Item 2

25th November 2020

Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

Contact: Richard McIndoe, Ext: 77383

Actuarial Valuation and Draft Funding Strategy Statement

Purpose of Report:

To present preliminary results of the actuarial valuation as at 31st March 2020 together with a draft Funding Strategy Statement

Recommendations:

The Committee is asked:

- **to NOTE** the preliminary results of the actuarial valuation as at 31st March 2020; and
- **to APPROVE** the draft Funding Strategy Statement for consultation with appropriate interested parties.

Ward No(s):	Citywide: ✓
Local member(s) advised: Yes ☐ No ☐	consulted: Yes ☐ No ☐

1 Background

1.1 Funding Strategy Statement (FSS)

Regulation 56 of the Local Government Pension Scheme (Scotland) Regulations 2018 requires each administering authority, after consultation with such persons as it considers appropriate, to:

- prepare, maintain and publish a written statement setting out its funding strategy; and
- to keep the statement under review.

1.2 Actuarial Valuation

Regulation 60 requires each administering authority to obtain an actuarial valuation of the assets and liabilities of each of its pension funds as at 31st March 2020 and in every third year afterwards. In completing the valuation the actuary must have regard to the current version of the administering authority's funding strategy statement

1.3 Practice

The actuarial valuation is essentially a measurement of the Fund's current and future liabilities. The funding strategy deals with how the liabilities will be managed. In practice, review of the FSS and completion of the actuarial valuation are carried out in tandem to ensure that the measurement and management processes are cohesive.

2 2020 Actuarial Valuation

2.1 Preliminary Results

Preliminary results of the valuation are as follows.

Valuation Date	*31 March 2017*	31 March 2020
Past Service Liabilities	***(£m)***	**(£m)**
Employees	*9,057*	8,948
Deferred Pensioners	*2,233*	2,451
Pensioners	*7,470*	8,344
Total Liabilities	***18,761***	**19,744**
Assets	***19,699***	**20,941**
Surplus	*939*	1,197
Funding Level	***105%***	**106%**

These figures provide a high-level snapshot of the funding position but their limitations should be noted:

- the liabilities have been valued using a single set of assumptions about the future. The figures are very sensitive to the assumptions used.
- the assets are shown at their market value as at the valuation date but that figure is volatile and will change constantly with market movements.

2.2 Fund Experience 2017 - 2020

The main outcomes since 2017 which have impacted on the valuation results are as follows.

	Expected	Actual	Difference	Impact
Investment Returns (p.a.)	3.5%	**2.7%**	(0.8%)	**Negative**
Inflation (p.a.)	2.4%	**2.4%**	0	**Neutral**
Salary Increases (p.a.)	4.2%	**4.3%**	0.1%	**Negative**
Pensions Ceasing	£33.8m	**£38.5m**	£4.7m	**Positive**

2.3 Key Assumptions

The key assumptions which have impacted on the results are as follows.

	31 March 2017	31 March 2020	Impact
Financial Assumptions	***(% p.a.)***	**(% p.a.)**	
Discount Rate	*3.5*	3.0	Negative
Inflation	*2.4*	1.9	Positive
Salary Increases	*3.6*	2.6	Positive
Life Expectancy (from age 65)	***Years***	**Years**	
Male pensioners	*21.4*	19.7	Positive
Male non-pensioners	*23.4*	20.8	Positive
Female pensioners	*23.7*	22.5	Positive
Female non-pensioners	*25.8*	24.2	Positive

The discount rate assumption of **3% p.a.** is a prudent estimate of investment returns over the target funding period of 13 years (the weighted average future working lifetime of the employee membership). It is based on detailed actuarial modelling of 5,000 future economic scenarios. The modelling indicates that there is a **75%** likelihood of the Fund's investments achieving a **3.0% p.a.** return over the next **13 years**.

2.4 Employer Contribution Rates

The reported funding level does not directly drive the employer contribution rates that will be set. Rates are set using similar actuarial modelling to that used to report the funding level, but projecting multiple, variable assumptions rather than relying on a single set. This allows a robust funding plan to be agreed for each employer which considers how the assets and liabilities will evolve over time in different economic scenarios. Contribution rates are set to ensure that each employer has an appropriate likelihood of achieving its funding target – a minimum of **66%** and a preferred probability of **75%** are used, similar to the 2017 valuation. Work on setting the employer contribution rates is still in progress, but the expected outcomes are summarised below.

2.5 Main Employer Group

The main employer group includes the 12 local authorities which participate in the Fund, associated employers such as arm's length external organisations which share their covenant, and other employers which are assessed as having a strong covenant or low risk profile.

Employers in this group have paid a contribution rate of **19.3%** of pensionable payroll since 1st April 2011. The actuary has confirmed that, in spite of the lower expectation of future investment returns at the current valuation, the vast majority of employers within this group will retain at least a 2/3rds probability of meeting their funding objective if they continue to pay the rate currently in force. It is therefore proposed that the employer contribution rate for the main employers will be certified as:

- **19.3%** (of pensionable payroll) from 1st April 2021 for 3 years.

