**FOR PUBLICATION**

**DERBYSHIRE COUNTY COUNCIL**

**PENSIONS AND INVESTMENTS COMMITTEE**

**WEDNESDAY, 7 DECEMBER 2022**

**Report of the Director of Finance and ICT**

# DERBYSHIRE PENSION FUND 2022 ACTUARIAL VALUATION

## 1. Purpose

To inform the Committee of the initial whole fund results of the actuarial valuation (the Valuation) of Derbyshire Pension Fund (the Fund/Pension Fund) at 31 March 2022 and to seek approval of the Fund's draft updated Funding Strategy Statement, attached as Appendix 2, for consultation with relevant stakeholders.

To seek approval for the Fund's draft updated Admission, Cessation and Bulk Transfer Policy attached as Appendix 3.

## 2. Information and Analysis

### 2.1 The Regulations

Under Regulation 58 of the Local Government Pension Scheme (LGPS) Regulations 2013 (2013 Regulations), administering authorities of LGPS funds are required to prepare, maintain and publish a funding strategy statement following consultation with 'such persons as it considers appropriate'.

Under Regulation 62 of the 2013 Regulations, administering authorities of LGPS funds are required to obtain an actuarial valuation of the assets and liabilities of the pension fund on 31 March every three years.

The 2013 Regulations (Parts 1, 2 & 3 of Schedule 2) set out the various types of employers who participate/are eligible to participate in the LGPS and the different requirements that apply to each category of employer.

## 2.2 The Purpose of the Actuarial Valuation

The Valuation is a planning exercise for the Fund to determine:

- The expected cost of providing the benefits built up by members at the valuation date in today's terms (the liabilities) compared to the investments held by the Pension Fund (the assets).
- The contributions needed over an appropriate time horizon to cover the cost of the benefits that active members will build up in the future (the Primary Contribution Rate).
- An adjustment for the difference between the Primary Contribution Rate above, and the actual contribution the employer needs to pay over the time horizon, referred to as the Secondary Contribution Rate. In broad terms, payment of the Secondary Contribution Rate is in respect of benefits already accrued at the valuation date.

The actuary determines the information above for individual employers, or pools of employers, as well as for the Pension Fund as a whole in order to determine the appropriate contribution rates for each employer, or pool of employers.

The Valuation is calculated as at 31 March 2022 and will set the contribution rates payable from 1st April 2023 to 31 March 2026, which will be detailed in the Rates and Adjustments Certificate appended to the actuary's final Valuation report.

## 2.3 The Funding Level

The funding level of the Pension Fund is the ratio of assets to liabilities at the valuation date. The market value of the Fund's assets (investments) is compared to the value placed on the Fund's accrued liabilities in today's terms. The accrued liabilities cover the expected cost of members' benefits in respect of scheme membership completed before the valuation date (past service).

## 2.4 Experience Since the March 2019 Valuation & Future Expectations

Since the last actuarial valuation, the Fund achieved investment returns of 24.3% over the three year period to 31 March 2022, compared to an anticipated investment return over that period of 11.2%, leading to a larger than expected increase in the value of the assets of the Fund.

Based on a forecast of slightly higher investment returns going forward, the assumed future investment return is 3.8% p.a., compared to an assumed return of 3.6% p.a. at the last valuation. The future investment return is used to discount future benefit payments to a present value of the Fund's liabilities and, everything else being equal, a higher investment return assumption results in a lower present value of the Fund's liabiities.

Pension benefit increases (both in payment and deferment) and the revaluation of career-average earnings are in line with CPI inflation; a higher level of CPI, therefore, results in an increase in the forecast costs of the benefits to be paid from the Fund. In the three years to March 2022, the inflationary increase in benefits was 1.8% p.a. against a forecast increase of 2.3% p.a, however, longer term inflation expectations have increased to 2.7% p.a.reflecting the significant increase in short term inflation expectations over the past year.

A greater than expected increase in salaries in the three years to March, 4.4% p.a. against 3.7% p.a., and an increase in expected salary increases going forward (CPI +1%), reflecting the strong job market, higher inflation and pressure from National Living Wage increases, has also increased the forecast cost of future benefit payments.

In line with guidance issued by the Department for Levelling Up, Housing and Communities (DLUHC), the Fund's actuary, Hymans Robertson LLP (Hymans), has made an allowance for the cost of the potential improvements in benefits accrued by certain members between 2014 and 2022 who may benefit from the implementation of the remedy to the McCloud 'age discrimination' case when the necessary amendments to the LGPS 2013 regulations are introduced.

The membership experience was largely in line with expectations over the period, although sadly there was a slightly higher number of deaths than expected. Overall, the impact of more positive actual and expected investment returns on the funding position of the Pension Fund, has outweighed the negative impact of higher future inflation expectations.

The valuation assumptions are based on recommendations from the Fund's actuary and have been agreed with the Director of Finance & ICT.

