REPORT TO:	**PENSION COMMITTEE** **11 October 2022**
SUBJECT:	**Croydon Pension Fund - 2022 Valuation Initial Results and Funding Strategy Statement Review**
LEAD OFFICER:	**Matthew Hallett** **Head of Pensions and Treasury**
SUMMARY OF REPORT: Under Local Government Pension (LGPS) Regulations an administering authority must obtain an actuarial valuation of the assets and liabilities of the Pension Fund every three years. An administering authority must also maintain and publish a Funding Strategy Statement (FSS) which needs to be kept under review, and after consultation with such persons as it considers appropriate, make such revisions as are appropriate following a material change in its policy set out in the statement. This report details progress made to date in preparing the valuation effective 31 March 2022 and changes made as part of the regular review of the Fund's FSS.	
FINANCIAL SUMMARY: The report sets out the initial whole Fund results of the valuation showing a funding level of 97% effective 31 March 2022.	
PUBLIC/EXEMPT: Public	

1 RECOMMENDATIONS

1.1 The Committee are asked to approve the draft FSS (Appendix A) and 'satellite' policy documents on contribution reviews (Appendix B), academy funding (Appendix C), bulk transfers (Appendix D), cessations (Appendix E) and prepayments (Appendix F) to be issued to all participating employers for comment alongside their 2022 valuation results.

1.2 Note the progress made towards the 2022 valuation.

1.3 Note the initial whole Fund results effective 31 March 2022.

2 BACKGROUND

2.1 Under LGPS Regulations, all funds have a statutory obligation to produce an FSS. It is a key document for the Fund, in two ways:

Firstly: the inputs it requires: the Fund's officers and Pensions Committee need to go through a process to be satisfied that the Fund is managing funding risks and will be collecting an appropriate level of contributions from all employers in the Fund. The FSS provides a helpful framework for organising this process and covering all the necessary areas.

Secondly: the outputs it gives: the finalised FSS itself should be a clear and transparent reference point for the Fund's stakeholders, to set out how the Fund manages funding risks and provide proof that the contribution arrangements are solidly derived, fair and consistent. It will also help in any future discussions with employers, perhaps where an approach is queried or questions are raised.

The FSS is prepared in collaboration with the Fund Actuary and forms an integral part of the framework within which to carry out the triennial valuation to set employer contributions. The FSS also outlines how the funding strategy fits in with the investment strategy.

The current FSS was approved by the Pensions Committee at the May 2021 meeting following updates to allow for regulation amendments for exit credits and employer flexibilities.

This report sets out a revised structure to the FSS and a few technical or regulatory updates required since the May 2021 review. The main updates for the Committee's attention are in relation to the funding assumptions, climate risk and the 'McCloud' judgement.

2.2 The 2022 valuation of the Fund is a regulatory requirement and is used to determine contribution rates payable by participating employers for the period commencing 1 April 2023. The valuation is carried out under Regulation 62 of the Local Government Pension Scheme Regulations 2013.

Fund officers are currently working with the actuary to progress the valuation. To date this has included: contribution modelling analysis and discussion with Croydon Council; assumptions analysis; and provision and cleansing of membership and cashflow data. The actuary has now used the data to calculate the initial results of the Fund as a whole.

3 FSS - REVIEW DETAIL

3.1 The 2022 review has focussed on adapting the FSS to fit in with the changing environment and circumstances within which the Fund operates.

3.2 The evolving challenges, increasing diversity of employers and the growing complexity and regulation in the LGPS over the last few years has meant the FSS has become increasingly unwieldy. While the purpose of the FSS is to act as a compliant and robust reference document, it is acknowledged that a more streamlined document and modular approach to policies would enhance the accessibility and useability - ultimately making it more practical for all stakeholders (particularly employers).

3.3 The revised structure is a streamlined “core” FSS document which is complemented by a number of “satellite” policy documents. The core document includes all the funding information required by LGPS Regulations and Statutory Guidance. It has also been restructured into sections within an LGPS employer’s lifecycle (ie arrangements on joining, calculating assets and liabilities, setting contributions, arrangements on leaving, etc)

3.4 The satellite policies work both to complement the FSS and as standalone documents in their own right. These documents set out the Fund’s policies with regards to specific elements of strategy and include more details on process and practicalities. Working with the actuary we have updated the bulk transfers and cessation policies and created policies to cover contribution reviews, contribution prepayment requests and academies.

3.5 Alongside the restructure there has been relatively few technical or regulatory updates required since the May 2021 FSS review. The most significant changes to bring to the Committee’s attention include:

1. Review of funding assumptions
The actuary has reviewed the funding assumptions as part of the 2022 valuation. These have been updated to reflect emerging experience and market conditions as at 31 March 2022. All assumptions remain best estimate except for the discount rate assumption which includes the margin of prudence required by the LGPS Regulations.

