City of London Corporation Pension Fund

Section 13 summary report

Graeme D Muir | Partner FFA

26 August 2024

Contents

Introduction

This paper has been requested by City of London Corporation, as administering authority to the City of London Corporation Pension Fund (the Fund).

This paper summarises the review of the actuarial valuations of LGPS funds as at 31 March 2022 as carried out by the Government Actuary's Department (GAD), under Section 13 of the Public Service Pensions Act 2013 (the Section 13 valuation) which was published on 14 August 2024[1]. This paper sets out the results of this review in relation to the Fund.

For the avoidance of doubt, the formal actuarial valuation is still carried out by ourselves as the Fund 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 three 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 results of the formal actuarial valuations of the 87 English and Welsh LGPS funds, as carried out by their fund actuary.

Standardised vs best estimate bases

For the purposes of comparing funding levels, GAD use a standardised basis consistent with the basis used by the Scheme Advisory Board (SAB) for comparing funds. This is not the same as the local funding basis but it is calculated by the local fund actuary. The standardised basis provides a level playing field so that funds can be compared on more of a like for like basis.

For some of the other tests GAD undertake, they use their own "best estimate" basis across all funds which is determined by GAD. The key difference between the two is that the financial assumptions in the standardised basis is not market related or based on market conditions.

Section 13 objectives for identifying outliers

The main purpose of the Section 13 valuation is for GAD to identify any outlying funds measured against the following four aims:

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

[1] Full report is published here: https://www.gov.uk/government/publications/lgps-ew-review-of-the-actuarial-valuations-of-funds-as-at-31-march-2022

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.

As part of the Section 13 valuation, GAD calculate measures to help consider the above aims and use a coloured flag system to identify any outlying funds.

Flag	Meaning
Red	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	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	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 GAD had broader concerns.
Green	There are no material issues that may contribute to a recommendation for remedial action in order to ensure solvency or long term cost efficiency.

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. Some funds will also have seen an improvement on individual measures, but this categorising does not provide that level of detail, and therefore where improvements have been made, they are not necessarily recognised as improvements.

Summary of overall results

Most funds reported a funding level improvement at 2022 compared to 2019, with an aggregate funding level of 119% at 2022, compared to 109% at 2019. These funding levels are calculated on GAD's best estimate basis. The main reason for this improvement has been the asset outperformance in 2020/21, as well as the secondary (deficit reduction) contributions paid by employers.

Average total contribution rates decreased although primary rates generally increased, which reflects the increase in funding levels on funds' local funding bases. As previously noted, the Section 13 valuation is not used to set employer contribution rates but functions as a comparator between the individual LGPS funds.

Progress since 2019 review

Following the 2019 valuation, GAD made a series of recommendations to be considered as part of the 2022 valuation. We have summarised the 2019 recommendations and the noted progress made on each. Please note these are not specific to the Fund.

1. SAB should consider the impact of inconsistency, particularly regarding academy conversions and assessing impact of McCloud.
    - SAB have prepared guidance on academy conversions; more detail is provided in the Consistency section below. In relation to McCloud liabilities, all funds quantified the estimated impact as a percentage of liabilities on the dashboard. Regulations to equalise for McCloud remedy have since been introduced, therefore GAD make no further recommendations in this area.
2. SAB should consider how funds should ensure their deficit recovery plan can be demonstrated to be a continuation of the previous plan.
    - SAB is engaging with stakeholders to update guidance on Funding Strategy Statements (FSS) and the inclusion of principles underlying deficit recovery plan. New guidance should be out later this year which we will incorporate as part of the next FSS review.
3. Fund actuaries provide additional information about total contributions, discount rates and reconciling deficit recovery plans in the dashboard.
    - This was provided and noted.
4. SAB should review asset transfer arrangements from local authorities to ensure appropriate governance to achieve long term cost efficiency.
    - Not aware of any new asset transfers arrangements put in place. SAB intend to consider this point as part of their review of the FSS guidance.

In the 2019 report, GAD also made a general risk comment about acknowledging the strain of the pension fund on local authority budgets and resources and the possibility of increased pension contributions in the future. GAD noted that they understand that administering authorities are generally aware of these risks and have factored this into the principles for setting contributions, with a particular focus on stability.

