Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**23 SEPTEMBER 2022**	**AGENDA ITEM NUMBER**
TITLE:	**FUNDING STRATEGY STATEMENT 2022**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Funding Strategy Statement Appendix 2 – Comments from Employing Bodies Appendix 3 – CIPFA guidance checklist		

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. The Committee approved a draft FSS at its meeting on 24 June 2022 which has been circulated to the employing bodies for comment.

1.2 An updated draft FSS is attached as Appendix 1 which, after consideration by Fund Officers and the Actuary, takes into account the comments received from the employing bodies following the consultation period. The Actuary will attend the meeting to discuss the comments and any changes to the draft FSS.

1.3 As the body responsible for agreeing the Funding Strategy, the Committee must consider the FSS 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).

1.4 Given the FSS includes regulatory/legal matters that are yet to be confirmed, delegated authority is requested for Officers to finalise before 31/03/22 having taken advice from the Actuary.

1.5 Individual employer results will be disseminated from late October. Meetings will be held with employers to explain the outcome as required.

2 RECOMMENDATION

The Committee:

2.1 **Notes the feedback responses received, and the proposed amendments to the FSS.**

2.2 **Approves the FSS as set out in Appendix 1, subject to**

(i) the insertion of information which can only be included when the actuarial valuation is complete and

(ii) confirmation from the Pension Board that the FSS complies with LGPS regulations and CIPFA guidance

2.3 **Delegates the refinement and finalisation of the FSS to Fund Officers, with assistance of Fund Actuary.**

3 FINANCIAL IMPLICATIONS

3.1 The actuarial costs for reviewing the FSS is included in the 2022 actuarial valuation fee and is provided for in the 2022/23 budget.

4 THE REPORT

4.1 The LGPS regulations require each administering authority to prepare and publish an 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 Procedurally, the Fund's actuary cannot finalise the valuation until the FSS has been approved by the Committee.

4.4 There are outstanding regulatory /legal matters that will need to be included in the FSS which may affect the contributions and /or funding policy (e.g. McCloud remedy, potential classification of certain employer groups and the requirement to undertake climate change scenario analysis). These may not be resolved until after the valuation is completed. As these are regulatory in nature, it is recommended that Officers are given delegated powers to finalise the FSS having received full advice from the Actuary, should there need to be any changes as a result of further development on these or similar matters. As noted at in the previous committee report, the Officers are working with the Fund Actuary regarding the update for outstanding technical information e.g. climate change risks, final design features/formatting of the FSS, to the extent this will improve the usability of the document.

4.5 Given the proposed changes to the regulations, it is reasonable to assume that the FSS will be reviewed before the next valuation in 2025. Any revisions will be brought to Committee for full consideration.

4.6 The draft FSS was circulated to the employing bodies with comments required by 24 August 2022. Those comments which have been received are summarised in Appendix 2.

4.7 The Pension Board was due to review the draft FSS for compliance with the LGPS regulations and CIPFA guidance at their meeting on 13 September 2022. However this was cancelled due to the national mourning period and a new date is yet to be confirmed. Therefore approval of the FSS by the Committee is subject to the Pension Board's feedback which will be provided to Committee at the December meeting. The Fund's checklist of compliance is provided in Appendix 3.

4.8 The comments received via the consultation were considered carefully and it has been concluded that no fundamental changes to the draft are required (other than to update the technical information as the valuation progresses) as it was felt that the framework covered the issues raised and there was sufficient flexibility within the FSS to address the points raised where appropriate.

4.9 The draft FSS for approval is attached as Appendix 1, estimates of certain information that can only be confirmed once the valuation and associated analysis has been completed. Once the valuation is finalised, the FSS will be updated and published. For admissions and exits, the 2022 FSS actuarial assumptions will be effective from 1 April 2023. This is consistent with our current policy.

5 COMMENTS ON RESPONSES FROM EMPLOYING BODIES

5.1 The consultation asked specifically for comments about:

a) The appropriateness of the assumptions and in particular those that relate to them e.g. the pay increases expected to award over the next few years?

b) In relation to the affordability of contributions and in particular whether there is any particular year over 2023/2026 which will be more challenging. This will help us form a view on any further flexibility required.

c) Whether the level of detail was sufficient and whether employers need anything further in terms of information to understand the content and implications

5.2 The responses are summarised by employer in Appendix 2. They highlight the severe funding pressures in the public sector given the higher costs all employers will need to meet over the valuation period. The main themes are summarised below with a response from the Fund to each:

a) Given the cost pressures facing the employers, maximum flexibility is needed for them to manage their costs especially since there has as yet been no increase in funding for public sector bodies

Officers and the Actuary are fully aware of the cost pressures facing all employers and the uncertainty of funding /support from government. The FSS builds in flexibility and officers have discretion to flex the funding plans further within the 3 year valuation period at the employer level.

b) What the assumptions for short term pay should be for the next 3 years given what employers have in their budgets

The valuation is using an average of 4% p.a. for the 3 years as the short term pay assumption for the Fund as a whole. Feedback from employers suggest that this

may be on the low side initially but may be overstating by year 3 of the valuation period. We have experienced a decade of very low inflation and interest rates. It is not inconceivable (and maybe markets are indicating) that we may now experience a period of higher interest rates and inflation. Therefore an average of 4% over the 3 years seems reasonable but where an employer demonstrates a material deviation is likely this can be allowed for within reasonable bands.

c) Has the level of prudence in the discount rate assumptions increased and why given the funding level has improved?

