LGPS England and Wales Section 13 Report - 31 March 2019: Executive Summary

Published 16 December 2021

1.1 The Government Actuary has been appointed by the Department for Levelling Up, Housing and Communities (DLUHC) to report under section 13 of the Public Service Pensions Act 2013 in connection with the actuarial valuations of the funds in the Local Government Pension Scheme in England and Wales ("LGPS" or "the Scheme").

1.2 Section 13 requires the Government Actuary to report on whether the following aims are achieved:

- Compliance
- Consistency
- Solvency
- Long term cost efficiency

1.3 This is the second formal section 13 report. Section 13 was applied for the first time to the fund valuations as at 31 March 2016. We refer to this as the 2016 section 13 report. The 2016 section 13 report was published in September 2018.

1.4 This report is based on the actuarial valuations of the funds, other data provided by the funds and their actuaries, and a significant engagement exercise with relevant funds. We are grateful to all stakeholders for their assistance in preparing this report. We are committed to preparing a section 13 report that makes practical recommendations to advance the aims listed above. We will continue to work with stakeholders to advance these aims and expect that our approach to section 13 will continue to evolve to reflect ever changing circumstances and feedback received.

Progress since 2016

1.5 We made five recommendations as part of the 2016 section 13 report. In summary we recommended that:

1. Standard information should be provided in a uniform dashboard format to facilitate comparisons between funds.
2. Consideration should be given to how greater clarity and consistency of actuarial assumptions could be achieved.
3. A common basis for academy conversions should be sought.
4. Within a named closed fund a plan should be put in place to ensure that benefits are funded in the event of insufficient contributions and exit payments.
5. Recovery plans could be demonstrated to be consistent with CIPFA guidance.

1.6 We are pleased to note good progress in relation to recommendations 1, 4 and 5. However we note that further progress is needed in relation to recommendations 2 and 3.

1.7 We set out our comments on this progress in more detail in Chapter 3.

Overall Comments

1.8 In aggregate the funding position of the LGPS has improved since 31 March 2016; and the scheme appears to be in a strong financial position, specifically:

- Total assets have grown in market value from £217 bn to £291 bn
- Total liabilities disclosed in the 2019 local valuation reports amounted to £296 bn. The local bases are required to be set using prudence
- The aggregate funding level on prudent local bases has improved from 85% to 98% (at 2019)
- The improved funding level is due in large part to strong asset returns over the 3 year period to 31 March 2019. Equities in particular performed strongly, averaging a return of circa 10-12% pa over the period. Funding also improved due to the continuation of substantial financial contributions from most LGPS employers
- The aggregate funding level on GAD’s best estimate basis is 109% (at 2019). GAD’s best estimate basis is the set of assumptions derived by GAD without allowance for prudence. There is a 50:50 likelihood of the actual experience being better or worse than the best estimate assumption, in our opinion
- We note that the size of funds has grown significantly over the three years to 31 March 2019. However, the ability of tax backed employers to increase contributions if this was to be required (as measured by their core spending power) has not kept pace. This could be a risk if, for example, there was to be a severe shock to return seeking asset classes.

1.9 We set out below our findings on each of the four aims and our recommendations.

Compliance

1.10 Our review indicated that fund valuations were compliant with relevant regulations. However greater clarity on the assumptions used to determine contributions in the Rates and Adjustment certificate for some funds would be helpful.

Consistency

1.11 We interpret “not inconsistent” to mean that methodologies and assumptions used, in conjunction with adequate disclosure in the report, should facilitate comparison by a reader of the reports. Local circumstances may merit different assumptions. For example financial assumptions are affected by the current and future planned investment strategy, and different financial circumstances might lead to different levels of prudence being adopted.

1.12 Further to our recommendation as part of the 2016 section 13 report, we are pleased to note all funds have adopted a consistent “dashboard”. We consider this a useful resource to aid stakeholders’ understanding, because information is presented in a consistent way in the dashboards. We have suggested a few minor changes to further assist stakeholders going forward.

1.13 However, even given consistency in presentation in the dashboards, differences in the underlying methodology and assumptions mean that it is not possible to make a like for like comparison. We encourage further discussion on how assumptions are derived based on local circumstances in valuation reports.

1.14 We welcome the improvements of the evidential consistency of key assumptions, fund actuaries have provided more consistent rationalisation of assumptions in funding strategy statements.

However, we note there appear to remain some areas of inconsistency. Furthermore, there are particular inconsistencies in the way Academy conversions are carried out in different funds, which derive from different valuation approaches. We believe that there are substantial benefits to improving consistency which are discussed later in the report.

Recommendation 1:

The Scheme Advisory Board should consider the impact of inconsistency on the funds, participating employers and other stakeholders. It should specifically consider whether a consistent approach needs to be adopted for conversions to academies, and for assessing the impact of emerging issues including McCloud.

