London Borough of Hammersmith & Fulham

Pensions Sub-Committee

Supplementary Agenda

Tuesday 20 November 2018 at 7.00 pm
Committee Room 3 - Hammersmith Town Hall

MEMBERSHIP

Administration	Opposition
Councillor Iain Cassidy Councillor Rebecca Harvey Councillor Asif Siddique	Councillor Matt Thorley
Co-optee	
Michael Adam	

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Date Issued: 15 November 2018

London Borough of Hammersmith & Fulham

Pensions Sub-Committee
Agenda

BARNETT WADDINGHAM
beyond the expected

London Borough of Hammersmith and Fulham Pension Fund

Funding update report as at 30 September 2018

Barnett Waddingham LLP

14 November 2018

Contents

Introduction

London Borough of Hammersmith and Fulham, as administering authority for the London Borough of Hammersmith and Fulham Pension Fund (the Fund) has asked that we carry out a quarterly monitoring assessment of the Fund as at 30 September 2018. The purpose of this assessment is to provide an update on the funding position.

We have shown the funding position as at 30 September 2018 using assumptions consistent with the triennial valuation as at 31 March 2016 (the ongoing basis) and also on a "SCAPE basis" where we have used the SCAPE discount rate of CPI plus 2.4%. The SCAPE discount rate is the discount rate that will be used in the unfunded public service schemes valuations and this rate may have an influence on the assumptions that we adopt at the forthcoming 2019 triennial valuation.

The Fund participates in the Local Government Pension Scheme (LGPS). The LGPS is a defined benefit statutory scheme administered in accordance with Local Government Pension Scheme Regulations 2013 (the Regulations).

The information in this report is addressed to and is provided for use by London Borough of Hammersmith and Fulham as the administering authority to the Fund. This report may be shared with other interested parties but it does not constitute advice to them.

This report complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 300: Pensions (TAS 300) as issued by the Financial Reporting Council (FRC).

We assess the funding position on a smoothed basis which is an estimate of the average position over a six month period spanning the reporting date. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures are projected numbers and likely to change up until three months after the reporting date. The smoothed results are indicative of the underlying trend.

