<table>
<tr><th colspan="3">Bath & North East Somerset Council</th></tr>
<tr><td>MEETING:</td><td colspan="2">AVON PENSION FUND COMMITTEE</td></tr>
<tr><td>MEETING DATE:</td><td>17 March 2023</td><td>AGENDA ITEM NUMBER</td></tr>
<tr><td>TITLE:</td><td colspan="2">ACTUARIAL VALUATION 2022 & UPDATED FUNDING STRATEGY STATEMENT</td></tr>
<tr><td>WARD:</td><td colspan="2">ALL</td></tr>
<tr><td colspan="3">AN OPEN PUBLIC ITEM</td></tr>
<tr><td colspan="3">List of attachments to this report:

Appendix 1 – 2022 Funding Strategy Statement</td></tr>
</table>

1 THE ISSUE

1.1 The Local Government Pension Scheme (LGPS) Regulations require LGPS funds to have an actuarial valuation every three years. The 2022 valuation has a base date of 31 March 2022 with new employer contribution requirements becoming effective from 1 April 2023.

1.2 In calculating the contribution rates and deficit recovery payments for the period from 1 April 2023, the Actuary has taken the Funding Strategy Statement (FSS) into account.

1.3 The Actuary will finalise the actuarial valuation report before 31 March 2023 which will be circulated to all employing bodies. In the meantime, the employing bodies have been notified of their revised contribution requirements for the period 1 April 2023 to 31 March 2026.

1.4 This report examines the outcome of the valuation process for the whole fund and highlights the principal changes which have occurred since the 2019 valuation.

1.5 The latest version of the Funding Strategy Statement is included for information only.

2 RECOMMENDATION

The Committee notes:

2.1 Notes the outcome of the 2022 actuarial valuation exercise.

2.2 Delegates the finalisation of the Funding Strategy Statement to Officers.

3 FINANCIAL IMPLICATIONS

3.1 The actuarial valuation assesses the funding position of the Fund as a whole, for the individual employers and sets the contribution rates due from all employers for the 3 years commencing 1 April 2023. The costs for completing the valuation are provided for in the 2022/23 budget.

4 Background and valuation approach

4.1 The long-term funding objective is to achieve a 100% solvency over a reasonable length of time, and then maintain that position. Contributions are set in relation to this objective which means that once 100% solvency is achieved, if the assumptions are borne out in practice, there would be sufficient assets to pay all benefits earned up to the valuation date as they fall due.

As market conditions change between valuations, the assumptions may need to change at subsequent valuations in order to meet this objective; hence contribution rates will vary from one valuation to the next.

The Fund’s approach is that the assumptions used will be chosen with sufficient prudence for this objective to be reasonably achieved in the long term at every valuation.

4.2 Alongside this overarching objective, employer contributions are set to achieve long-term cost efficiency, meaning the funding plan must provide equity between different generations of taxpayers. Therefore contributions must not be set at a level that is likely to give rise to additional costs to future taxpayers or that put too high a burden on current taxpayers. Given the difficult economic and public sector funding environment at the time of the 2022 valuation, significant consideration was given to both the solvency and long-term cost efficiency objectives.

4.3 Finally, the 2022 valuation sought to maintain stable employer contributions where possible, and the FSS, which was approved by the Committee in September 2022, set out the parameters as to how these aims would be met.

4.4 By utilising the flexibility allowed within the FSS, the 2022 funding plans balance affordability for individual employers and solvency of the Fund. The main pressure on contributions is the impact on the discount rate due to lower long-term return expectations. In terms of setting contributions, the relationship of the expected investment return on assets 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).

4.5 The current rise in inflation, and the uncertainty of how persistent this period of higher inflation may be, has led to a reduction in the expected level of real returns over CPI so that a lower discount rate is needed to deliver the same level of prudence in the funding strategy. However, given that investment returns have been higher than was expected in the 2019 valuation, asset values have increased materially, and so the funding level has improved and deficit reduced when allowing for the lower discount rate. Likewise the real return for the future service discount rate has been reduced leading to higher contribution rates (all other things being equal).

4.6 Individual employer results will vary significantly due to other factors such as changes in the membership profile and salary growth (versus assumptions).

4.7 The actuary has applied the flexibility within the FSS to accommodate, as far as possible, the budgetary pressures facing all scheme employers while not compromising the long-term solvency of the Fund. In particular, an allowance for short term pay increases of 3%, 4% (versus 4.6% p.a. for long term pay increases).

5 ACTUARIAL VALUATION 2022 OUTCOME

5.1 The current valuation has been taken at 31 March 2022 and a summary of the valuation is in the table below.

5.2 The FSS provides a flexible framework to take account of affordability when setting contribution rates and deficit recovery payments as follows:

a) Phased in increases in deficit recovery payment increases over 3 years
b) Phased in increases in future service rates over a maximum of 3 years
c) Option to pay contributions in advance to benefit from a monetary discount.