2.6 Employer Contribution Rates – Other Employers

Employers not in the main group pay rates individual to their own circumstances. During December all employers will receive individual results schedules setting out their own:

- membership details;
- funding position; and
- contribution rates for the 3 years from 1st April 2021.

SPFO staff will engage with employers on queries arising from these results schedules. The actuary's final report on the valuation will set out the individual rate certified for each employer.

2.7 Changes to the Benefit Structure

There are 2 current issues which may entail changes to the benefit structure of the LGPS in Scotland: the McCloud judgement and the cost cap valuation. The actuarial treatment of these is summarised as follows.

2.7.1 McCloud Judgement

The outcome of this court case requires the removal of unlawful age discrimination from the LGPS. The current proposal, which was the subject of a recent consultation, is to extend the "underpin" protection which formed part of changes to scheme in 2015, to those who were not old enough to receive it when it was originally introduced. The actuarial valuation includes an estimate of the cost of this change.

2.7.2 Cost Cap Mechanism

Alongside the McCloud judgement, there is another ongoing national process which is resulting in current uncertainty around the benefit structure of the LGPS – the "cost cap" mechanism. As part of the public sector pension scheme reforms in 2015, a mechanism was put in place to protect employers from significant increases in future pension costs. The mechanism is symmetrical in its design – following a Cost Cap valuation, if the scheme is determined to have either a lower or higher than intended cost to employers, then action will be taken: either a change in the benefit structure for future benefit accrual or a change in employee contribution rates. The first Cost Cap review for LGPS Scotland was as at 31 March 2017, however this was put on hold until the McCloud judgement is resolved. There is currently no information available about the results of the 2017 Cost Cap valuation and whether a change in the benefit structure from 1 April 2020 may occur. Therefore, the actuarial valuation does not make any allowance for the impact of the Cost Cap mechanism. This may change if information becomes available before 31st March 2021, the statutory date for completion of the valuation process. If no further information becomes available and a more expensive benefit structure is subsequently introduced, the cost will have to be absorbed in the next actuarial valuation as at 31st March 2023.

3. 2020 (Draft) Funding Strategy Statement (FSS)

3.1 Funding Strategy

The proposed funding strategy for the 2020 actuarial valuation is set out in a draft FSS which is attached at Appendix A. The preliminary results of the valuation as summarised above are based on this strategy.

3.2 History

The Strathclyde Pension Fund's first FSS was published in March 2006 in conjunction with the results of the 2005 actuarial valuation of the Fund. The statement has been reviewed and revised at each subsequent valuation

3.3 Format and Content

The draft 2020 statement retains broadly the same format as previous versions. The content is as required by the regulations and in accordance with statutory guidance published by CIPFA (the Chartered Institute of Public Finance and Accountancy). The statement sets out how funding is managed both for the Fund as a whole and for individual employers. Key aspects include:

- objectives of the Funding Strategy
- responsibility of key parties involved in management of Fund
- solvency and long term cost efficiency
- funding strategy for individual employers
- contributions strategy
- links to investment strategy and
- identification of risks and counter measures.

3.4 2020 Strategy

The funding strategy proposed for the 2020 valuation is not fundamentally different to the strategy adopted at the 2017 valuation. The document has been updated to reflect:

- changes in the regulatory background including certain provisions of the Local Government Pension Scheme (Scotland) regulations 2018;
- changes in associated guidance; and
- some improvements in underlying processes including covenant assessment, and the actuary's probabilistic approach to reporting the funding level and setting employer contributions.

Some stylistic improvements have also been incorporated.

4 Timetable

The regulations require the actuarial valuation to be completed within one year of the valuation date. Timetable for completion is summarised as follows.

December 2020	▪ Draft individual results schedules issued to employers. ▪ Funding Strategy Statement issued for consultation.
February 2021	▪ Consultation on FSS closes.

	▪ Employer results finalised.
March	▪ Publication of FSS approved by the Committee.
	▪ Actuary's report received by the Committee.
	▪ Final report signed off by the actuary.
April	▪ Revised employer contributions take effect.

5 Policy and Resource Implications

Resource Implications:

Financial:	The actuarial valuation sets employer contribution rates for the 3 years from 1st April 2021.
Legal:	The process is carried out in accordance with regulations 56 and 60 of the Local Government Pension Scheme (Scotland) Regulations 2018
Personnel:	None.
Procurement:	None.

Council Strategic Plan:	Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality and Socio-Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2017-22	Equalities issues are addressed in the Fund's Responsible Investment strategy, in the scheme rules which are the responsibility of Scottish Government and in the Fund's Communications Policy which has been the subject of an Equalities Impact Assessment.
What are the potential equality impacts as a result of this report?	No specific equalities impacts.
Please highlight if the policy/proposal will help address socio economic disadvantage.	Not applicable.

Sustainability Impacts:

Environmental:	No impact at present but results of the actuarial valuation will be used as the basis for climate change scenario modelling.
Social, including	No impact

opportunities under Article 20 of the European Public Procurement Directive:	
Economic:	No impact
Privacy and Data Protection impacts:	None

6 Recommendations

The Committee is asked to note the preliminary results of the actuarial valuation as at 31st March 2020 and to approve the draft Funding Strategy Statement for consultation with appropriate interested parties.