2020 to 31 March 2023. The contribution arrangements certified by the Actuary following the valuation must be set to ensure solvency of the Fund and the long term cost efficiency of the Scheme – i.e. to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the Pension Fund and that contribution rates are set at an appropriate level.
3. The purpose of this report is to advise members of the outcome of the 2019 Pension Fund valuation undertaken by Barnett Waddingham LLP and the consequent impact on the employers' contribution rates for the three years commencing 1 April 2020.
4. The summary report is appended at Appendix A.

Previous Valuation

5. The last formal actuarial valuation of the Fund was carried out as at 31 March 2016.
6. The results of that formal valuation indicated that the assets of the Fund represented 84% of the accrued liabilities as at 31 March 2016 and the total annual contribution required across the Fund was 20.7% of payroll for the period 1 April 2016 to 31 March 2019, This average employer contribution rate assumed that the past service funding level would be restored to 100% over a period of 17 years. The rate certified for the Corporation as an employer and based on its own position in the Fund was 21.0% of pay per annum, an increase of 3.5% on the previous rate.

Valuation Process and Assumptions

7. When undertaking a valuation, Regulation 62 specifies four requirements that the Actuary "must have regard to" as follows:
    - The desirability of maintaining as nearly constant a primary rate as possible;
    - The current version of the administering authority's funding strategy statement;
    - The requirement to secure the solvency of the Pension Fund; and
    - The long term cost efficiency of the Scheme (i.e. the LGPS for England and Wales as a whole), so far as relating to the Pension Fund.
8. The Government Actuary's Department (GAD) on behalf of the Ministry for Housing, Communities and Local Government (MHCLG) will be scrutinising the assumptions used by LGPS actuaries to ensure that employers are taking a sufficiently prudent approach to financing the LGPS benefits and they will be publishing a report to identify any Pension Funds that cause concerns in respect

of solvency and long term cost efficiency. GAD's report is not expected to be published until late 2021 as it is based on the final certified contribution rates.

Funding Model

9. A very similar funding model (the approach used to derive the assumptions) to that used in previous years has been used for the 2019 valuation. The key features are as follows:

    - *Inflation*: Future levels of Retail Price Index (RPI) inflation are based and derived by considering the difference between index-linked gilts and fixed interest gilt yields over the 6 month period straddling the valuation date. CPI Inflation is assumed to be 1.0% lower than RPI because of the different statistical methodology used to calculate the measure and due to differences in composition.

    - *Salary increases:* The LGPS was a final salary scheme for benefits earned prior to 1 April 2014 but is now a career average revalued earnings (CARE) scheme so that benefits earned after 1 April 2014 are increased in line with CPI inflation rather than salary increases. The overall effect of the salary increase assumption is less than it was previously.

    - *Discount Rate*: The discount rate used to discount future payments to and from the Pension Fund and so determine the value placed on the liabilities reflects a neutral view of the expected net return that will be earned by the actual investment strategy adopted by the Pension Fund.

    - *Assets:* Rather than take the market value of the assets at the valuation date, the Actuary has used a figure based on the average market values over the 6 month period straddling the valuation date.

    - *Prudence Allowance:* a margin for prudence is subtracted from the discount rate to account for inherent uncertainties around future investment returns and other assumptions. The prudence allowance used in the latest valuation is 1.2% per annum (compared to 1.0% in 2016). The increase reflects greater uncertainty around regulatory developments concerning McCloud and the cost management process (see para 12 below).

    - *Mortality:* the Actuary makes several demographic assumptions, the most important of which is post-retirement mortality. These assumptions have been reviewed by the Actuary to take account of the latest available mortality data and to ensure they remain appropriate for the Fund. **The principal change to the mortality assumptions in the current valuation is a *slowing down* in the rate of improvement of long-term life expectancy.**

Regulatory Uncertainties

10. There are currently a few important regulatory uncertainties surrounding the Scheme which the Actuary has had to consider during the 2019 valuation as follows:

    - "McCloud" and "Sargeant" judgements – members of the judges' (McCloud) and firefighters' (Sargeant) pension schemes have successfully challenged transitional arrangements implemented following the 2015 public sector pension scheme reforms on the basis of age discrimination. The Government has exhausted the appeals process and confirmed that it will make remedies to all public service pension schemes, including the LGPS. The exact nature and scope of the remedy is yet to be determined.

