| Bath & North East Somerset Council | |
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| MEETING: | **AVON PENSION FUND COMMITTEE** |
| MEETING DATE: | **10 DECEMBER 2021** |
| TITLE: | **INTERIM ACTUARIAL VALUATION 2021** |
| WARD: | ALL |
| **AN OPEN PUBLIC ITEM** | |
| **List of attachments to this report:**<br>Exempt Appendix 1 – **2021 Funding review report** | |

## 1. THE ISSUE

1.1 Local Government Pension Scheme Regulations 2013 require the Fund to carry out an actuarial valuation every three years, the next is due as at 31 March 2022. Between these mandatory valuations, the Fund periodically requests interim valuations to assess whether the funding strategy is on track and to begin the discussions with the actuary, committee and employers about the 2022 valuation.

1.2 The Fund commissioned an interim valuation as at March 2021 (but also considered the results as at 31 August 2021) which provides the current context for the 2022 valuation.

1.3 The interim valuation provides an update to the current funding plan. Current employer contribution rates and deficit payments are not revised as a result of this update; however, it provides an indication of rates at 2022. **It is important to note that the interim valuation is a snapshot of the funding level at a particular point in time.**

1.4 The Actuary presented the interim valuation report at a Committee workshop on 01 December 2021. The report used at the workshop is in Appendix 1.

## 2. RECOMMENDATION

That the Avon Pension Fund Committee notes:

**2.1 The outcome of the 2021 interim valuation and 2022 valuation timetable.**

## 3. FINANCIAL IMPLICATIONS

3.1 The actuarial valuation sets the contribution rates and deficits payments required from scheme employers for the three years following the valuation. The Interim valuation provides some insight into how the funding position has progressed against the funding strategy set out at the 2019 valuation and an indication of the potential changes in contributions required at the 2022 valuation which will set the employer contributions from 1 April 2023.

3.2 The cost of the valuation is included in the budget for 2021/22.

## 4. THE REPORT

4.1 The Interim Valuation Report from the Actuary is in Appendix 1. The key points are as follows:

a) The funding level has improved since 2019 indicating a reduction in deficit contributions at the total Fund level

b) However the asset outperformance assumption used in the discount rates has fallen due to the lower expected returns from the investment portfolio; this negatively impacts the future service rate in particular

c) Inflation as measured by CPI has risen, increasing liabilities

d) The 2019 valuation assumption for short term pay of 2% maybe too low given current wage pressure in some sectors; employers will need to consider carefully what level is included in their valuation

e) There is as yet no change to the longevity assumption to reflect impact of COVID as too early to understand longer term health implications; a full demographic analysis will be undertaken as part of the 2022 valuation

4.2 The interim valuation updates the 2019 valuation using updated membership data as at 31 March 2021, actual cash flow data since 2019, updated financial assumptions to reflect changes in market values, updated the 2019 longevity assumptions to broadly incorporate recent national trends and used the same other demographic/actuarial assumptions used in 2019. A short term pay assumption of 2% (for the 3 years of the 2022 valuation period, 2023-26) has also been used for this interim exercise. The actuary initially estimated the position at March 2021 and then updated with financial market levels at 31 August 2021 for the Committee workshop.

4.3 The key assumption which drives the value of the pension Fund liabilities (the future benefit payments) is the discount rate. This is set by the Actuary to reflect the overall investment return which we expect to achieve on the Fund's assets over the long term with a suitable allowance for prudence. In terms of setting contributions, the relationship of the expected investment return compared to the rate of expected future increases in benefit payments i.e. CPI inflation, is critical (in other words we need to reflect the "real" investment return expected on the Fund assets).

4.4 Given the strong performance of asset prices since the 2019 valuation, the expected return on assets for our investment strategy has fallen when modelled by the actuary. In 2019, the best estimate for expected returns per annum (representing a 50% chance of achieving the return on our strategy) was CPI +2.7% i.e. a real investment return over inflation of 2.7% per annum. By 2021 this has fallen to CPI +2.2%. At 2019 the discount rate was CPI +1.75% for past service; indicative for 2022 is CPI +1.50 which in isolation increases the value of the past liabilities. The fall in the asset return expectations will have greater impact on the Future Service Rate (FSR) given its greater sensitivity to future investment returns. In 2019 the FSR discount rate was CPI +2.25% whereas indicative for 2021 is CPI +2.0% resulting in an increase in the FSR.

4.5 Inflation has risen since 2019 with market derived CPI increasing from 2.4% to 2.9% currently.

4.6 The interim valuation outcome shows the funding level has risen to c.101% on a consistent basis to 2019 valuation; it falls to 99% on the proposed 2022 basis. The improvement is driven primarily by excess investment returns causing the deficit to narrow to £65m (on the proposed basis), c. £219m ahead of the 2019 funding plan.

4.7 The objective of the Fund is to keep contributions as stable and affordable as possible. Therefore, the aim in 2022 will be to maintain the 2019 overall contribution levels and depending on the actual outcome, allow reductions in contributions where they are supported by the employer covenant assessment and deficit recovery periods.

4.8 A key discussion for the 2022 valuation will be the level of 'prudence margin' in the discount rate assumptions which enables the contribution rates to be smoothed over time. The Fund has two investment strategies purely to reduce investment risk within the portfolio (the Liability Driven Investing strategy and the Equity Protection strategy) with the objective to increase the certainty of achieving the target investment return. As a result the actuary can 'release' some of the prudence within the discount rate assumptions given the greater certainty of achieving the investment return. If these strategies had not been implemented, the discount rates used would be c. 0.25% lower than those currently proposed.

4.9 The actuary discussed the interim position in detail at the workshop on 01 December 2021. It has also been discussed with large employers (UAs and HFE employers) to provide a context for budget planning for contribution rates from 1 April 2023.

## 5. 2022 VALUATION TIMETABLE

5.1 The indicative timetable for the 2022 Valuation is as follows:

a) The actuary and officers will develop the funding strategy during 1Q22 and assess the impact of the market derived financial assumptions in 2Q22. At this stage the membership data as at 31 March 2022 will not have been processed.

b) A Committee workshop will be held in June 2022 prior to the June Committee meeting to review the Funding Strategy Statement (FSS) and initial valuation outcome, updated only for financial assumptions. The draft FSS which sets the parameters for the valuation including the actuarial assumptions and the deficit recovery policy will be agreed at the June Committee meeting. The draft FSS will then be circulated to employers for consultation (as required in the regulations).

c) The final Funding Strategy Statement will be agreed at the September 2022 Committee meeting following which the individual employer results will be calculated by the actuary and disseminated to employers.

d) 2022 valuation report to be presented at March 2023 committee meeting.

## 6. RISK MANAGEMENT

6.1. The funding strategy is key to ensuring pension liabilities can be met in the future and therefore the strategy must be regularly monitored so that the Fund and employers are aware as to whether the current funding level deviates from the long term funding plan and the scale of any shortfall / surplus. Such information can assist employers in planning their medium term budgets and assist the Fund officers in managing those employers that pose a greater financial risk to the Fund.

## 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 in line with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change addresses this through its strategic asset allocation to Sustainable and Paris Aligned Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

## 8. EQUALITIES

8.1. An Equalities Impact Assessment has not been completed as the report is for information only.

## 9. OTHER OPTIONS CONSIDERED

9.1. N/a, for noting only.

## 10. CONSULTATION

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

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| **Background papers** | None |
| **Please contact the report author if you need to access this report in an alternative format** | |