Initial Fund Outcome:

	2019	**2022**
Deficit	£284m	£198m
Funding Level	94%	97%
Value of assets	£4,818m	£5,822m
Value of Liabilities	£5,102m	£6,020m *
Average employee contribution rate	6.4% of pay	6.4% of pay
Average future service rate (employer) **	17.1% of pay	18.5% of pay
Past service recovery period (years)	13	12

Notes:
** includes lower risk strategy results for employers within that strategy at the valuation date*
*** this is the average ongoing open future service rate for transparency*

5.3 The average deficit recovery for the Fund has reduced from 13 years in 2019 to 12 years in 2022 which is line with the medium-term target. The main drivers of the valuation outcome are:

a. The investment return over the 3 years to 31 March 2022 was approximately 6.5% p.a. compared to an expected return in 2019 of 4.15% p.a. This served to reduce the deficit by c. £384m.

b. The discount rate used to value the past service a liability is based on the expected return on the assets relative to CPI. At 31 March 2019 the equivalent annual discount rate relative to CPI was CPI +1.75% p.a. This was reduced to CPI +1.50% in 2022.

c. The fall in return expectations has also affected the FSR. The Actuary uses a “smoothed” discount rate to value future accruals, in order to keep the FSR as stable as possible in line with the Regulations. The 2019 discount rate of CPI +2.25% was reduced to reflect the challenging economic outlook at 31 March 2022, in particular headwinds from inflation and therefore pressure on the real return outlook and increased risk of stagflation in the near term. Therefore the discount rate for future service was reduced by 0.25% p.a. to CPI + 2.00% p.a. The average FSR across all employers in the Fund increased by 1.6% of pay p.a. as a result of this change to the assumptions; however the impact at the individual employer level varies depending on the profile of their active members and their funding strategy.

d. At each valuation the actuary uses an analysis of the life expectancy experienced by the Fund and other LGPS funds alongside improvement trend models from the Continuous Mortality Investigation (CMI) to assess the adequacy of the longevity assumptions.

   The longevity assumption is made up of two elements, the current life expectancy (or baseline assumption) and an assumption of future improvement / deterioration around the baseline assumption. The Actuary has altered the baseline assumption for the 2022 valuation reflecting the updated membership information to include the Fund's experience since 2019. For the long-term life expectancy improvement assumption, the latest 2021 CMI tables have been used which show a slowing in the rate of improvement evidenced by mortality data. As a result the higher mortality has reduced liabilities overall.

e. Whilst the final McCloud remedy regulations are awaited, in line with guidance issued by DLUHC, the Actuary has included an allowance for the cost of the McCloud remedy within the valuation balance sheet. At the whole Fund level the impact has been an increase in liabilities of c1.1% although the impact for individual employers has varied depending on the available data and the membership profile. There is no impact on the FSR as the extension to the final salary underpin to CARE benefits (the McCloud remedy) ceased in respect of benefits earned from 1 April 2022.

f. Overall the changes in the financial and demographic assumptions have increased the average FSR by 1.3% of pay p.a. The impact of the change in membership profile (and other factors) is an increase of 0.1%, giving an overall average increase in the FSR of 1.4% of pensionable pay.

5.5 The changes are summarised in the following tables:

Changes to past service position since 2019 valuation

	£m
Deficit at 31 March 2019	**-284**
Interest on deficit	-37
Investment returns versus assumptions	+384
Contributions paid versus benefits accruing	+6
Salary gain/loss (i.e. salary increases less/more than assumption)	-53
CPI pension increases vs 2019 assumption	+85
Change in discount rate	-260
Change in demographic assumptions	+98
McCloud / GMP indexation	-89
Approximate allowance for April 2023 pension increase	-121

Allowance for 4% short term pay for 3 years from April 2023	+61
Member movement and other factors	+12
Deficit at 31 March 2022	**-198**

Changes to future service rate

Average Employer Rate at 31 March 2019	**17.1% of pay**
Change in membership profile	+0.1% of pay
Change in Discount rate	+1.6% of pay
Change in demographic assumptions	-0.3% of pay
Average Employer Rate at 31 March 2022	**18.5% of pay**

6 COMMUNICATION WITH EMPLOYING BODIES

6.1 The 2022 actuarial report will be published by 31 March 2023. In the meantime, the employing bodies have been notified of their revised rates and officers are responding to queries from employers.

7 FUNDING STRATEGY STATEMENT (FSS)

7.1 The 2022 FSS was approved by Committee in September 2022, and finalisation of the FSS was delegated to Fund Officers, with assistance of Fund Actuary.

7.2 The version in Appendix 1 has been updated for the actuarial and financial assumptions/data and the section on Climate Change. There may be further minor amendments once the Actuarial Valuation Report is completed.

8 RISK MANAGEMENT

8.1 A key risk to the Fund is the inability of an individual employer to meet its liabilities, especially when it ceases to be an employing body within the Fund. The Funding Strategy is designed to manage this risk to ensure the Fund achieves full solvency over an appropriate period. Assessing the strength of an employing body's covenant is also a crucial component in managing the potential risk of default to the Fund and is incorporated in the contribution plans.

9 CLIMATE CHANGE

9.1 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 addresses this through its strategic asset allocation to Paris Aligned Global Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

9.2 In terms of the current valuation, an analysis of different climate change scenarios at the Whole Fund level has been undertaken relative to the baseline position assuming that the funding assumptions are played out on a best estimate basis. The projections are meant to illustrate the different elements of risk under three climate change scenarios based on the current strategic allocation. The scenarios are not meant to be predictors of what may happen and are only a small subset of a very wide range of scenarios that could arise. The analysis considers a projection of the funding levels under the scenarios considered which are designed to illustrate the transition and physical risks over different periods depending on what actions are taken globally on climate change. Further detail is set out in the FSS appended to this report (pages 10 and 11), and a summary of the results of the analysis will be included in the Actuary's valuation report.

10 OTHER OPTIONS CONSIDERED

10.1 Report for information only.

11 CONSULTATION

11.1 The Council's Monitoring Officer and Section 151 Officer have reviewed this paper for publication.

Contact person	Julia Grace, Pensions Valuation Advisor 01225 395392
Background papers	Actuary reports and presentations; 2022 FSS
Please contact the report author if you need to access this report in an alternative format	