In summary:

- Future investment return assumption – this covers the projected annual returns and volatility on asset classes invested by the Fund. For the purposes of reporting a funding level, a flat 4.0% pa future investment return assumption has been selected. The likelihood of the Fund’s assets yielding at least 4.0% pa over the next 20 years is 75%. This is the same level of prudence that was adopted at the 2019 valuation.

- Benefit increases / CARE revaluation assumption - to determine the size of future benefit payments (LGPS benefits are index-linked to CPI inflation). Significantly higher short-term inflation expectations have increased the CPI assumption.

- Life expectancy assumptions - the effect of recent experience has been allowed for in the longevity assumptions. However, an appropriate adjustment has been made to avoid the assumption being skewed by excess deaths due to Covid-19 in 2020 and 2021.

2. Climate risk
The Fund recognises that climate change is a key risk due to the open-ended time horizons of the liabilities. As part of the modelling analysis for reviewing the Council’s

contribution strategy, the actuary stress-tested the results under additional climate scenarios.

The modelling results under the stress tests were slightly worse than the core modelling results but were still within risk tolerance levels, particularly given the severity of the stresses applied. The results provide assurance that the modelling approach does not significantly underestimate the potential impact of climate change and that the funding strategy is resilient to climate risks.

3. 'McCloud' judgement treatment
The benefits accrued by certain members between 2014 and 2022 are expected to increase following the McCloud case, which ruled that transitional protections introduced in 2014 for older members were discriminatory. At the 2019 valuation there was uncertainty around if and how to allow for the potential extra costs. The Fund made an approximate allowance for the potential impact in setting employer contribution rates by building in a slightly higher level of prudence. However, the Department for Levelling Up, Housing and Communities has since provided guidance (dated 22 March 2022) around the treatment of McCloud for valuation purposes. The actuary has therefore now been able to use the guidance to build the expected impact of the benefit improvements directly into the liability calculations. The extra prudence allowed for at 2019 can now be removed from the assessment of employer contributions.

4 FSS - RECOMMENDATION AND NEXT STEPS

4.1 The Committee are asked to approve the draft FSS (Appendix A) and 'satellite' policy documents on contribution reviews (Appendix B), academy funding (Appendix C), bulk transfers (Appendix D), cessations (Appendix E) and prepayments (Appendix F) to be issued to all participating employers for comment alongside their 2022 valuation results.

4.2 Once approved by Committee, a draft version of the FSS and policies will be issued to all participating employers for comment alongside their 2022 valuation results. Following the end of the consultation period, any comments received may lead to amendments to the document. The Committee will then be asked to approve the final version of the FSS at its March 2023 meeting thus allowing the Actuary to sign off the final valuation report in time for the statutory deadline of 31 March 2023.

5 2022 VALUATION UPDATE

5.1 Fund officers are currently working with the actuary to progress the valuation. To date this has included: contribution modelling analysis and discussion with Croydon Council; assumptions analysis; and provision and cleansing of membership and cashflow data. The actuary has now used the data to calculate the initial results of the Fund as a whole.

5.2 A key output of the valuation is a measurement of past service liabilities at the valuation date to determine the funding level. To calculate a current funding level, the actuary compares the market value of assets against a value of the benefits accrued to date. The value of assets is easily obtained via market valuations. Placing a single value on the liabilities requires a single set of assumptions about the future, so it is important to acknowledge the results are very sensitive to the choice of assumptions.

5.3 Using this approach, a high-level snapshot of the funding position on 31 March 2022 is below:

Valuation Date	31 March 2022	31 March 2019
Past Service Liabilities	**(£m)**	**(£m)**
Employees	520	395
Deferred Pensioners	459	351
Pensioners	811	676
Total Liabilities	**1,790**	**1,423**
Assets	**1,731**	**1,258**
Surplus/(Deficit)	**(59)**	**(165)**
Funding Level	**97%**	**88%**

5.4 As at 31 March 2022, the past service funding position has improved from a funding level of 88% at the last valuation to 97%. This is based on assumed future investment returns of 4.0% pa.

5.5 The future investment return the Fund would need to generate to be 100% funded is now 4.2% pa (compared to 4.8% pa at 2019). The likelihood of the Fund's investment strategy achieving this required return of 4.2% pa is now 73% (there was a 66% of the Fund achieving the required 4.8% pa at 2019). Put another way, the Fund is putting less reliance on future investment return to pay for benefits already accrued by members than at 2019.

5.6 The main factor driving the funding position improvement is stronger than expected investment returns since the 2019 valuation. These have more than offset the increase in liabilities due to the short- to medium-term inflation expectations. Despite the Covid-19 pandemic, the funding impact of mortality experience has not been significantly different from expectations.

5.7 However, it is important to understand reported funding level does not directly drive employers' contribution rates. Contribution rates consider how assets and liabilities will evolve over time in different economic scenarios and reflect each employer's funding profile and covenant.

