City of London Corporation Pension Fund

Section 13 summary report

Introduction

This paper has been requested by City of London Corporation, as Administering Authority to the City of London Corporation Pension Fund.

This paper summarises the review of the actuarial valuations of LGPS Funds as at 31 March 2019 as carried out by the Government Actuary's Department (GAD), under section 13 of the Public Service Pensions Act 2013 ("the Section 13 valuation"). This paper also sets out the results of this review in relation to the City of London Corporation Pension Fund ("the Fund").

For the avoidance of doubt, the formal actuarial valuation is still carried out by ourselves as the Fund's actuary based on assumptions set locally and agreed with the Fund. The key objectives of the formal valuation are to check the financial position of the Fund and to set employer contribution rates for the subsequent 3 years. The Section 13 valuation does not directly impact employer contribution rates but is an influencing factor.

Background

The Section 13 valuation carried out by GAD is based on the formal actuarial valuations of 88 English and Welsh LGPS Funds, as carried out by their Fund actuary. The Section 13 valuation adopts standard assumptions for all LGPS Funds with the aim of providing a level playing field so that Funds can be compared on more of a like for like basis.

For the purposes of comparing Funding levels, GAD use a standardised basis consistent with the basis used by the Scheme Advisory Board for comparing Funds. For the other tests GAD undertake they use their "best estimate" basis across all Funds.

In summary, one of the purpose of the Section 13 valuation is to identify any outlying Funds measured against the following objectives:

1) Compliance – whether, in their view, the actuarial valuation has been carried out in accordance with the Regulations;

2) Consistency – whether, in their view, the actuarial valuation has been carried out "not inconsistently" with other Funds;

3) Solvency – whether, in their view, a Fund has sufficient assets together with employer and employee contributions to pay all the benefits due over the long term; and

4) Long term cost efficiency – whether, in their view, a Fund is receiving sufficient contributions to meet the cost of benefits accruing and to repair any existing deficit over an appropriate period.

To identify whether these objectives have been met GAD is using colour coded flags for each Fund:

Flag colour	Meaning
Red	Indicates a material issue that may result in the aims of section 13 not being met. In such circumstances remedial action to ensure solvency and/or long term cost efficiency may be considered.
Amber	Indicates a potential material issue that we would expect Funds to be aware of. In isolation this would not usually contribute to a recommendation for remedial action in order to ensure solvency and/or long term cost efficiency.
White	A new flag this time round and is an advisory flag that highlights a general issue but one which does not require an action in isolation. It may have been an amber flag if they had broader concerns.
Green	Indicates that there are no material issues that may contribute to a recommendation for remedial action in order to ensure solvency or long term cost efficiency.

Overall, there has been an improvement in the Funding position of the LGPS with over 62 of the Funds (71%) now being in surplus on GAD's best estimate basis and an aggregate best estimate Funding level of 109%. This compares to 60 Funds in surplus and an aggregate Funding level of 106% in 2016. The main reason for this improvement has been the asset outperformance over the intervaluation period. As usual the Section 13 valuation is not used to set employer contribution rates but functions as a comparator between the individual LGPS Funds.

The Section 13 valuation has calculated a large number of measures to help GAD consider the above objectives and uses a flagging system to identify any outlying Funds. Having been identified as an outlier, the outlying Fund would be expected to put a plan in place to help improve their position.

However, this application of measures is not helpful when each is considered in isolation and a more holistic view is required. For example, a reader may conclude that significant contribution increases may be required for a particular Fund at the next formal Funding valuation, when in fact, this might not be the case.

Moreover, as flags usually indicate deviations from other Funds this does not necessarily mean there are problems with the Fund itself as each Fund is different and requires a tailored approach to Funding and setting contribution rates.

Summary of overall results

This section summarises the key points against the objectives above.

Compliance

All LGPS actuarial valuation reports complied with Section 13, meeting the requirements of the LGPS regulations. However, the report points out that additional clarity on how contributions are set would be useful.

Consistency

There are no flags raised for any Fund under the objective of consistency. GAD's interpretation of the consistency requirement (or lack of non-consistency) is such that valuations should have "consistent" rather than "not inconsistent" assumptions unless local circumstances justify something different. Compared to 2016 consistency has improved in relation to key assumptions but GAD would still prefer a higher level of consistency to increase ease of comparability between the Funds.