Key findings under the four aims

The following section summarises each of GAD's objectives and the key takeaways for each as part of the 2022 review.

Compliance

GAD reported that all LGPS actuarial valuation reports complied with Section 13, meeting the requirements of the LGPS Regulations.

Consistency

GAD did not raise any flags for any fund under the objective of consistency.

GAD's interpretation of the consistency requirement (or lack of inconsistency) is such that valuations should have "consistent" rather than "not inconsistent" assumptions unless local circumstances justify something different.

GAD reports on two types of consistency criteria:

- ***Presentational consistency*:** Information may be presented in different ways in different reports, and sometimes information is contained in some reports but not others, so readers may have difficulties in locating the information they wish to compare. GAD call this presentational inconsistency and expect this to include sufficient rationale.
- ***Evidential consistency*:** When the reader has located the relevant information (e.g. funding levels), differences in the underlying methodology and assumptions mean that it is not possible to make a like for like comparison. GAD call this evidential inconsistency. They believe that local circumstances may merit different assumptions, but wherever possible, information should be presented in a way that facilitates comparisons.

Compared to 2019, GAD believe presentational consistency has improved due to the additional dashboard information provided. However, GAD's view is that there is no indication of any significant improvement in evidential consistency since the 2019 valuation.

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.

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.

GAD advised that the valuation dashboard should be reviewed again prior to the 2025 valuation to consider if any additional information should be provided. BW will be part of that review process.

The report also puts a strong focus on emerging issues where consistency between the funds is considered to be useful and dialogue between actuarial advisors is encouraged. The main issues addressed were climate risk, treatment of academies, and the emergence of surpluses.

Climate risk

It was noted that significant progress had been made to improve consistency in the presentation of climate risk since 2019. This is due to the engagement with the fund actuaries and DLUHC (now renamed the Ministry of Housing, Communities & Local Government (MHCLG)) to agree broad principles on which to base the analysis. Of the 87 funds, 82 carried out climate risk analyses in line with these broad principles. The Fund was included in the 82 funds.

MHCLG has consulted on proposals for new requirements in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) but has not yet responded. GAD strongly promote the further development of climate risk analysis and its integration in decision-making by funds. The broad principles will be reviewed in advance of the 2025 valuation which BW will also feed heavily into.

Academies

GAD continue to mention the known inconsistencies around academy conversions between funds. A working group was set up to consider this issue and SAB have produced guidance on academy conversions but funds continue to take different approaches.

It is a complicated issue and in our view, this commentary falls outside the remit of the Section 13 valuation.

Surpluses

GAD are encouraging SAB's Funding Strategy Statement (FSS) working group, to consider consistency of how LGPS funds may approach the use of any surplus when reviewing the FSS guidance.

GAD recommendations

GAD made two formal recommendations in the Section 13 report regarding the consistency objective.

Recommendation 1

"We recommend that the Scheme Advisory Board consider whether greater consistency could and should be achieved to allow easier comparison between funds and better understanding of risks."

Recommendation 2

"We recommend that the Scheme Advisory Board continue to consider emerging issues and, where appropriate, whether guidance would be helpful to support greater consistency.

As part of great consistency on climate risk, we recommend that work continues to refine the climate change principles document in advance of the 2025 fund valuations."

BW views

GAD have made a number of recommendations within the report which link into these two formal recommendations.

These include reviewing the valuation dashboard in advance of 2025, reviewing the FSS guidance and reviewing the approach to climate risk analysis. We are already engaging with GAD on these subjects or sit on the relevant working groups.

We consider the valuation dashboard to be a useful addition to the valuation report but we do not foresee a significant number of changes at 2025.

We are happy to feedback any of your comments into those reviews.

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 76 out of the 87 funds as at 2022 achieving green flags across all measures. This has slightly improved since 2019 and no fund received an amber or red flag so no action in isolation is required for any fund.

The Fund received one white flag and three green flags on solvency measures.