5.8 Being 100% funded in a scheme like the LGPS which is both open to future accrual and new entrants, is not the endgame. For the average fund employer, two-thirds of the benefit payments made over the next 50 years will be in respect of future service benefits, i.e. benefits yet to be earned. This will include benefits earned by existing members (new accrual) and benefits earned by new members who begin service in the LGPS after the valuation date (new joiners). The assets held today only cover past service benefits – we still need to fund those benefits yet to be earned.

5.9 Every employer is responsible for its own 'share' of the pension fund. While individual employer results will be varied depending on each employer's own membership, the main drivers of change such as investment performance and market conditions effect all employers to a similar degree. Therefore, the actuary expects most employers to see improvements to their funding positions.

5.10 The worsening future economic outlook, notably short-term inflationary pressures, will lead to upward pressure on the cost of future benefit accrual (Primary contribution rates). The improvement in past service funding position may see a reduction in Secondary contribution rates for most employers. The net impact on total contributions will vary across employers.

5.11 The contribution modelling analysis carried out for the Council supports a contribution freeze or moderate reduction from 1 April 2023.

6 VALUATION - NEXT STEPS

6.1 Subject to Committee agreement of the Funding Strategy Statement, the next major step in the valuation process is to calculate the individual funding positions and set the contribution rates for all other employers in the Fund. The results will then be issued to employers who will be invited to ask questions and comments as part of an employer consultation period, including at the planned employer forum.

6.2 As above, this consultation process is already underway for the Council.

6.3 The outcome of these discussions and final contribution rates will be presented to the Committee for approval at the March meeting. The contribution rates will then come into payment from 1 April 2023.

6.4 A summary of the valuation timetable is set out below:

Date	Activity
Q1 2022	Council contribution rate modelling and discussion
Q2 2022	Assumptions analysis
Q3 2022	• Data provision to actuary • Ongoing engagement with Fund employers
13 October 2022	**Committee meeting**: Approval sought for draft Funding Strategy Statement
Q4 2022	• Funding Strategy Statement consultation with employers invited to comment • Issue valuation results schedules to employers • Employer forum
31 January 2023	Employer contribution rates finalised
March 2023	**Committee meeting**: Approval sought for final Funding Strategy Statement and 2022 valuation report
31 March 2023	Statutory deadline for completion of final 2022 valuation report and certifying new employer contribution rates
1 April 2023	New employer contribution rates come into payment

7 CONSULTATION

7.1 Officers have fully consulted with the Pension Fund's actuarial advisers in preparing this report.

8 FINANCIAL CONSIDERATIONS

8.1 This report deals exclusively with the funding strategy and valuation of the Council's Pension Fund.

Approved by: Alan Layton on behalf of Jane West, Corporate Director of Resources (Section 151 Officer)

9 LEGAL CONSIDERATIONS

9.1 Burges Salmon LLP (a legal advisor appointed to the Pension Fund) comments that the funding strategy statement is a key document setting out a number of policies which impact employers within the Pension Fund and it is therefore important to keep this document under review (as is also required by the Local Government Pension Scheme Regulations 2013)

10 HUMAN RESOURCES IMPACT

10.1 There are no direct workforce implications arising from the recommendations within this report.

Approved by: Gillian Bevan, Head of HR, Resources and Chief Executives on behalf of Dean Shoesmith, Chief People Officer

11 EQUALITIES IMPACT

11.1 There are no equality implications arising from the report and the valuation of the pension scheme. The council has an obligation under the Public Sector Equality Duty, which is to eliminate unlawful discrimination, to advance equality of opportunity and to build better relationships between groups with protected characteristics. However, when undertaking consultation with staff it will be important to ensure that a representative range of feedback is received across the protected characteristic groups.

Approved by: Gavin Handford, Director of Policy, Programmes and Performance

12 ENVIRONMENTAL IMPACT

12.1 There are no environmental impacts arising from this report.

13 CRIME AND DISORDER REDUCTION IMPACT

13.1 There are no crime and disorder impacts arising from this report.

14. DATA PROTECTION CONSIDERATIONS

14.1 WILL THE SUBJECT OF THE REPORT INVOLVE THE PROCESSING OF 'PERSONAL DATA'?

NO

14.2 HAS A DATA PROTECTION IMPACT ASSESSMENT (DPIA) BEEN COMPLETED?

NO
Approved by: Alan Layton on behalf of Jane West, Corporate Director of Resources (Section 151 Officer)

CONTACT OFFICER:

Matthew Hallett, Acting Head of Pensions and Treasury,

BACKGROUND DOCUMENTS:

N/a

Appendices:

APPENDIX A Croydon PF - Draft Funding Strategy Statement (Oct 2022)
APPENDIX B Croydon PF - Policy on contribution reviews (Oct 2022)
APPENDIX C Croydon PF - Academies funding policy (Oct 2022)
APPENDIX D Croydon PF - Bulk Transfer Policy (Oct 2022)
APPENDIX E Croydon PF - Cessation Policy (Oct 2022)
APPENDIX F Croydon PF - Prepayments policy (Oct 2022)