As expected, there are differences in financial and demographic assumptions across LGPS Funds. This is valid and appropriate as Funds have different investment strategies which affects the assumed discount rate and different membership profiles which affects the demographic assumptions.

For example, the life expectancy of members is very different in different parts of the country and an investment strategy that has a heavy growth allocation should in theory over the long term provide a higher return than a more defensive strategy.

The report does acknowledge that assumptions can be expected to vary between Funds and that this is not a problem in itself as long as the local circumstances driving the assumptions are made transparent. Compared to 2016 there has been an improvement in said transparency but further progress is still encouraged.

The report welcomes that in terms of presentation, consistency has improved significantly with the move to a common dashboard. However, there is room for improvement with respect to the presentation of discount rates, secondary contribution rates and each Fund's recovery plan objectives.

The report puts a strong focus on emerging issues where consistency between the Funds is considered to be useful and dialogue between actuarial advisors is encouraged. These issues are climate risk, allowance for Covid-19, the McCloud remedy, and academy conversions.

Recommendations

The report explicitly recommends the Scheme Advisory Board to consider whether a consistent approach for academy conversions and the McCloud remedy should be adopted. In our view, the academy conversion approach does not fall under the remit of Section 13 but we appreciate the desire to find some consistency in the treatment of academies in the LGPS and we are working with GAD to explore the various options to try and achieve this.

Similarly, there was insufficient information regarding McCloud at the time of the 2019 valuations to ensure a consistent approach, and our approach was discussed and agreed with GAD at the time. We are engaging with GAD in advance of the 2022 valuations to understand their views on McCloud, however in the absence of new Regulations and the fact that the Universal Data Extract (the membership data file structure and content that is produced for actuarial valuations) is still not able to output the data we need, we are in a similar place to 2019.

Solvency

Where a Fund achieved a green flag on solvency, this demonstrates that in GAD's opinion, the Fund's assets and contribution levels should be sufficient to meet all the benefits over the long term. Most Funds demonstrated they met the objective of solvency, with 72 out of the 88 Funds as at 2019 achieving a green flag. While this is around the same level as in 2016 the situation has overall improved as only white flags were raised this year which are used for general issues that require no action in isolation.

The City of London Corporation Pension Fund achieved green flags on all solvency measures.

The measures used are the following:

- *SAB Funding level:* The Funding level on the SAB standardised basis. In 2016 the City of London Corporation Pension Fund received an amber flag on this. As the Fund's funding level has improved (from 84% in 2016 to 92% in 2019) the Fund received a green flag for their standardised funding level in 2019.
- *Non- Statutory Employees:* The proportion of active members employed by employers without tax raising powers or statutory backing. This is a proxy for the proportion of higher risk employers and therefore liabilities the Fund has as these employers do not have any form of guarantee. A low percentage is a good result as it means the Fund is less exposed to default risk from employers who may not be able to pay any shortfall if they leave the Fund or become insolvent.
- *Asset shock:* This measures the change in the average employer pension costs as a percentage of what is called "core spending" if there was a fall in markets and the Fund's "growth" assets– essentially non bonds - fell by 15% and never recovered. A lower percentage is regarded as good here as it indicates that employer contributions are more resilient to market volatility. Similar to 2016 the asset shock for the Fund has been assessed as a percentage of pensionable pay instead of "core spending power" to reflect the unique way the Corporation is funded.
- *Employer default:* This is the change in average employer contributions if all employers without tax raising powers/statutory backing cannot repay their deficit amount as calculated at the 2019 valuation. A low percentage means the Fund is less exposed to default of more risky employers and the impact on employer contribution rates would be low.

The results for the Fund are set out below:

SAB Funding level	Non-Statutory employees	Asset shock	Employer default
92.4%	10.9%	3.6%	0.5%

Please see the Appendix for distribution of the individual SAB funding levels of all Funds.

Long term cost efficiency

Where a Fund achieved a green flag under Long Term Cost Efficiency, this demonstrates that the contributions being paid are, in GAD's view, sufficient to meet the cost of benefits accruing and to repair any deficit over an "appropriate period". In particular, it demonstrates the Fund is not deferring payments excessively so that they unfairly impact future generations.