The measures used are the following:

- *SAB funding level:* The SAB funding level for the Fund has improved (from 92.4% in 2019 to 102.1% in 2022). **The Fund received a green flag.** White flags were awarded to the five funds with the lowest funding levels. For funds with white flags, GAD expected no specific action other than a general review.
- *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. **The Fund received a green flag.**
- *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. **The Fund received a white flag.** Similar to 2019 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 2022 valuation. A low percentage means the fund is less exposed to the default of more risky employers and the impact on employer contribution rates would be low. **The Fund received a green flag.**

The results for the Fund are set out below: [background colour indicates flag]

SAB Funding level	Non-Statutory employees	Asset shock	Employer default
102%	10.5%	7.2%	N/A

GAD chose not to engage with funds that received a white flag for *SAB funding level* as it is a purely relative measure and the actual overall improvement in funding levels was a positive outcome. Please see the Appendix for the distribution of the individual SAB funding levels of all funds.

GAD recommendations

GAD did not make any specific recommendations under their solvency objective.

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 2022, three funds received an amber flag in relation to long term cost efficiency, with four funds receiving a white flag. At 2019, four funds received an amber flag and 18 received at least one white flag.

The Fund received five 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 a green flag.**
- *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 actual total contributions (primary and secondary) and the total contributions that GAD calculate on a best estimate basis. 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 a green flag.**
- *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, alongside the rank (where relevant) amongst the other LGPS funds:

Implied deficit recovery period (GAD basis)	Required return	Repayment shortfall	Return scope	Deficit reconciliation
Surplus	3.8% (Rank 72)	Surplus	1.5% (Rank 46)	Green

Deficit reconciliation

In the report, GAD comment that administering authorities should aim to, where possible and appropriate:

- maintain the levels of contributions and/or
- reduce deficit recovery periods by maintaining the end point of the recovery period.

GAD noted that most funds maintained their deficit recovery end point in accordance with the above recommendation.

Surplus considerations

Since the 2022 valuation, an emerging issue is the increase in funds with surpluses, with over 70% of funds being in surplus on their local funding basis at 2022, well over double of that seen at 2019. This has largely been driven by funds using a gilts-based discount rate, which is not the BW approach.

GAD noted that there are a range of reasonable uses of fund surpluses, namely:

- reduction in contributions
- revisions to investment strategies and
- reviewing the level of prudence used.

GAD notes that their focus will be on contribution rate outcomes and intergenerational fairness. They note that there needs to be a balance between funds:

- using up surpluses too quickly; and
- retaining large surpluses.

GAD has not flagged any funds on their utilisation of surplus at this review but note that it will be reviewed as part of future Section 13 valuations.

GAD recommendations

Recommendation 3

"We recommend that the Scheme Advisory Board consider the following:

- *Where funds are in surplus, whether additional guidance can be provided to support funds in balancing different considerations.*
- *Where deficits exist, how can all funds ensure that the deficit recovery plan be demonstrated to be a continuation of the previous plan.*
- *Whether additional guidance is required in relation to the treatment of asset transfers from local authorities."*

BW recommendations to the City of London Corporation Pension Fund

A lot of LGPS funds are reporting improved funding positions and surpluses on their local funding basis since the 2022 valuation. This is largely been driven by funds using a gilts-based discount rate, which is not the BW approach.

However, GAD have provided some recommendations to funds around dealing with surpluses which should be considered as part of the 2025 valuation process. They note that there needs to be a balance between paying out surpluses too quickly and retaining large surpluses. We will pick up this issue with the Fund as part of the pre-valuation discussions and as part of the contribution rate setting process.

Conclusion

The City of London Corporation Pension Fund has met all the criteria of the Section 13 valuation although one white flag was raised. The key aim of the review 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 fund.

There is no requirement to take any action as a result of the white flag, however the Fund may want to think about how it can minimise the risk of any flags being raised at 2025.

The Fund will shortly be considering its Funding Strategy and Investment Strategy as part of the 2025 valuation process and we suggest that the results of this review are considered. However, 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.

