

## CLWYD PENSION FUND COMMITTEE

<b>Date of Meeting</b>	27 September 2016
<b>Report Subject</b>	2016 Actuarial Valuation and Funding/Flightpath Update
<b>Report Author</b>	Clwyd Pension Fund Manager

### EXECUTIVE SUMMARY

The purpose of the report is to provide an update on the actuarial valuation project alongside an update on the Flightpath strategy.

The actuarial valuation project is not only required by legislation, but it is also critical to the good governance of the CPF for the benefit of the members and employers.

#### Actuarial Valuation

The main progress on the project since the last report has been made in the following areas:

- The demographic experience analysis for CPF and the wider LGPS has now been completed, and this has informed the Actuary when determining the appropriate non-financial assumptions e.g. life expectancy, ill health rates etc, for the CPF.
- The Actuary has completed preliminary calculations based on the actual data provided by the Fund. The emerging deficit has been assessed as £447m, representing a funding level of 76% and an average employer future service cost (or Primary contribution rate) of 15.3% of pay.
- A number of meetings have taken place to discuss the high level valuation results:
  - Fund Actuary and the Fund Officers,
  - Fund Actuary, Fund Officers and Chief Finance Officers of the Unitary Authorities.
- The draft Funding Strategy Statement will be updated to reflect the discussions in the above meetings, and the formal consultation with all interested parties is due to commence in October. The Employer risk management framework will be developed alongside this.
- Data has been submitted to GAD for the S13 valuation as required by legislation.

- High level analysis of Data Quality (including the impact of the Backlog project) has been performed which goes beyond the basic requirements that TPR/legislation set out in relation to “Common Data” in order to maximise value.

#### Funding and Flightpath Update and Review

- The funding position was behind the expected position under the 2013 funding plan at the end of July but of course the position is being reviewed as part of the 2016 valuation and will be “rebased” in terms of the monitoring framework.
- The level of hedging at 30<sup>th</sup> June was around 16% for interest rate and 40% for inflation. No triggers have been hit since the last update report.
- Insight are operating the liability hedging mandate in line with the tolerances set by our advisors.
- A review of the Flightpath Framework is planned, with a full cost / benefit analysis will taking place in advance. It is anticipated that the review will consist of:
  - reviewing the flightpath plus updating the interest rate and inflation triggers,
  - possibly restructuring the current LDI portfolio;
  - exploration of potential the use of “equity options” to protect against falls in the Insight mandate.

### **RECOMMENDATIONS**

1	It is recommended that all PFC members note this report, the progress being made with the actuarial valuation project, the current position regarding the funding and flightpath framework and its review over the coming months.
2	The PFC should also note the preliminary results of the CPF valuation as contained in paragraph 1.02.

### **REPORT DETAILS**

<b>1.00</b>	<b>2016 Actuarial Valuation and Funding &amp; Flightpath Update</b>
1.01	<p><b><u>Actuarial Valuation</u></b></p> <p>The purpose of this report is to update PFC Members on the 2016 actuarial valuation project, including key milestones, communications with employers and other events.</p> <p>This is the next report of the series of reports for the PFC meetings throughout 2016/17 until the conclusion of the valuation project.</p>