When considering the assumptions to adopt the Actuary takes into account all available information (including the market outlook after the valuation date) in order to achieve a funding plan which balances affordability of contributions versus the long-term sustainability of contributions at future valuations. Ultimately the objective is to protect the financial health of the Fund in the long term. The primary reason for adjusting the assumptions is due to the material shift in the market outlook over the medium term since the valuation date and that the likelihood of a more persistent stagflationary environment (higher inflation and low asset growth) has increased. The intention of this is to provide more sustainability in contribution rates into the future. The Actuary has advised that this represents a reasonable balance to support the stability in contributions for the Fund and takes into account the risk management strategies implemented by the Fund that provide some protection. More prudent adjustments were considered to reflect a prolonged stagflationary environment. The discount rate agreed upon in the FSS appropriately balances the current environment with contribution affordability.

d) The rationale for reducing the deficit recovery period to 12 years and by 3 years?

At the last valuation the medium-term deficit recovery period was 12 years which is retained at this valuation. The actuary has to take long term cost efficiency into account which essentially means we cannot push the burden of the deficit onto future taxpayers. Given the open nature of the scheme, we think the medium-term target of 12 years is reasonable to achieve this objective and also aids stability of contributions where shorter periods would mean small changes in the funding position would have a material effect on contributions. In general, the 3 year reduction in the recovery period relates to the natural reduction over a valuation cycle to achieve full funding at the same end point.

e) How will the Fund use any improvement in funding levels – to reduce contributions or to create a buffer for possible deterioration during this valuation period?

We currently face a very uncertain economic and market environment which could be detrimental to the financial health of the Fund, especially if high levels of inflation persist in the long term which is not matched by investment returns. Furthermore, even if the economy recovers by the next valuation there is a significant risk that funding in the public sector is severely restricted due to the level of government debt from the pandemic and cost of living crisis. Therefore our approach is to have a buffer to protect employers against any deterioration at a time when they will still experience significant funding pressure. For tax raising bodies the use of a surplus to reduce contributions in the near term is equally a consideration for prudential management of current and future budgets. The discussion with employers on the final contribution rates will consider this and the FSS provides a framework to achieve this. Also where an employer's covenant

is weak or the employer is expecting to exit the Fund, holding a buffer (for all or part of any surplus) means that is reduces the risk to the Fund of unpaid or unaffordable contributions.

f) Why should the HFE bodies have different deficit recovery periods to the tax raising bodies?

The recovery period for HE/FE employers depends in part on decisions regarding the recovery period made by the employer in the past and progression of the employer funding plans between valuations. This was in part dependent on the affordability of contributions as well as the covenant of each HE/FE employer. When compared to tax raising bodies, the HE/FE covenant is not as secure as it is not backed by the taxpayer (and there is a divergence of covenant strength between HE/FE bodies); therefore it is desirable to reach full solvency as quickly as possible (to reduce the risk of underfunding) having taken in account the impact on contribution payments. The recovery period will be kept under review in light of changing circumstances and discussed with the HE/FE employers at the appropriate time.

g) Has the investment strategy been changed given current economic environment and market volatility?

The investment strategy is long term in its outlook and as a result is diversified across assets and return drivers to help withstand financial market volatility. We also have hedging strategies in place to protect (to a degree) against equity losses and rising inflation. However, the investment strategy and returns achieved are a critical part of the funding strategy as it reduces the costs to the employers. The Actuary takes into account the risk management strategies when considering the valuation assumptions and allows a higher discount rate to be adopted (all other things equal) given the hedging strategies in place. The investment strategy is being reviewed in line with the valuation and a key question being considered is whether it should target a higher return albeit this will also increase investment risk. We are confident that the current strategy can deliver the return required in the funding strategy at an acceptable level of risk; however, if we can increase the expected risk adjusted return, the funding position will be improved at the next valuation, everything else being equal.

6 PRELIMINARY WHOLE FUND RESULT

6.1 The final actuarial outcome will be reported to Committee at March 2023 meeting. The 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	5,822
Liabilities	6,020
Deficit	198
Average Funding Level	97%
Average Employer future service contribution rate	18.5% 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 (the results above assume an average pay award of 4% for the next 3 years) and the impact of the any employers moving into the lower risk investment strategy. The impact of McCloud and GMP indexation has been allowed for based on the proposed remedies. This has reduced the finding level by c1% at a whole Fund level and has no effect on the future service rate.

7 RISK MANAGEMENT

7.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. In addition it monitors the benefits administration, the risk register and compliance with relevant investment, finance and administration regulations. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

8 CLIMATE CHANGE

8.1 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 Paris Aligned Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee. As part of the valuation the Actuary will report on the potential impact of climate change risks in his final valuation report in line with best practice.

9 OTHER OPTIONS CONSIDERED

9.1 None.

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.

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