**2.5 Initial Whole Fund Results**

There has been an improvement in the funding level of the Pension Fund from 97% at 31 March 2019 to 100% at 31 March 2022, with the 2019 deficit of £163m moving to a small positive surplus of £3m.

| Valuation Date | 31 March 2022 | 31 March 2019 |
|---|---|---|
| **Past Service Liabilities** | **(£m)** | **(£m)** |
| Employees | 2,470 | 2,019 |
| Deferred Pensioners | 1,115 | 923 |
| Pensioners | 2,543 | 2,150 |
| **Total Liabilities** | **6,128** | **5,092** |
| **Assets** | **6,132** | **4,929** |
| **Surplus/(Deficit)** | **3** | **(163)** |
| **Funding Level** | **100%** | **97%** |

The funding level provides a high-level snapshot of the funding position at a particular date and could be very different the following day on a sharp move in investment markets.

**2.6 Funding Strategy Statement**
As part of the valuation process, the Fund reviews the funding strategy to ensure that an appropriate contribution plan and investment strategy is in place. The funding strategy is set out in the Funding Strategy Statement (FSS) which is the Fund's key governance document in relation to the actuarial valuation.

The FSS sets out the funding policies adopted, the actuarial assumptions used and the time horizons considered for each category of employer.

The draft updated Funding Strategy Statement is attached as Appendix 2. The FSS has been streamlined to make it more accessible to stakeholders. The main changes to the FSS since it was last updated in September 2021 are:

- maximum time horizons for local authorities, the police authority, the fire authority, arm's length management organisations, Peak District National Park and Chesterfield Crematorium, the academies and the town and parish councils, reduced from 19 years to 18 years, in the interests of intergenerational fairness
- stabilisation approach extended to allow contribution rate reductions of up to 1% of pay a year for local authorities, the police authority, the fire authority, arm's length management organisations, Peak District National Park and Chesterfield Crematorium, in recognition of generally stronger funding positions
- low risk exit basis changed from a gilts exit basis to a risk based approach (further information provided below)

- additional detail on the Fund's criteria for considering requests for the prepayment of employer contributions, on the implementation of prepayments and on employer considerations related to prepayments
- section on employer flexibities related to exit payments on cessation (covering debt spreading arrangements and deferrred debt agreements) moved to the Admission, Cessation and Bulk Transfer Policy

When an employer ceases to participate in the Pension Fund, the Fund's actuary carries out an exit valuation to place a value in today's terms on the future benefit payments (liabilities) of the ceasing employer to determine whether the employer has a cessation debt to pay to the Fund or whether there is a potential exit credit for the Fund to pay out. This requires an assumption to be made about the level of future investment returns that will be earned on the Fund's assets.

A low risk exit basis is used to value a ceasing employer's liabilities when there is no guarantor to stand behind ongoing pension liabilities relating to the ceased employer in order to provide an enhanced level of protection to the Fund's remaining employers who would be required to fund any unfunded liabilities. This added protection is allowed for by assessing the ceasing employer's liabilities using a more prudent investment return assumption.

The Fund's current strategy is to use a single investment return assumption based on long term UK government bonds (long term gilts). It is now proposed that the Fund moves to a risk based approach for low risk exit valuations, deriving an investment return assumption based on the Fund's actual investment strategy, with a higher level of prudence than the ongoing funding basis.

It is also proposed that a 'corridor' approach is adopted, with the actuary calculating two target asset values, equal to the liabilities calculated using a minimum and maximum likelihood of success of achieving the investment return. These two values would represent the bounds of the 'cessation corridor'. If the ceasing employer's asset share falls within this corridor, no payment would be required in either direction (i.e. no cessation debt or exit credit) as the employer's asset share would be deemed to be broadly sufficient to cover the calculated liabilities.

The actuary has recommended likelihood of success corridor bounds of 85% and 95% which is forecast to maintain the current level of prudence adopted by the Fund when carrying out low risk exit valuations. The benefits of the proposed new approach include:

- aligning the basis of calulating the valuation of low risk exits with the risk based approach used for reporting liabilities for ongoing employers and with the invested assets of the ceased employer (a large percentage of the Fund is invested in growth assets)

- reducing the risk of the significant volatility in exit valuations that can arise as a result of market conditions on a particular day, which can increase the difficulty of planning for future cessation events
- reducing the exposure of low risk exit valuations to distortions in the gilts market caused by supply and demand issues

Committee's approval of the draft updated FSS for consultation with the Fund's stakeholders, including scheme employers and Derbyshire Pension Board, is sought.

Subject to Committee's approval, it is intended that the draft updated FSS will be presented to the Fund's employers on 15 December 2022 at an Employer Valuation Meeting attended by Hymans. It is proposed that a consultation will be launched the following week to run for six weeks to 31 January 2023.

Following consideration of the responses received during the consultation, the final FSS will be presented to Committee for approval in early March 2023.