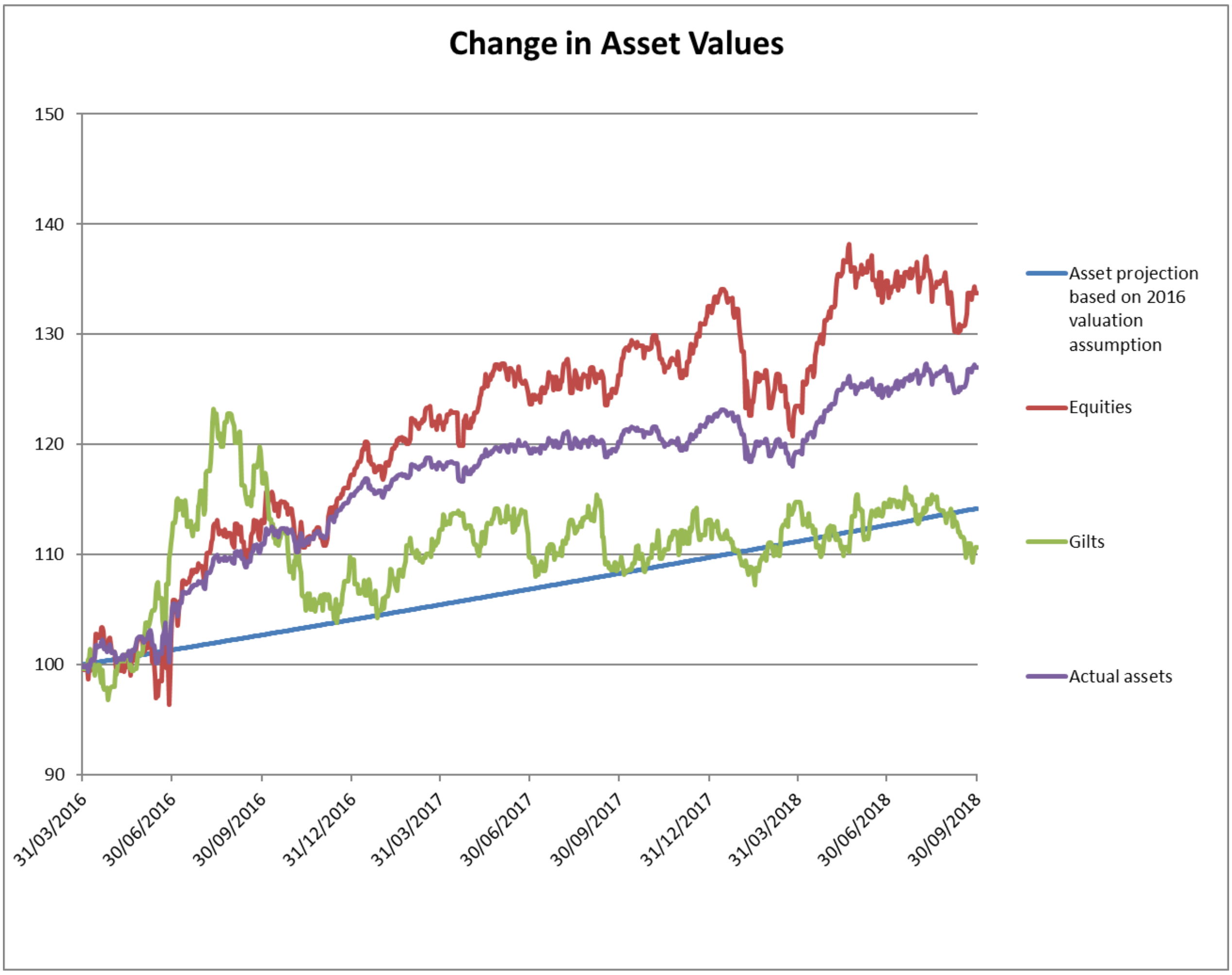
Assets

The estimated (unsmoothed) asset allocation of the London Borough of Hammersmith and Fulham Pension Fund as at 30 September 2018, based on data received from London Borough of Hammersmith and Fulham, is as follows:

Assets (market value)	30 Sep 2018		30 Jun 2018		31 Mar 2016	
	£000s	%	£000s	%	£000s	%
Inflation plus funds	102,329	9.6%	100,387	9.5%	81,552	9.5%
Cash plus funds	217,777	20.4%	291,158	27.7%	171,608	20.0%
UK and overseas equities	620,573	58.2%	542,473	51.6%	469,870	54.9%
Property and infrastructure	97,383	9.1%	90,324	8.6%	45,364	5.3%
Gilts	0	-	0	-	36,771	4.3%
Cash and accruals	27,561	2.6%	27,249	2.6%	51,154	6.0%
Total assets	**1,065,623**	**100%**	**1,051,591**	**100%**	**856,319**	**100%**

The investment return achieved by the Fund's assets in market value terms for the quarter to 30 September 2018 is estimated to be 1.5%. The return achieved since the previous valuation is estimated to be 27.0% (which is equivalent to 10.0% p.a.).

The following chart shows the changes in equity and bond markets since the previous actuarial valuation and compares them with the estimated actual fund returns and the expected fund returns assumed at the previous valuation:



As we can see the asset value as at 30 September 2018 in market value terms is more than where it was projected to be at the previous valuation.

Changes in market conditions – market yields and discount rates

The actual investment returns earned by the Fund will affect the value of the Fund's assets. The value of the Fund's liabilities, however, is dependent on the assumptions used to value the future benefits payable.

For the purpose of this exercise it is appropriate to use the method and assumptions consistent with those set by the Fund actuary for the purpose of the 31 March 2016 actuarial valuation, updated where necessary to reflect market conditions. Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report.

The following table show how these assumptions have changed since the last triennial valuation:

Assumptions (smoothed)	30 Sep 2018		30 Jun 2018		31 Mar 2016	
	Nominal	Real	Nominal	Real	Nominal	Real
	% p.a.		% p.a.		% p.a.	
Pension increases (CPI)	2.64%	-	2.61%	-	2.39%	-
Salary increases	4.14%	1.50%	4.11%	1.50%	3.89%	1.50%
Discount rate	5.59%	2.95%	5.51%	2.90%	5.45%	3.06%

In addition to that, it is assumed that salaries increase in line with CPI until 31 March 2020.

The ongoing discount rate assumption is set with reference to the Fund's long term investment strategy and therefore reflects the long term expected return on assets for the Fund. Consistent with the method adopted for the 31 March 2016 valuation, we have included in the discount rate assumption an explicit prudence allowance of 0.7%.

As noted in the Introduction, the discount rate on the SCAPE basis is CPI plus 2.4% p.a.

The key assumption which has the greatest impact on the valuation of liabilities is the real discount rate (the discount rate relative to CPI inflation) – the higher the real discount rate the lower the value of liabilities. As we see the real discount rate is broadly similar as at the 31 March 2016 valuation, maintaining the value of liabilities used for funding purposes.

The real discount rate on the SCAPE basis is lower than on the ongoing basis and therefore would place a higher value on the liabilities.

Results

The funding position for each month has been rolled forward from the formal valuation and is shown in Appendix 1. It should be borne in mind that the nature of the calculations is approximate and so the results are only indicative of the underlying position.

The results of our assessment indicate that:

- The current projection of the smoothed funding level as at 30 September 2018 is 97.5% and the average required employer contribution would be 18.0% of payroll assuming the deficit is to be paid by 2036.
- This compares with the reported (smoothed) funding level of 88.1% and average required employer contribution of 22.9% of payroll at the 31 March 2016 funding valuation.

The ongoing discount rate underlying the smoothed funding level as at 30 September 2018 is 5.6% p.a. The investment return required to restore the funding level to 100% by 2036, without the employers paying deficit contributions, would be 5.7% p.a.