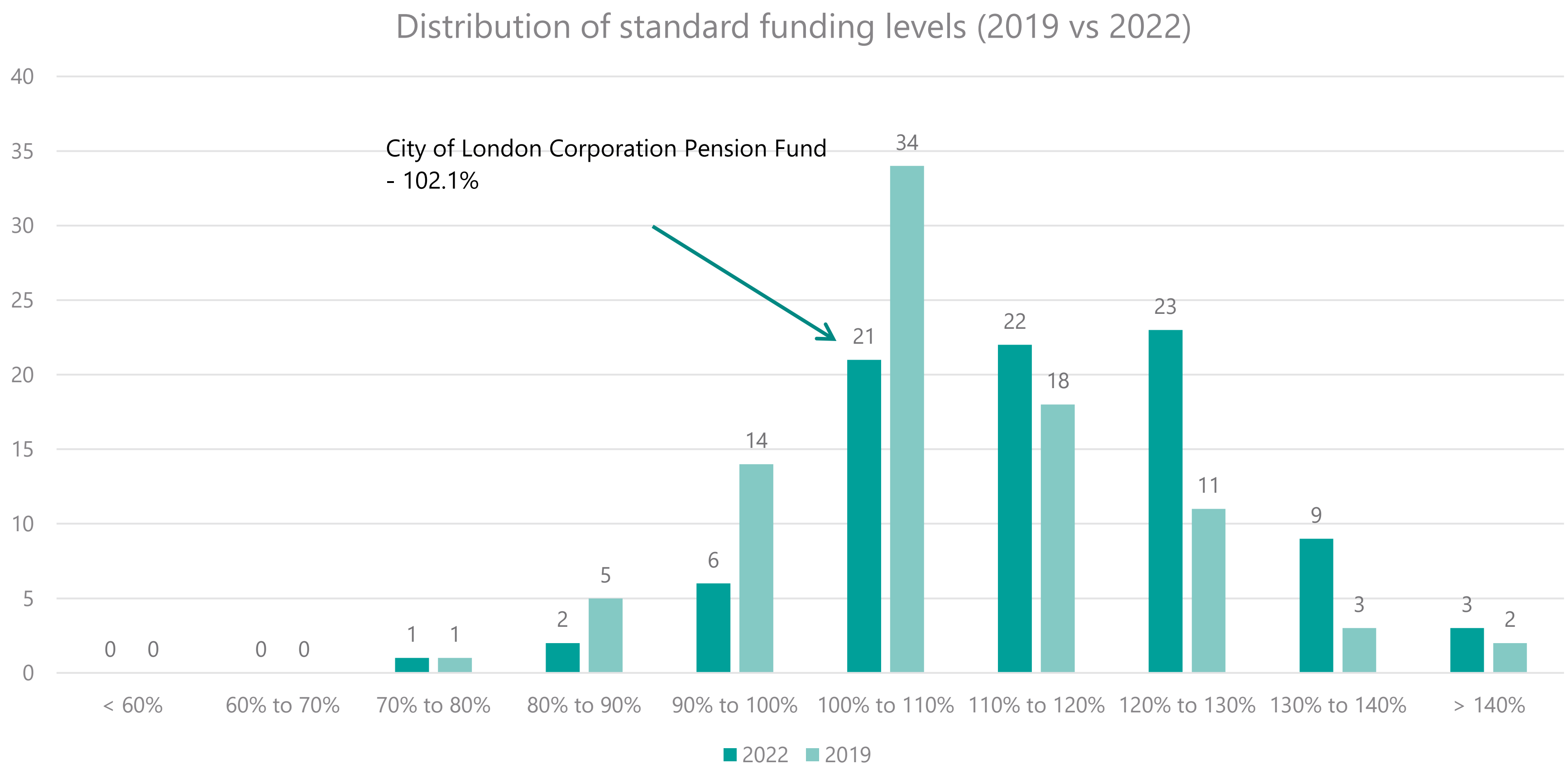
Although the Section 13 valuation is a useful check on the health of the LGPS and its funds, it should not be a key driver for the Fund in making decisions.

We would be pleased to answer any questions arising from this report.

