Bath & North East Somerset Council		
MEETING:	**LOCAL PENSION BOARD - AVON PENSION FUND**	
MEETING DATE:	**28 November 2019**	**AGENDA ITEM NUMBER**
TITLE:	**FUNDING STRATEGY STATEMENT 2019**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Nil		

1 THE ISSUE

1.1 The Local Government Pension Scheme (LGPS) regulations require each administering authority to prepare and publish a Funding Strategy Statement (FSS). The FSS sets out the key assumptions which the actuary has used in preparing the actuarial valuation and, in those cases where the Administering Authority has some discretion, the policies adopted by the Administering Authority.

1.2 Following consultation with the scheme employers and Pension Board the Committee approved the FSS at its meeting on 27 September 2019.

2 RECOMMENDATION

The Board notes:

2.1 **The process undertaken to finalise the Funding Strategy Statement.**

3 FINANCIAL IMPLICATIONS

3.1 The actuarial costs for reviewing the FSS is included in the 2019 actuarial valuation fee and is provided for in the 2019/20 budget.

4 FSS CONSULTATION

4.1 The LGPS regulations require each administering authority to prepare and publish a FSS. The key points of the regulation for the FSS are as follows:-

- After consultation with all employing bodies, the administering authority must prepare and publish their funding strategy
- In preparing the FSS, the administering authority must have regard to:
  - (i) FSS guidance issued by CIPFA
  - (ii) The Investment Strategy Statement (ISS) under Regulation 12 of the LGPS (Management and Investment of Funds) Regulations 2016
- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles/ISS.
- The Fund's actuary must have regard to the FSS as part of the valuation process.

4.2 The FSS sets out all the key assumptions which the actuary has used in preparing the actuarial valuation, together with the Administering Authority's policies in the areas where the Administering Authority has discretion to manage the funding position of the Fund.

4.3 When preparing the FSS the Committee must consider it within the regulatory framework:

a) Ensure that the benefits paid out in the future will be reasonably met (the Solvency Objective)

b) That the amount paid in annually covers the current cost of the pension benefit accrued

c) That current pension debt is not deferred for future generations to fund (the Long Term Cost Efficiency Objective).

4.4 Comments were received from 16 employers (including UAs, academies, HFE bodies and Town & Parish Councils) and the Pension Board.

4.5 The Pension Board concluded that it complied with the regulations. In line with the Board's recommendation, a checklist of compliance was included in the report to the Committee.

4.6 The consultation asked specifically for comments about:

- The appropriateness of the assumptions and in particular those that relate to them e.g. short term pay increases
- In relation to the affordability of contributions and in particular whether there is any particular year over 2020/2023 which will be more challenging. This will help form a view on any further flexibility required.
- Whether the level of detail was sufficient and whether they need anything further in terms of information / meeting etc. to understand the content and implications

4.7 The responses focused in general on:

a) Affordability given the severe funding pressures in the public sector,

b) Whether the margin for prudence in the assumptions are too high in relation to:

(i) The long term salary Increase assumption set at CPI plus 1.5% is too high given recent pay awards have been in line with inflation at best.

(ii) The lower asset out performance target used in the discount rate.

(iii) Longevity improvements given that the rate of mortality had increased (i.e. more deaths than previously)

(iv) The GAD Section 13 assumption which uses a higher discount rate.

c) That the deficit recovery period (DRP) should not automatically reduce by 3 years. In addition, those employers with a DRP less than 12 years challenged whether it should reduce regardless of contribution levels versus the previous valuation.

d) Disagreement that deficit contributions should be maintained at the expected monetary amounts from the preceding valuation.

e) Employers in surplus should be allowed greater flexibility to accelerate the runoff over 12 years.

f) McCloud could significantly affect employer contribution rates and employers requested clarification on the how it will be allowed for.

g) A range of investment strategy related issues

4.8 The committee considered all the comments and the Actuary's response. As a result there were no substantive changes to the FSS; the Committee were satisfied that the FSS met the solvency and long term cost efficiency objectives and that there was sufficient flexibility to ensure affordability could be managed on an individual employer basis having taken the employer's covenant into account.

4.9 In light of the comments received, the changes to the FSS are as follows:

a) Greater clarity about achieving solvency and long term cost efficiency

b) Clarified the reduction in DRP by 3 years, medium term target of 12 years and how this delivers long term cost efficiency.

c) Made it explicit that if DRP is below 12 years it will be maintained. However, where an employer is expected to exit the Fund, then in normal circumstances, the deficit would be recovered over the remaining period to exit.

d) Clarified wording on how the McCloud liabilities will be calculated and that employers will have choice to either include in contribution rate from 01/04/20 or to make a provision and pay backdated contributions once the remedy is known

e) Included explanation of the margin of prudence in the investment return assumption used in the discount rate.

4.10 With specific reference to the Pension Board comments:

a) Solvency – the actuary advised that targeting 100% is adequate for the Fund given the current funding level and risk aware investment strategy. The investment strategy incorporates a number of risk management strategies which means the asset outperformance assumption is already prudent.

b) Deficit recovery – the deficit funding plans contain flexibility for affordability to be tailored to employers' specific pressures. As the deficit has reduced significantly since 2016, it is of less concern than the increase in the future service rate.

c) Future regulatory changes – all known potential changes have been included in the FSS in terms of how they *may* be implemented. The policy on McCloud has been made more specific.

d) Climate change – this is not specifically referred to in the FSS as the Investment Strategy Statement is the more appropriate strategic document. However the level of prudence included in the asset outperformance assumption is a contingency for all investment risk amongst which is the impact of climate change on investment returns. The impact of climate change on demographics and how this could be addressed will be explored with the Actuary ahead of the next valuation.

e) Efficacy – the impact on contributions from pooling assets will not be apparent until net savings start to accrue to the Fund. The Business Case for pooling had a breakeven (cumulative net savings after all transition costs and costs of Brunel) in FY 2024 – so it is too early to see the benefit and as set out in the business case, we are in a "net cost" period. It is also important to put the expected savings into context – we anticipate lower investments costs in the region of 10-15% p.a. i.e. £3-4m p.a.

   In addition we expect net returns to improve due to the way Brunel will manage our assets and if there is persistent evidence of this in the future it could be taken into account (but need a reasonable track record to demonstrate persistency). Each valuation reflects realised asset values after all costs so savings are reflected as they are achieved.

5 PRELIMINARY WHOLE FUND RESULT

5.1 The final actuarial outcome will be reported to Committee at March 2020 meeting, however preliminary whole Fund results (based on the proposed assumptions to assess solvency and future service plus updated demographic assumptions) are set out below:

	£m
Assets	4,820
Liabilities	5,078
Deficit	258
Average Funding Level	95%
Average Employer future service contribution rate	17.1% p.a.

These results will be subject to change as the valuation is completed for each employer – in particular any changes in the assumption for short term pay award (as advised by employers) and the impact of the employers moving into the lower risk investment strategy. The impact of McCloud on employer contributions over

2020/23 will be considered with individual employers as per the policy set out in the FSS.

6 RISK MANAGEMENT

6.1 No significant issues to report as this is an information report.

7 CLIMATE CHANGE

7.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and is in the process of addressing this through its strategic asset allocation to Low Carbon Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

8 OTHER OPTIONS CONSIDERED

8.1 N/a.

9 CONSULTATION

9.1 The Council's Monitoring Officer and Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Woodyard, Investments Manager 01225 395306
Background papers	CIPFA Pensions Panel (guidance on preparing FSS) Committee papers
Please contact the report author if you need to access this report in an alternative format	