In 2019, four Funds received at least one amber flag in relation to long term cost efficiency which is a small improvement on 2016 when six Funds were flagged.

City of London Corporation received two amber flags and three green flags in terms of long term cost efficiency.

The measures used are the following:

- *Implied deficit recovery period:* This measures the time it will take to pay off the Section 13 best estimate deficit at the current level of deficit contributions. **The Fund received an amber flag.** The reason for this is that the recovery period is higher than GAD's arbitrary threshold of ten years. This would have been reversed to a white flag had this been the only issue flagged in terms of long term cost efficiency.

- *Required return:* This determines the return the Fund's assets need to achieve to be fully funded in 20 years' time on the Section 13 best estimate basis. A lower required return means a lower bar for the Fund to exceed and so a greater chance of doing so. **The Fund received a green flag.**
- *Repayment shortfall:* The difference between the Fund's total contributions (primary and secondary) and the total contributions on a standardised best estimate basis (primary and secondary using a deficit recovery period of 20 years) expressed as a percentage of payroll. This measures the affordability of the best estimate deficit and the higher this figure is the better. **The Fund received a green flag.**
- *Return scope:* The estimated return that the Fund's investment strategy is expected to deliver, in excess of the required return. **The Fund received an amber flag.** The reason for this is that the return scope was between 0% and 0.5% (under GAD's rather arbitrary rules, a negative value would have led to a red flag and a value exceeding 0.5% would have led to a green flag). This would have been reversed to a white flag had this been the only issue flagged in terms of long term cost efficiency.
- *Deficit reconciliation:* This is a check on whether the current deficit recovery period is a continuation of the previous deficit recovery period. **The Fund received a green flag.**

The results for the Fund are set out below:

Implied deficit recovery period (GAD basis)	Required return	Repayment shortfall	Return scope	Deficit reconciliation
15	4.1%	1.2%	0.3%	Green

The amber flags are mainly caused by the Fund's contribution rates being relatively low given GAD's best estimate deficit. However, this does not mean that the contribution rates are too low in absolute terms as they are set at a level that aims for a fully funded position in 2033. The report does in fact acknowledge that the deficit recovery end point at 2033 has been maintained over the last three valuations.

The report also says "Following engagement with the City of London Corporation Pension Fund we were advised that employers have been adhering to their plan to remove the deficit by 2033. We were reassured by this long-term commitment". The amber flags therefore only mean that compared to other Funds with similar best estimate funding levels the contributions paid by employers in the City of London Corporation Pension Fund are lower than other Funds.

We have already voiced our opinion that using a common best estimate basis is not a good way to assess whether contribution rates are sufficient. The actuarial valuation is a complex process that produces employers' contribution rates in accordance with local Funding Strategy Statements, the views on the economic outlook, attitude to risk and funding objectives which will all impact the financial assumptions but are not reflected in the common best estimate basis.

Recommendations

There are several more recommendations in this section of the report:

- The recommendation for SAB to ensure that the Funds' recovery plans are continuations of the plan set up at the previous valuation. We disagree with GAD's interpretation of the CIPFA guidance in relation to deficit recovery periods. GAD's view is that they would not expect to see Funds reducing contributions and extending recovery periods. Our continued interpretation of the guidance is that the focus shouldn't be on a fixed end point, rather a period over which it is appropriate to Fund any appearing deficit. If a recovery period is too short then there could be unnecessary burden placed on current tax payers and it is more important to focus on the stability of contributions for affordability and cashflow reasons.
- The recommendation is that Fund actuaries provide additional information about total contributions, discount rates and reconciling deficit recovery plans in the dashboard. We consider the dashboard, which was introduced in 2019, useful and conversations have already started between the four actuarial firms and GAD for the 2022 valuation and we do not foresee a significant number of changes.
- The recommendation for SAB to review asset transfer arrangements from local authorities to ensure that appropriate governance is in place around any such transfers to achieve long term cost efficiency. Although we do not agree with some of the terminology and references made by GAD regarding asset transfers, we appreciate the overriding desire to ensure that appropriate governance and paperwork is in place when additional contributions are made in the form of assets rather than cash. This is an action that is becoming more prevalent in LGPS Funds and therefore having a clear reporting process in place is welcomed.

