



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

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Item 4

13th September 2023

Actuarial Valuation and Funding Strategy

Purpose of Report:

To present preliminary results of the actuarial valuation as at 31st March 2023 together with a proposed Funding Strategy.

Recommendations:

The Committee is asked:

- **to NOTE** the preliminary results of the actuarial valuation as at 31st March 2023;
- **to APPROVE** the proposed Funding Strategy; and
- **to APPROVE** the draft Funding Strategy Statement (FSS) for consultation with appropriate interested parties.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes ☐ No ☐ consulted: Yes ☐ No ☐

PLEASE NOTE THE FOLLOWING:

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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 FSS.

1.3 Practice

The actuarial valuation is essentially a measurement of the Fund's current and future liabilities, and the associated funding risk. The funding strategy deals with how the liabilities and the risk 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 2023 Actuarial Valuation

2.1 Preliminary Results

Preliminary results of the valuation are as follows.

Valuation Date	31 March 2020	31 March 2023
Past Service Liabilities	(£m)	(£m)
Employees	8,948	8,156
Deferred Pensioners	2,451	2,145
Pensioners	8,344	8,669
Total Liabilities	19,744	18,970
Assets	20,941	27,872
Surplus	1,197	8,902
Funding Level	106%	147%

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 2020 - 2023

The main outcomes since 2020 which have impacted on the valuation results are as follows.

	Expected	Actual	Difference	Impact
Investment Returns (p.a.)	3.0%	9.9%	+6.9%	Positive
Inflation (p.a.)	1.9%	4.5%	+2.6%	Negative
Salary Increases (p.a.)	3.3%	5.9%	+2.6%	Negative
Pensions Ceasing (£m)	47.6	47.4	-0.2	Negative

Although the final year of the intervaluation period produced a small negative return (**-1.6%**), strong returns in the previous 2 years mean that overall investment returns are very strongly positive (cumulative **+32.7%** v **+9.2%**).

2.3 Key Assumptions

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

	31 March 2020	31 March 2023	Impact
Financial Assumptions	(% p.a.)	(% p.a.)	
Discount Rate	3.0	5.0	Positive
Inflation	1.9	2.7	Negative
Salary Increases	2.6	3.4	Negative
Life Expectancy (from age 65)	Years		
Male pensioners	19.9	19.8	Positive
Male non-pensioners	21.3	20.6	Positive
Female pensioners	22.6	22.5	Positive
Female non-pensioners	24.7	24.2	Positive

The discount rate assumption of **5.0% 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 (Asset Liability Modelling or ALM) of 5,000 future economic scenarios. The modelling indicates that there is at least a **80%** likelihood (**75% in 2020**) of the Fund's investments achieving that return over the target funding period. The discount rate is significantly higher than at the 2020 valuation as a result of steep increases in global interest rates, which form the basis for future investment return expectations.

2.4 Impact of Improved Funding Position

In principle the improved funding position allows flexibility in 4 broad areas of the funding strategy:

- retain the surplus (as insurance against future adverse economic conditions)
- change the investment strategy (to take less investment risk)
- increase prudence levels (to take less funding risk)
- reduce employer contribution rates.

2.5 Employer Contribution Rates

The next step in the valuation process is to calculate employer contribution rates for each of the Fund's 150 employers. (Member contribution rates are fixed by the regulations and are not affected by the actuarial valuation).

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 their assets and liabilities will evolve over time in different economic scenarios.

Preliminary modelling has been carried out at a whole fund level and on a small sample of employers. This included: isolated future service modelling, how results compare on different time horizons, different funding targets, downside risk measures, and impact of an asset shock.

This preliminary analysis confirms that the very strong funding position allows some flexibility to reduce contribution rates as part of the funding strategy adopted at this valuation. The proposed funding strategy is summarised below.

3 2023 Funding Strategy

The proposed funding strategy incorporates a combination of the options for flexibility outlined above. In brief:

- retention of surplus – whilst the target funding level remains 100%, much of the modelling has focused on downside risk to ensure that at least some of the surplus is retained;
- change the investment strategy – the investment strategy has already been significantly de-risked in comparison to the Fund's history, but the review of investment strategy which is being carried out alongside the actuarial valuation is looking at further options for de-risking, in particular minimising downside risk;
- increasing prudence levels – the actuarial approach already incorporates significant levels of prudence and high probabilities of success. This has been increased with the use of a 2023 discount rate which produces a **80%** likelihood of success (*75% in 2020*). An additional margin of **0.3%** (above the market-implied rate) has been added to the inflation and CPI assumptions used in this valuation to reflect the increased uncertainty in the current inflation environment;
- employer contribution rates – even after the measures above, the current position allows significant flexibility to reduce employer contribution rates. Calculation of individual employer rates has still to be carried out, but a number of principles are proposed as a basis for the contributions strategy.