1.02	<p>The final actuarial outcome will be reported to Committee at the next meeting, however preliminary whole Fund results (based on the proposed assumptions to assess solvency and future service contributions ) are set out below:</p> <table border="1" data-bbox="496 286 1198 707"> <thead> <tr> <th></th> <th style="text-align: right;">£Ms</th> </tr> </thead> <tbody> <tr> <td>Assets</td> <td style="text-align: right;">1,381</td> </tr> <tr> <td>Liabilities</td> <td style="text-align: right;">1,828</td> </tr> <tr> <td>Deficit</td> <td style="text-align: right;">447</td> </tr> <tr> <td>Funding Level</td> <td style="text-align: right;">76%</td> </tr> <tr> <td>Average employer future service contribution rate*</td> <td style="text-align: right;">15.3% p.a.</td> </tr> </tbody> </table> <p><i>* no allowance for 50/50 take-up.</i></p> <p>Discussions have also commenced in relation to the funding strategy that will be adopted by the Fund, and individual results for the all employers.</p>		£Ms	Assets	1,381	Liabilities	1,828	Deficit	447	Funding Level	76%	Average employer future service contribution rate*	15.3% p.a.
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1.03	<p>The Actuary has met with the Unitary Authority Chief Finance Officers, to communicate their results. Dialogue will continue with them over the coming weeks.</p> <p>Other individual employers' results will be communicated over the next few weeks, and the FSS consultation process/Annual Joint Consultative Meeting will provide a forum for further discussion/update.</p> <p>As part of the consultation on the FSS the Fund will continue dialogue with all employers over the coming months.</p>												
1.04	<p>The PFC is asked to note the progress made with the 2016 actuarial valuation, in particular the outline above of the discussions that have taken place since March 2016.</p>												
1.05	<p><b><u>Funding and Flightpath Update &amp; Review</u></b></p> <p>The monthly summary report from Mercer on the funding position and an overview liability hedging mandate is attached as at 31 July 2016. It includes a "traffic light" of the key components of the Flightpath and hedging mandate with Insight. Pending the actuarial valuation, the flightpath dashboard shows the funding level flag as blank pending the valuation and the flightpath framework review which will result in a refresh of the monitoring framework.</p>												
1.06	<p>The funding position was behind the plan at the end of July when measured relative to the 2013 funding plan. The funding position and monitoring framework is being reviewed alongside the flightpath framework, which is discussed further below.</p>												
1.07	<p>The level of hedging at 31 July 2016 was around 16% for interest rate and 40% for inflation. The hedging implemented over 2014 and 2015 has</p>												

	<p>provided some protection to the funding position against the changes in interest interests and inflation. In particular, without this hedging the deficit would have been approximately £125m higher since inception than if the original strategy had remained in place when measured on a like for like basis. This strategy has provided further protection since the result of the EU Referendum and interest rate cut by the Bank of England, and the consequent reduction in return expectations.</p>
1.08	<p>Based on data from Insight, the analysis shows that the management of the Insight mandate is rated as “green” meaning it is operating in line within the tolerances set by our advisors.</p>
1.09	<p><b><u>Flightpath Framework Review</u></b></p> <p>Market conditions are particularly challenging and we are expecting further volatility over potentially a long period. Interest rates and therefore investment return expectations remain subdued which affects the funding and investment outlook. We are reviewing the Flightpath framework in light of the updated valuation and market positions. This is to ensure we are managing risk at the most efficient levels with the intention to be in a better position to capture opportunities as cost effectively as we can. This will comprise of:</p> <ol style="list-style-type: none"> <li>1. <i>Reviewing the flightpath plus updating the interest rate and inflation triggers.</i> This review will account for the new benefit cashflows following changes to the membership profile, updated market conditions and the actuarial valuation. This was already in the Fund’s business plan.</li> <li>2. <i>Potentially restructure the current LDI portfolio</i>”. Insight and Mercer have identified an opportunity to restructure Insight’s mandate that will be more efficient for the Fund. This will require a certain level of transaction costs and work will be initially done to assess its cost versus its value to the CPF before proceeding.</li> <li>3. <i>Explore potential use of “equity options” to protect against market falls on the Insight mandate.</i> This is being explored to provide further downside protection given the current equity market levels. Again work will be initially done to assess its cost versus its value to the CPF before proceeding.</li> </ol>

<b>2.00</b>	<b>RESOURCE IMPLICATIONS</b>
2.01	<p>None directly as a result of this report. Significant resource requirements will be required from the administration and investment teams to support the valuation process and consult with employers.</p> <p>Officers will also be heavily involved in the review of the funding framework.</p>

<b>3.00</b>	<b>CONSULTATIONS REQUIRED / CARRIED OUT</b>
3.01	The Fund is required to consult with employing bodies over the development of the FSS and overall framework of the actuarial valuation.

<b>4.00</b>	<b>RISK MANAGEMENT</b>
4.01	<p>This report addresses some of the risks identified in the Fund's Risk Register. Specifically, this covers the following (either in whole or in part):</p> <ul style="list-style-type: none"> <li>• Governance risk: G2</li> <li>• Funding and Investment risks: F1 - F6</li> </ul>
4.02	The actuarial valuation is a key Governance tool and is meant to control the risks relating to the CPF's funding position and employer contributions requirements. The funding strategy (along with the investment strategy) which comes from the actuarial valuation is a key determinate of the overall financial risk levels in the CPF.
4.03	The recent market volatility has increased the relative risk levels in relation to CPF solvency position and the required contribution rates from 1 April 2017. The Flightpath Strategy manages/controls the interest rate and inflation rate impact on the liabilities of the Fund to give more stability of funding outcomes and employer contribution rates.