- The cost cap mechanism – the cost cap was brought in following Lord Hutton's review of public service pensions with the aim of providing protection to taxpayers and employees against unexpected changes in pension costs. HM Treasury conducted a cost cap valuation in 2016 which revealed a fall in member costs (e.g. costs relating to mortality) indicating that an enhancement of scheme benefits was required. Changes were due to be consulted on and implemented from April 2019. However, in December 2018 the Government announced a pause in the cost cap process due to the McCloud and Sargeant employment tribunal cases noted above.

It is still unclear what these changes will mean for the LGPS. In May 2019 the Scheme Advisory Board advised administering authorities to consider how they approach the additional risks that these potential extra costs may pose. For the City of London, the Fund Actuary has imposed an increase to the prudence allowance (as noted in para 11 above) to address these uncertainties.

11. Another uncertainty relates to the timing and frequency of future actuarial valuations. MHCLG are considering the implications of moving the triennial local Fund valuations to a quadrennial basis to match the national scheme valuation and the outcome of a consultation undertaken in 2019 is awaited. As such, the next actuarial valuation could be delayed until 2024 and therefore it is unclear how many years of contributions the Actuary will need to certify as part of the 2019 valuation. However, there is a proposal enabling interim valuations as well as a requirement for funds to reassess funding positions and contribution rates prior to 2024, should this be required.

Initial Review of Assumptions

12. The Fund Actuary presented the initial draft valuation results to Members (Clare James, Randall Anderson, Paul Martinelli and Andrien Meyers) and Officers (the Deputy Chamberlain, the Corporate Treasurer and Group Accountant for Pensions & Treasury) in November. This initial review enabled scrutiny and challenge of the various actuarial assumptions used by the Actuary, as detailed in paragraph 10. The initial review concluded that all the Actuary's key assumptions – including those used for determining future investment returns, inflation and life expectancy – are reasonable.

Current Pension Fund Position

13. The deficit recovery plan at the last revaluation was set at 17 years. The overall funding level of the Pension Fund has increased from 84% as at 31 March 2016 to 90% as at 31 March 2019 and the deficit has decreased from £149m to £113m.

14. In order to maintain the current deficit recovery plan, contribution rates should be set with a view to achieving 100% funding in 14 years. This results in the average employers' contribution rate remaining at 20.7% for the City of London and the admitted and scheduled bodies.

15. The actual contribution rates due from each participating employer vary because the Actuary assesses each employer's funding position on an individual basis. The

City of London Corporation and most admitted bodies will pay a total contribution rate of 21.0%. Exceptions to this are:

a) The Museum of London, which will continue to pay the same rate of 16.1% as it is currently paying in 2019/20;

b) The City Academy which will continue to pay a contribution rate of 17.1%;

c) The City of London Academies Trust which will also pay a contribution rate of 17.1% (this employer has been paying the City of London Corporation's assessed rate of 21.0% since joining in 2017/18); and

d) The London CIV whose employer rate is to be confirmed

Financial Implications

16. Should the proposal on the employer's rate be agreed, the effect on the City's budgets and on other employer costs will be neutral. No adjustments to budgets or financial resources levels will be necessary and it is suggested that this is a prudent approach.

Conclusion

17. The City Corporation remains on track to recover the deficit over the remaining term of the recovery plan; and it is proposed that employer contribution rates remain the same, with the exception of the City of London Academies Trust (whose contribution rate will be reduced) and the London CIV (whose rate is to be confirmed). The overall funding level of the Pension Fund has increased from 84% as at 31 March 2016 to 90% as at 31 March 2019 and the deficit has decreased from £149m to £113m which is mainly due to changes in actuarial assumptions.

18. It is believed that this approach represents an appropriate balance of prudence and affordability.

Appendices

Appendix 1 – Summary Report – Actuarial Valuation as at 31 March 2019

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