Appendix 3

<u>Avon Pension Fund (APF) Statutory Funding Strategy Statement (FSS)</u>

<u>Response by independent Chair of Local Pension Board (LPB)</u>

<u>Introduction</u>

1) Thank you for email of 12th July providing members of the LPB the opportunity to comment on the Avon Pension Fund (APF) updated FSS. I understand our comments will be included in papers or tabled at the Pension Committee (PC) meeting on 27 September.

<u>Locus</u>

2) The statutory locus of the APF LPB is to assist the APF Administering Authority comply with Public Service Pensions Act, LGPS regulations, and TPR requirements; and to ensure the governance and management of the APF is efficient and effective.

3) In respect of the updated FSS the LPB role is to consider a) does the APF FSS comply with LGPS Regulation 58, b) does the APF FSS comply with MHCLG statutory guidance on preparing and maintaining FSS issued in 2016, c) does the FSS comply with the LGPS regulations and TPR Code 14 in respect of consultation and disclosure to employers and fund member communication requirements, and d) does the FSS assist BANES in improving the efficiency and effectiveness of the APF

4) The Pensions Committee should note that under LGPS regulation 8 the LPB would consulted by Secretary of State for DCLG prior to his/her intervention if he/she considers the Administering Authority is failing to act in accordance with the FSS statutory guidance.

<u>Comments and recommendations to the Administering Authority</u>

<u>Statutory compliance</u>

5) It is my view the preparation, consultation with fund stakeholders, and contents of the FSS appears robust and to cover the regulatory requirements. However the LPB recommends that this should be confirmed by the funds actuaries and senior officers at the time when the PC are asked to approve the final FSS.

6) The LPB recommend this would best be done on a factual basis by the use of compliance table/tick sheet against the 2016 FSS statutory guidance (as was done by APF officers for the statutory Investment Strategy Statement (ISS) against its statutory guidance) and any MHCLG or national LGPS scheme advisory board (SAB) supplementary guidance.

<u>Solvency</u>

7) The FSS refers to an objective to achieve 100% solvency level. The PC should note that the actual market value of the funds assets needed to maintain this on an ongoing basis will undoubtedly fluctuate (possibly markedly) by a varying % over different market and economic cycles and geo-political changes during inter-valuation years.

8) Consequently it might be prudent for the FSS to actually target slightly >100% solvency in order to reduce and smooth out this risk in order to consistently maintaining an average solvency of 100% for say 95% of the time or some other % or statistical probability recommended by the funds actuary. This approach is used

by some public sector funds in the EU to ensure they are continually 100% funded with no risk of falling below 100% in inter-valuation periods. As the LGPS is moving from triennial to quadrennial valuations this becomes more important consideration.

Actuarial assumption comparatives

9) In various places the covering paper and draft FSS refer to changing the 2016 assumptions for the 2019 valuation. However for absolute clarity for the FSS users it be would helpful throughout the covering paper and in the FSS for the following convention to be adopted. Where the 2019 assumption/figure to be used is presented then immediately behind/next to it in brackets the 2016 assumption figure that was used in the 2016 valuation should be provided for comparison. By doing so the reader can more easily tell to what extent the 2019 assumption/figure is reducing or increasing from the 2016. This is especially important for key financial assumptions like “real expected asset return above CPI”, “discount rate”, “future service rates”, “deficit recovery period” etc.

Deficit recovery

10) Seeking to reduce historic funding deficit is very laudable and is consistent with best practice and supported by the Pensions Regulator. However the proposal to reduce the deficit recovery period from 16 to13 years could impact on employer contributions and may well cause a negative reaction from the funds key stakeholders. This might benefit from further consideration by the PC who may wish to understand the actual quanta of the additional cash needed from large employers (who have other financial pressures). The PC might wish to consider a range of mitigation measures or seek further actuarial advice on other options to reduce the fund past service deficit - be this in respect of other actuarial assumptions and or to adjust the investment strategy risk profile and asset allocation to deliver a higher investment return.

Future regulatory changes

11) In addition to the McCloud judgement there are a number of other known and likely potential regulatory changes being put forward by the MHCLG and or national LGPS SAB. Most are likely to further increase the funds future liabilities and cash flows above and beyond what has currently been modelled in the valuation process so far. It is recommended that the PC seek advice from the funds actuary on whether and how to incorporate an allowance for them in the current or new actuarial assumptions or if alternatively to adjust the investment strategy risk profile and asset allocation to deliver a higher investment return.

Climate change

12) The covering paper (section 7) refers to climate change and reducing financial risk via the investment strategy and asset allocation. This is welcomed and important given the current predictions about the impact of climate change on mankind.

13) However the draft FSS document is actually silent on climate change. As well as possibly negatively affecting the value of some of the funds assets, the Committee must be aware climate change may also impact on the fund and its members in other ways – such as mortality and longevity, as well population migration into BANES and political change.

14) The Bank of England, Financial Conduct Authority, Financial Reporting Council, the Pensions Regulator, Association of British Insurers, and Government Actuaries Department are all actively now taking climate change into account in their funding strategy policy work, albeit in different ways and different extents. The Avon Pension Fund FSS should do so to.

15) Specifically the Institute and Faculty of Actuaries has issued specific guidance on climate change https://www.actuaries.org.uk/practice-areas/resource-and-environment/research-working-parties/practical-guide-climate-change-life-actuaries The Committee is recommended to ask the fund actuaries to include a statement in the 2019 FSS how the impact of climate change has been and will be integrated into the 2019 and future fund valuations (in addition to statements in the fund Investment Strategy Statement (ISS).

Efficacy

16) In general terms the updated FSS should help improve the effectiveness and efficiency of the APF future funding level. However because of the strategic importance of the on-going transfer of APF asset management to BBP, it is recommended the FSS would strongly benefit by the inclusion of a policy statements on how the financial savings from APF asset pooling into BPP will affect future employers contributions from 2019 onwards.

Howard Pearce

Chair of the Local Pension Board