**2.7 Contribution Rate Modelling**
The Fund's actuary has carried out contribution rate modelling in respect of some chosen long term, secure employers in the Pension Fund to allow the Fund to consider appropriate future contributions and the interaction of the long term funding strategies for the Fund's stabilised employers. The chosen employers included a select number of councils and a pool of the worst funded academies.

**2.8 Remaining Actuarial Valuation Timetable**

| | |
|---|---|
| | **2022** |
| Draft employer results schedules & draft updated FSS issued to employers | w/c 12 Dec |
| Employer Valuation Meeting | 15 Dec |
| Commence FSS consultation | w/c 19 Dec |
| | **2023** |
| Individual meetings with actuary available for employers | 12 Jan |
| End of FSS consultation | 31 Jan |
| Committee to consider results of FSS consultation & finalise funding strategy | 8 Mrch |
| Final valuation sign-off by the actuary | 31 Mrch |

The final actuarial valuation report will be presented to Committee for noting in due course.

**2.9 Admission,Cessation and Bulk Transfer Policy**
The draft updated Admission, Cessation and Bulk Transfer Policy (the Policy), attached at Appendix 3, sets out the Fund's approach to the admission of new employers to the Pension Fund, how it deals with possible bulk transfers of members, and employers ceasing their participation in the Fund. The Policy also includes the Fund's approach to dealing with exit credits which LGPS regulations introduced in 2018 allowed to be paid for the first time.

Employers are responsible for any surplus or deficit arising with respect to their members during the period of participation in the Fund so that if or when the participation ceases, they are 100% funded. However, if an employer fails or ceases to exist and any deficit cannot be met by the employer or claimed from any bond, indemnity or guarantor, the liability would fall to other employers in the Fund.

The purpose of the Policy is to ensure that only appropriate bodies are admitted to the Fund and that the financial risk to Fund, and to other employers, associated with employers' participation in the Fund is identified, minimised and managed accordingly. The Policy also seeks to ensure that bulk transfers out of the Fund do not allow a deficit to remain behind and that bulk transfers into the Fund are sufficient to pay for the associated benefits being awarded to the members transferring into the Fund.

The main changes to the Policy since it was last approved by Committee in July 2021 are:

- Clarification that academies which outsource services to an admission body must comply with Education and Skills Funding Agency requirements in order for the Department of Education's (DfE) guarantee in respect of LGPS funding to apply (the DfE provides a guarantee for any shortfall in the payment of LGPS liabilities in the event of an academy closure to ensure that any outstanding liabilities do not revert to LGPS funds).
- Recognition of the ability of a Multi Academy Trust (MAT) to apply to DHULC for a Direction Order to substitute a different administering authority for academies which a MAT is seeking to consolidate into a single Fund.
- Clarification that the Fund reserves the right to request a secure and financially durable bond or other form of security from a scheduled body, depending on the employer's financial circumstances.
- The addition of the basis for calculating an employer's liabilities on exit, according to the category of employer.
- The addition of the Fund's approach to the employer flexibilities related to exit payments on cessation (covering debt spreading arrangements and deferrred debt agreements).

- The updating of the Fund's approach to dealing with exit credits to reflect the inclusion of the basis for calculating an employer's pension liabilities on exit in the Policy and to reflect the new low risk exit basis.
- Clarification of the roles and responsibilities of ceasing employers, the administering authority and the Fund's actuary in relation to exits from the Pension Fund.

**2.10 Hymans Robertson LLP - Attendance at Committee**
The Fund's actuary is attending Committee to present on the initial whole fund results, the proposed updates to the Funding Strategy Statement and the conclusions of the contribution rate modelling.

## 3. Implications

Appendix 1 sets out the relevant implications considered in the preparation of the report.

## 4. Background Papers

Papers held by the Pension Fund.

## 5. Appendices

5.1 Appendix 1 – Implications

5.2 Appendix 2 – Draft Updated Funding Strategy Statement

5.3 Appendix 3 – Draft Updated Admission, Cessation and Bulk Transfer Policy

## 6. Recommendations

That Committee:

a) Notes the initial whole fund results of the actuarial valuation of Derbyshire Pension Fund.
b) Approves the Fund's draft updated Funding Strategy Statement, attached as Appendix 2, for consultation with relevant stakeholders.
c) Approves the Fund's draft updated Admission, Cessation and Bulk Transfer policy, attached as Appendix 3.

## 7. Reasons for Recommendations

It is the role of Committee is to review and approve the Fund's statements, strategies and policies and to receive and consider the Fund's actuarial valuation report.



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**Appendix 1**

**<u>Implications</u>**

**Financial**

1.1 None

**Legal**

2.1 None

**Human Resources**

3.1 None

**Information Technology**

4.1 None

**Equalities Impact**

5.1 None

**Corporate objectives and priorities for change**

6.1 None

**Other (for example, Health and Safety, Environmental, Sustainability, Property and Asset Management, Risk Management and Safeguarding)**

7.1 None