Solvency

1.15 As set out on the CIPFA website in [CIPFA's Funding Strategy Statement Guidance], the employer contribution rate is appropriate if:

- the rate of employer contributions is set to target a funding level for the whole fund of 100% over an appropriate time period and using appropriate actuarial assumptions

and either:

- employers collectively have the financial capacity to increase employer contributions, should future circumstances require, in order to continue to target a funding level of 100%

or

- there is an appropriate plan in place should there be an expectation of a future reduction in the number of fund employers, or a material reduction in the capacity of fund employers to increase contributions as might be needed

1.16 Over the three years to 31 March 2019, funds' assets have grown by around a third and liabilities by around 15%. However, the size of the employers has not grown at the same pace. This increases the risk to funds if, for example, there was to be a sustained reduction in the value of return seeking assets. This represents a general increase in risk for the LGPS as a whole, so we provide a general risk comment (rather than focus on any individual funds).

1.17 In GAD's view, the prevailing economic conditions have deteriorated between 2016 and 2019. Many funds have reduced their contribution rates as a result of the improvement of their funding position. In our opinion, for some funds, the deterioration in economic conditions may have warranted a strengthening of the valuation basis, resulting in a requirement to maintain or increase contributions.

1.18 We have performed an asset liability modelling (ALM) exercise for the scheme as a whole. This modelling illustrated:

- potential for material variability around future employer contribution rates (the current investment strategy includes a high proportion of equity investments which contribute to this variability but has the upside potential of greater expected long term investment returns)
- the potential impact on funding levels if there were to be constraints on the level of employer contributions

1.19 The following risk comment highlights the ongoing risk that pension funding presents to local authorities. We are not suggesting administering authorities and their advisors are unaware of this risk, but we have illustrated possible implications in our ALM.

General risk comment

Local authorities have finite resources and in recent years the size of pension funds has increased considerably more than local authority budgets. Given that pension funding levels change it is not unlikely that a period of increased pension contributions may be required at some point in the future.

If additional spending is required for pension contributions this may lead to a strain on local authority budgets.

We would expect that administering authorities are aware of this risk in relation to solvency and would monitor it over time. Administering authorities may wish to discuss the potential volatility of future contributions with employers in relation to overall affordability.

Long term cost efficiency

Under solvency and long term cost efficiency we have designed a number of metrics and raised flags against these metrics to highlight areas where risk may be present, or further investigation is required, using a red/amber/green rating approach. Where we do not expect specific action other than a general review, we have introduced a white flag.

1.20 As set out in CIPFA's Funding Strategy Statement Guidance, we consider that the rate of employer contributions has been set at an appropriate level to ensure long term cost efficiency if it is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

1.21 In 2019 we are flagging four funds as raising potential concern in relation to long term cost efficiency; this is two fewer than in 2016.

1.22 For two funds we are concerned that employer contributions are too low, as indicated by flags on a combination of GAD's deficit period, required return and return scope measures.

1.23 For a further two funds we are concerned that employer contribution rates are decreasing (reducing the burden on current taxpayers) at the same time as the deficit recovery is being extended further into the future (increasing the burden on future taxpayers).

1.24 During our review, we engaged with a number of funds with concerns in relation to a combination of deficit period, required return and return scope measures. We are pleased to note that, following these discussions, we were able to take into account a post valuation asset transfer in respect of one fund and allow for a firm commitment to make additional contributions in respect of a further fund. As a result, we have not raised long term cost efficiency amber flags in respect of these two funds.

1.25 In the 2016 section 13 exercise, we noted that several funds were extending their deficit recovery end points and recommended that funds reviewed their funding strategy. Whilst we note the improved funding position has reduced or removed deficits for some funds, where a deficit remains, we are pleased to observe that most funds in 2019 have maintained their deficit recovery end points.

1.26 However, this does not appear to be the case for two funds which we have flagged on this measure.

1.27 We note that different approaches have been taken by different actuarial advisors to determine deficit recovery plans. Whilst we acknowledge that different approaches may be appropriate, it is important for stakeholders to be able to assess how the deficit recovery plan changes over time. We have therefore made a recommendation to extend the information provided, and the appendices include the information to be provided.

Recommendation 2:

We recommend the Scheme Advisory Board consider how all funds ensure that the deficit recovery plan can be demonstrated to be a continuation of the previous plan, after allowing for actual fund experience.

Recommendation 3:

We recommend fund actuaries provide additional information about total contributions, discount rates and reconciling deficit recovery plans in the dashboard.

1.28 Some councils have made or may be considering asset "gifts" to their pension funds. These arrangements are novel, may be complex and in some cases are established with a long time horizon. For these reasons, the governance around any such asset transfer arrangements requires careful consideration.

Recommendation 4:

We recommend the Scheme Advisory Board review asset transfer arrangements from local authorities to ensure that appropriate governance is in place around any such transfers to achieve long term cost efficiency.

Contents