3.1 Contributions Strategy - Principles

Given the difficult public finance environment and the gearing effect of the Fund's liabilities in comparison to employer payrolls, any future increases in contribution rates would be extremely difficult for employers to accommodate

in budgets, particularly if they are unexpected. To address that, the following principles are proposed for the contributions strategy.

- The contributions strategy will apply reductions in the first 2 years of the certification period (2024/25 and 2025/26) but will revert to a prudent estimate of a sustainable long-term rate in the final year (2026/27). This should ensure that employers factor a realistic long-term cost into future budgets.
- Rates will not reduce to zero. In any year, the employer contribution rate will not be lower than the average member contribution rate.
- Rates will continue to be based on each employer's individual characteristics including their membership, risk profile, covenant and time horizon. Reductions will only be applied where the rate achieves an acceptable likelihood of success for the employer's funding target.

There may be some exceptions, but these principles will be applied as far as practicable, in particular to the Main Employer Group.

3.2 Contributions Strategy - Main Employer Group (MEG)

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 long-term employers which are assessed as having a strong covenant or low risk profile. The MEG comprised around 70 employers at the 2020 valuation. Its composition has reduced at each valuation, and it may at some point be discontinued in favour of individual rates for all employers.

Employers in this group have paid a contribution rate of **19.3%** of pensionable payroll since 1st April 2011. It is proposed that the employer contribution rate for the MEG will be:

- **6.5%** (of pensionable payroll) from 1st April 2024
- **6.5%** (of pensionable payroll) from 1st April 2025
- **17.5%** (of pensionable payroll) from 1st April 2026

Employers may make additional payments or make payment in advance of the due date by prior agreement with SPF.

3.3 Contributions Strategy – Other Employers

Employers not in the main group pay rates appropriate to their own individual circumstances. It is anticipated that rates for employers in this group will follow a similar pattern to the MEG, but the other employers are less homogenous, particularly with regards to their time horizons, so there will be variations.

3.4 Employer Results

All employers will receive individual results schedules setting out their own:

- membership details;
- funding position as at 31st March 2023; and
- contribution rates for the 3 years from 1st April 2024.

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.

4 2023 (Draft) Funding Strategy Statement (FSS)

The proposed funding strategy for the 2023 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. Some further background is set out below.

4.1 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

4.2 Format and Content

The draft 2023 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.

The document has been updated to reflect:

- changes in the regulatory background;
- changes in associated guidance; and
- some improvements in underlying processes.

Some stylistic improvements have also been incorporated.

4.3 Timetable

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

September/November	<ul style="list-style-type: none">▪ Funding Strategy Statement issued for consultation.▪ Employer results prepared by Hymans Robertson and reviewed by Fund officers.
November/December	<ul style="list-style-type: none">▪ Employer Forum (virtual) to present high level results.▪ Draft individual results schedules issued to employers.▪ Consultation on FSS closes.
December/January	<ul style="list-style-type: none">▪ Engagement with Employers

February	▪ 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:

<i>Financial:</i>	None at this time.
<i>Legal:</i>	The actuarial valuation is carried out in accordance with regulations 56 and 60 of the Local Government Pension Scheme (Scotland) regulations 2018.
<i>Personnel:</i>	None at this time.
<i>Procurement:</i>	None at this time.

Council Strategic Plan:	SPF supports all Missions within the Grand Challenge of: <i>Enable staff to deliver essential services in a sustainable, innovative and efficient way for our communities.</i> The LGPS is one of the key benefits which enables the Council to recruit and retain staff.
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Equality and Socio-Economic Impacts :

<i>Does the proposal support the Council's Equality Outcomes 2022-25?</i>	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.
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<i>What are the potential equality impacts as a result of this report?</i>	No specific equalities impacts.
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<i>Please highlight if the policy/proposal will help address socio economic disadvantage.</i>	N/a.
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Climate Impacts:

<i>Does the proposal support any Climate Plan actions? Please</i>	Not directly. The actuarial data will form the basis for climate scenario modelling at later stage in the
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specify: process.

What are the potential climate impacts as a result of this proposal? N/a.

Will the proposal contribute to Glasgow's net zero carbon target? N/a.

Privacy and Data

Protection Impacts:

Are there any potential data protection impacts as a result of this report
Y/N No.

If Yes, please confirm that a Data Protection Impact Assessment (DPIA) has been carried out N/a.

6 Recommendations

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