Conclusion

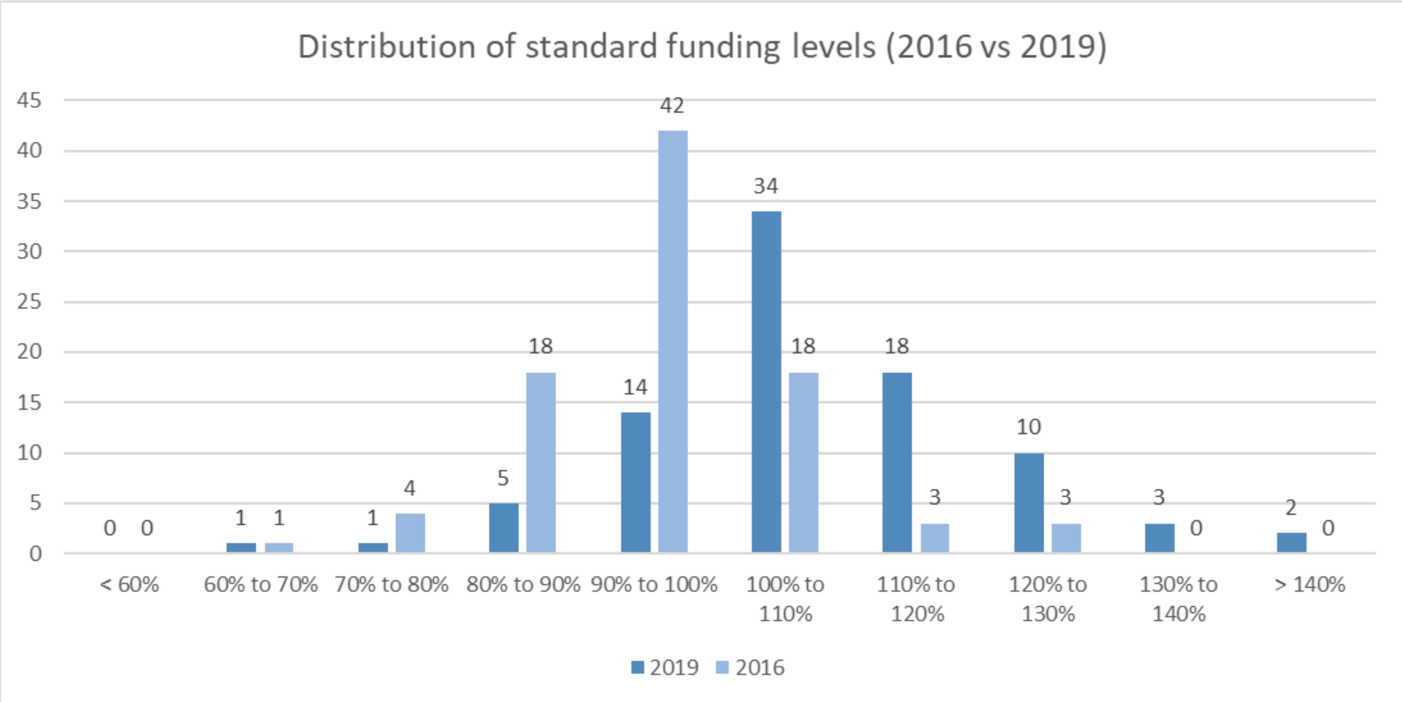
The City of London Corporation Pension Fund has met all the criteria of the Section 13 valuation, except for the level of contributions which were lower relative to other Funds with similar funding levels, raising amber flags.