<b>5.00</b>	<b>APPENDICES</b>
5.01	Appendix 1 - Overview of risk management framework - July 2016

<b>6.00</b>	<b>LIST OF ACCESSIBLE BACKGROUND DOCUMENTS</b>
6.01	Report to Pension Fund Committee – 2016 Actuarial Valuation – 24 May 2016, Report to Pension Fund Committee – 2016 Actuarial Valuation – 22 March 2016, Report to Pension Fund Committee – 2016 Actuarial Valuation – 26 November 2015, current FSS and 2013 Actuarial Valuation report.
6.02	<p>Report to Pension Fund Committee – Overview of risk management framework – Previous monthly reports and more detailed quarterly overview.</p> <p><b>Contact Officer:</b> Philip Latham, Clwyd Pension Fund Manager  <b>Telephone:</b> 01352 702264  <b>E-mail:</b> philip.latham@flintshire.gov.uk</p>

7.00	GLOSSARY OF TERMS
7.01	<p>(a) <b>CPF – Clwyd Pension Fund</b> – The Pension Fund managed by Flintshire County Council for local authority employees in the region and employees of other employers with links to local government in the region</p> <p>(b) <b>Administering authority or scheme manager</b> – Flintshire County Council is the administering authority and scheme manager for the Clwyd Pension Fund, which means it is responsible for the management and stewardship of the Fund.</p> <p>(c) <b>PFC – Clwyd Pension Fund Committee</b> - the Flintshire County Council committee responsible for the majority of decisions relating to the management of the Clwyd Pension Fund</p> <p>(d) <b>LPB or PB – Local Pension Board or Pension Board</b> – each LGPS Fund has an LPB. Their purpose is to assist the administering authority in ensuring compliance with the scheme regulations, TPR requirements and efficient and effective governance and administration of the Fund.</p> <p>(e) <b>LGPS – Local Government Pension Scheme</b> – the national scheme, which Clwyd Pension Fund is part of</p> <p>(f) <b>FSS – Funding Strategy Statement</b> – the main document that outlines how we will manage employers contributions to the Fund</p> <p>(g) <b>Actuarial Valuation</b> - The formal valuation assessment of the Fund detailing the solvency position and determine the contribution rates payable by the employers to fund the cost of benefits and make good any existing shortfalls as set out in the separate Funding Strategy Statement.</p> <p>(h) <b>Actuary</b> - A professional advisor, specialising in financial risk, who is appointed by pension Funds to provide advice on financial related matters. In the LGPS, one of the Actuary's primary responsibilities is the setting of contribution rates payable by all participating employers as part of the actuarial valuation exercise.</p> <p>(i) <b>GAD – Government Actuary's Department</b> - The Government Actuary's Department is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.</p> <p>(j) <b>Section 13 Actuarial Valuation</b> - Section 13 of the Public Service Pensions Act 2013 provides for a review of the LGPS valuations and employer contribution rates to check that they are appropriate and requires remedial steps to be taken where it is considered appropriate. The GAD will undertake this review based on the results of the 2016 actuarial valuations.</p>

- (k) **SIP – Statement of Investment Principles** - The main document that outlines our strategy in relation to the investment of assets in the Clwyd Pension Fund
- (l) **Flightpath** - A framework that defines a de-risking process whereby exposure to growth assets is reduced as and when it is affordable to do so i.e. when “triggers” are hit, whilst still expecting to achieve the overall funding target.
- (m) **Deficit** - The extent to which the value of the Fund’s liabilities exceeds the value of the Fund’s assets.
- (n) **Funding - level** - The difference between the value of the Fund’s assets and the value of the Fund’s liabilities expressed as a percentage.
- (o) **Hedging** - A strategy that aims to reduce funding volatility. This is achieved by investing in assets that mimic changes in liability values due to changes in market conditions.
- (p) **Insight QIF – Insight Qualified Investor Fund** - An investment fund specifically designed for the Fund to allow Insight to manage the liability hedging and synthetic equity assets.