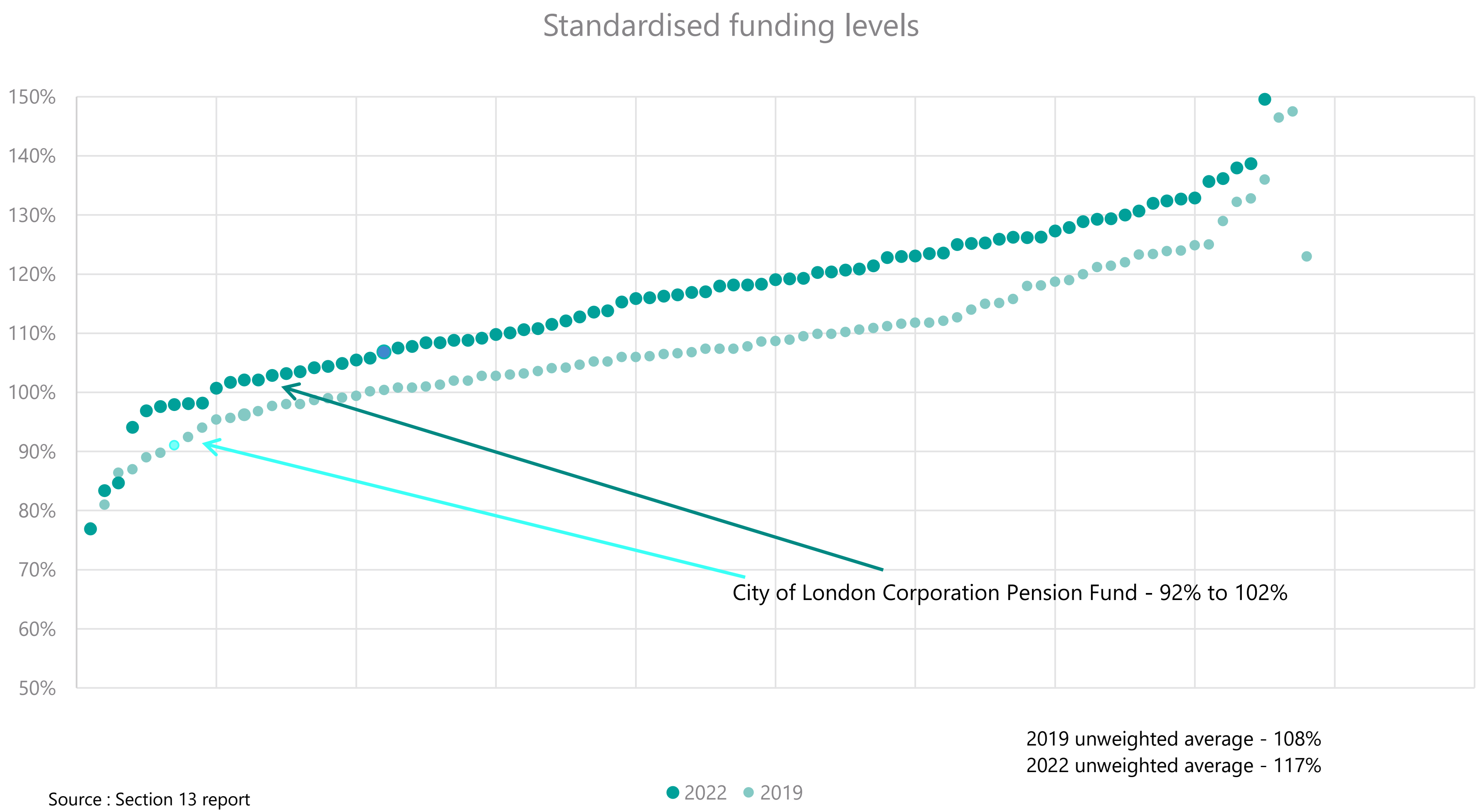
Graeme D Muir FFA
Partner
Barnett Waddingham LLP

Appendix

The charts below shows the distribution of the funding levels on the SAB standardised basis at 2019 and 2022 and where the City of London Corporation Pension Fund sits on each chart. The unweighted average has increased from 108% in 2019 to 117% in 2022.



Source : Section 13 report



Source : Section 13 report

BARNETT WADDINGHAM
beyond the expected

www.barnett-waddingham.co.uk