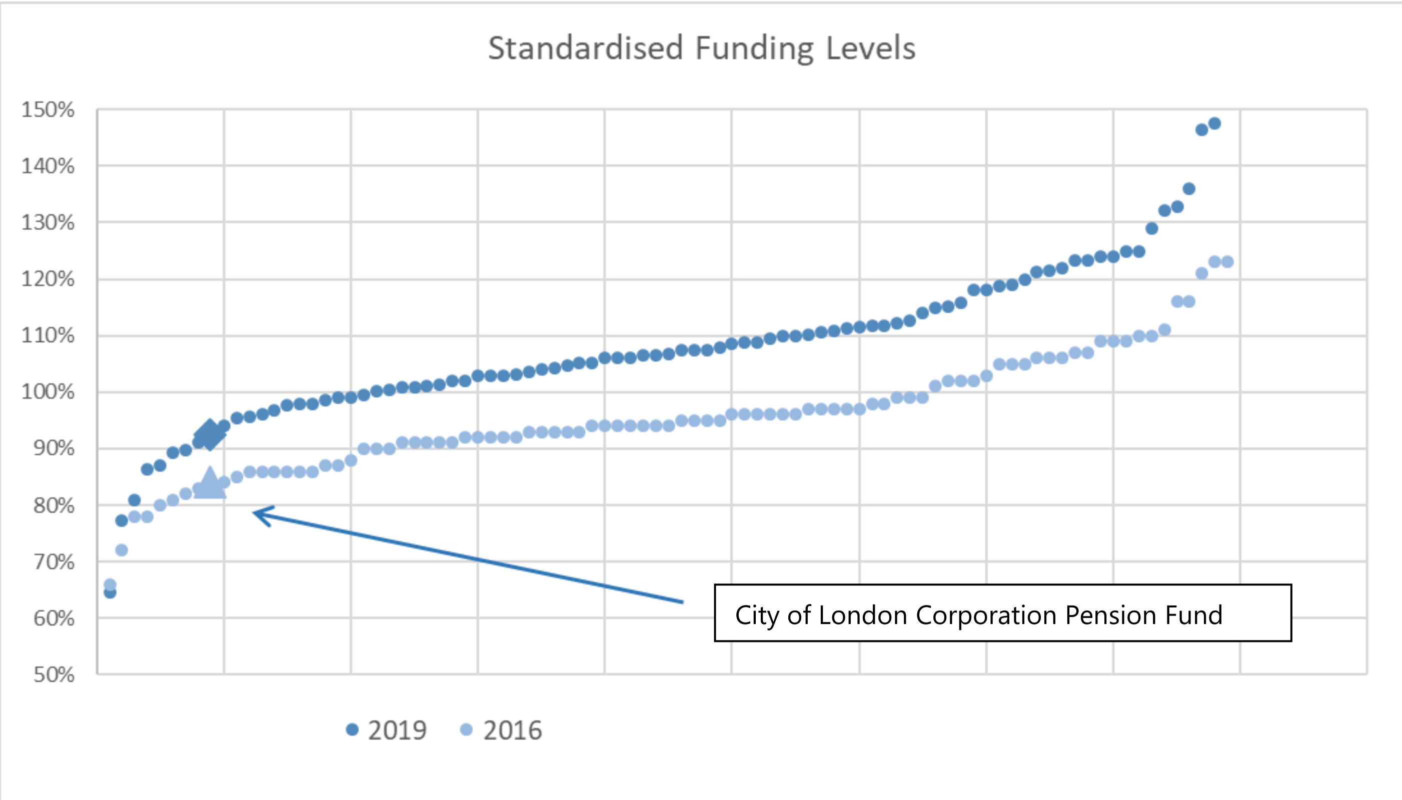
The key aim is to ensure that the contributions are set at a suitable level to target 100% funding over an appropriate period using suitable assumptions for the City of London Corporation Pension Fund. The report makes it clear that the deficit end point at 2033 has been retained and GAD is reassured that employers have been adhering to their plan to remove the deficit by 2033. The amber flags were caused as a result of the Corporation's position relative to the other LGPS Funds and are not a reason for concern.

It is equally important to ensure that decisions taken by the Fund are taken for the right reasons and meet the Fund's own objectives, Funding Strategy Statement and Investment Strategy Statement. Although the Section 13 valuation is a useful check on the health of the LGPS and its Funds, it should not be a key driver for the City of London Corporation Pension Fund in making decisions.

Appendix

The charts below show the distribution of the Funding levels on the SAB standardised basis. The unweighted average has increased from 96% in 2016 to 108% in 2019.





The charts below show the distribution of the primary and secondary rates in 2019. The primary and secondary rate of the City of London Corporation Pension Fund are 15.0% and 5.5%, respectively.