Report of: Corporate Director of Resources

Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: Corporate Director of Resources

Meeting of: Pension Board / Pensions sub-Committee

Date: 5th December 2022

Ward(s): n/a

SUBJECT: 2022 ACTUARIAL VALUATION -DRAFT FUNDING STRATEGY STATEMENT CONSULTATION

1. Synopsis

1.1 A Funding Strategy Statement will be prepared by London Borough of Islington (the Administering Authority) to set out the funding strategy for the Islington Council Pension Fund (the "Fund"), in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

Under the Regulations, the administering authority must prepare, maintain and publish a written statement setting out their funding strategy. In doing so, the administering authority must consult with such persons, as they feel appropriate. The Fund actuary must have regard to the FSS in carrying out the formal actuarial valuation of the Fund.

1.2 This report informs the pension board and pensions sub-committee of the main issues that employers admitted into the Fund are to be consulted on, in the draft FSS, (attached as Appendix 1) as part of the 2022 actuarial review.

2. Recommendations

2.1 To review and note a summary of the main updates in the draft FSS that employers are going to be consulted on between December and January 2023.

2.2 Agree that officers, with the Fund Actuary update the draft FSS for consultation with the Employers who are admitted into the Islington Fund.

2.3 Agree to receive the consultation results and delegate powers to officers, where necessary, to update and finalise the draft FSS at the next meeting in March 2023.

3. Background

Introduction

3.1 The 2022 actuarial valuation is now underway and as part of the process preparatory work is being undertaken to determine the funding position and investment strategy review that can support sustainable contributions from employers.

3.1.1 The LGPS Regulations provide the statutory framework under which the Administering Authority is required to prepare and publish a Funding Strategy Statement (FSS) alongside each actuarial valuation. The Fund Actuary must have regard to the FSS as part of the actuarial valuation process.

The FSS must also be revised and published whenever there is a material change in either the policy set out in the FSS or the Investment Strategy Statement.

3.1.2 The draft FSS is being prepared and as part of this the Actuary has been working to streamline the content in order to improve the usability of the document. The main updates since the policies update in November 2021 include the following:

i) Administrative (and Oversight and Governance) Expenses are met out of the Fund, in accordance with the Regulations. It is proposed to allow for such expenses from 1 April 2023 by adding 0.9% of pensionable pay to the contributions from participating employers. This allowance has been reassessed at the 2022 valuation, and represents an increase of 0.2% of pensionable pay relative to the current allowance of 0.7%. Investment expenses have been allowed for implicitly in determining the discount rates.

ii) We have incorporated reference to surplus offsets only being permissible for employers above 110% funded. For those employers assessed to be in surplus at the valuation date, surplus offsets will not be available to those with a funding level of less than 110%. For those with funding levels greater than 110%, surplus offsets will be based on the surplus above 110% only (such offsets will also only be permitted if the employer is in surplus on the termination basis).

iii) The discount rates used to determine the Fund's liabilities are derived from the expected return on the Fund assets based on the current long-term strategy set out in the ISS, including appropriate margins for prudence. For the 2022 valuation it is proposed to use an assumed return of 4.65% p.a. for past service liabilities, i.e. that is 1.55% p.a. above CPI inflation and 5.10% p.a. for future service liabilities i.e. that is 2.0% p.a. above CPI inflation. This real return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics. The reduction in the real returns relative to the 2019 valuation represent the Fund's objective of ensuring contribution rate sustainability given the current uncertain economic outlook.

iv) Unlike previous actuarial valuations, the Actuary has recommended to build in an allowance for actual inflation between September 2021 and March 2022 (which feeds into the 2023 pension increase) rather than assuming inflation in line with the funding assumption over that period. This will provide additional protection against the cost of the 2023 pension increase once implemented. The reduction in the real discount rates, as referred to above, then provide for additional protection more generally in relation to post 31 March 2022 events.

v) Updates to the life expectancy assumptions following analysis performed on the Fund's membership. The analysis indicates that whilst life expectancy is still increasing, the rate of increase experienced in short-term since the 2019 valuation was less than was built into the assumptions. This has been incorporated into the assumptions for the 2022 valuation along with an adjustment to the longer-term projection to reflect current views. To avoid understating life expectancy (and therefore understating liabilities), the Actuary has ignored experience from certain periods of the Covid-19 pandemic where mortality rates were significantly higher than previously.

vi) Subject to covenant and affordability considerations of employers, it is proposed that the average deficit recovery periods will reduce by 3 years to 16 years. This is generally equivalent to maintaining the same end date as the 2019 deficit recovery plan. This will be incorporated into the contribution outcomes for employers.

vii) For certain employers in the Fund (following discussions with the Fund Actuary) a captive insurance arrangement is being established by the Administering Authority to cover ill-health retirement costs. This will apply to all ill-health retirements from 1 April 2023 and will minimise the risk to the employers of such retirements, the cost of which can otherwise be very high and volatile. It applies only to ill-health retirements involving the early payment of pension and to the associated benefit costs. All employers in the captive insurance arrangement will be required to pay a "premium" into the arrangement to meet the expected ill-health retirement costs of the eligible members. This "premium" will be reassessed at each valuation by the Actuary.

viii) Whilst reserving the right to consider options on a case by case basis, the Fund's current policy is that a termination assessment will be made based on low risk funding basis, unless the employing body has a guarantor within the Fund or a successor body exists to take over the employing body's liabilities (including those for former employees). This is to protect the other employers in the Fund as, at termination, the employing body's liabilities will become orphan liabilities within the Fund, and there will be no recourse to it if a shortfall emerges in the future (after participation has terminated). Given recent extreme market events, for the current policy to remain robust and to ensure both the outgoing employers, and those remaining in the Fund are protected, it is proposed to update the policy to provide the Fund with the flexibility to review the low risk assumptions in times of extreme market conditions.

At a Whole Fund level, taking into account the above, the results of the 31 March 2022 actuarial valuation have showed that the Fund is 96% funded. This represents a deficit of £79m which will be recovered by secondary rate contributions (where appropriate) payable by employers from 1 April 2023. The primary rate emerging from the 2022 valuation is 18.3% of pensionable pay. Individual employer positions will vary significantly and will depend on their own membership profile, experience since 2019, and also their starting point relative to the Whole Fund as at 31 March 2019.

Further updates on the progress of other Regulatory issues will be provided to the Board and Committee in due course.

3.1.3 Members are asked to note the updates and agree that officers with the Fund Actuary update the FSS for consultation with Employers admitted into the Islington Fund. The results of the consultation will be reported to Members at the March meeting so that an informed decision can be made to approve the final version of FSS for publication by end of March.

4. Implications

4.1 Financial implications

4.1.1 The cost of providing actuarial advice is part of fund management and administration fees charged to the pension fund.

4.1.2 The funding level of the pension fund directly affects employer contributions. A reduced Pension Fund deficit would provide employers with a lower required deficit recovery contribution. Full financial implications to employers will be available once the final valuation is completed

4.2 Legal Implications

The Local Government Pension Scheme Regulations 2013 (as amended) ("the 2013 Regulations") and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 ("the 2014 Transitional Regulations") (collectively; "the Regulations") provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS).

Prior to agreeing the statement, the Council must have proper regard to any comments received from the consultees.

4.3 Environmental Implications and contribution to achieving a net zero carbon Islington by 2030:

None applicable to this report. Environmental implications will be included in each report to the Pension Board Committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2022 to reduce the current and future carbon exposure by 50% and 75% respectively compared to when it was measured in 2016 and also invest 15% of the fund in green opportunities. The link to the full document is https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonboroughofislingtonpensionfundinvestmentstrategystatement.pdf

4.4 Resident Impact Assessment

None applicable to this report. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

4.4.1 An equalities impact assessment has not been conducted because this report is seeking opinions on updating an existing document and therefore no specific equality implications arising from this report.

5. Conclusion and reasons for recommendation

5.1 Members asked to review and note the updates to prepare the draft FSS for employers' consultation.

Appendices: Draft FSS -Appendix1

Background papers:
None

Final report clearance:

Signed by:

Corporate Director of Resources

Date: 23 November 2022

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