SCAPE basis

The results summarised above and in the Appendix are based on the ongoing basis. On the SCAPE basis, as at 30 September 2018, we estimate the comparable funding level to be 88% and the average required employer contribution rate would be 28.4% of payroll assuming the deficit is to be paid by 2036. This contribution includes 19.2% of payroll towards the cost of future benefits and 9.2% of payroll towards deficit recovery.

Although the SCAPE discount rate is used for the purpose of the valuations of the unfunded public service pension schemes rather than the LGPS, it is likely that this will be used as a guide for the purpose of the Section 13 assessments applied to the local LGPS valuations and therefore may influence the assumptions to be adopted for the Fund's 2019 valuation.

Final comments

There are many factors that affect the Fund's funding position and could lead to the Fund's funding objectives not being met within the timescales expected. Some of the key risks that could have a material impact on the Fund include longevity risk and financial risks (including inflation and investment risk). There is more detail on this contained within the Fund's Funding Strategy Statement and the 31 March 2016 actuarial valuation report.

Note that the funding position at a future date will be dependent on the investment performance of the Fund as well as future market conditions which determine the financial assumptions.

Looking forward to 2019

Since the last valuation at 31 March 2016, assets have performed well and deficits have reduced (using assumptions consistent with the 2016 valuation), reducing the deficit recovery rate (the secondary rate).

However, since the 2016 valuation the real discount rate (the assumed investment return above inflation) has decreased, increasing the cost of future benefits i.e. the future service rate (the primary rate). This is primarily due to a higher expectation for future levels of inflation.

Overall, on a basis consistent with the 2016 valuation, the total required contribution rate is estimated to have reduced since 31 March 2016. The next triennial valuation will be taking place as at 31 March 2019, with revised contribution rates payable from 1 April 2020. As part of the 2019 valuation, the Fund and Fund Actuary will work together in setting the assumptions for the valuation. Given the improvement in funding position over the period and the level of uncertainty in the markets going forward, it may be appropriate to increase the level of prudence underlying the valuation funding assumptions.

We would be pleased to answer any questions arising from this report.

M Paton

Matthew Paton FFA
Actuary
Barnett Waddingham LLP

Appendix 1 Financial position since previous valuation

Below we show the financial position on a smoothed basis for each month since the previous full valuation. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures for the previous three months are projected numbers and likely to change up until three months after the reporting date.

The results shown below are calculated on the ongoing basis.

Please note that the results shown below are sensitive to the underlying assumptions. For example, increasing the discount rate assumption by 0.5% will increase the funding level by about 9%, and increasing the CPI inflation assumption by 0.5% will reduce the funding level by about 8%.

Smoothed Valuation date	Assets £000s	Liabilities £000s	Surplus / Deficit £000s	Funding level %	CARE ongoing cost (% of payroll)	Past service ctbn	Total ctbn (% of payroll)	Discount rate	Return required to restore funding level (p.a.)
31 Mar 2016	851,202	965,636	(114,434)	88%	15.5%	7.4%	22.9%	5.4%	6.1%
30 Apr 2016	863,067	978,276	(115,209)	88%	15.8%	7.4%	23.2%	5.3%	6.0%
31 May 2016	879,844	994,003	(114,159)	89%	16.2%	7.4%	23.6%	5.2%	5.9%
30 Jun 2016	897,724	1,008,545	(110,821)	89%	16.5%	7.1%	23.6%	5.2%	5.8%
31 Jul 2016	914,136	1,023,851	(109,715)	89%	16.9%	7.0%	23.9%	5.2%	5.7%
31 Aug 2016	927,238	1,036,964	(109,726)	89%	17.2%	7.0%	24.2%	5.2%	5.8%
30 Sep 2016	941,773	1,048,814	(107,041)	90%	17.4%	6.8%	24.2%	5.2%	5.8%
31 Oct 2016	954,597	1,056,392	(101,795)	90%	17.6%	6.5%	24.1%	5.3%	5.8%
30 Nov 2016	964,604	1,061,274	(96,670)	91%	17.6%	6.2%	23.8%	5.4%	5.9%
31 Dec 2016	980,052	1,064,071	(84,019)	92%	17.6%	5.4%	23.0%	5.5%	5.9%
31 Jan 2017	984,207	1,066,600	(82,393)	92%	17.5%	5.3%	22.8%	5.5%	5.9%
28 Feb 2017	993,825	1,071,557	(77,732)	93%	17.6%	5.0%	22.6%	5.5%	5.9%
31 Mar 2017	1,003,495	1,076,367	(72,872)	93%	17.6%	4.7%	22.3%	5.5%	5.8%
30 Apr 2017	1,001,425	1,075,681	(74,256)	93%	17.5%	4.7%	22.2%	5.5%	5.8%
31 May 2017	1,004,023	1,075,658	(71,635)	93%	17.4%	4.6%	22.0%	5.4%	5.8%
30 Jun 2017	1,015,033	1,074,424	(59,391)	94%	17.3%	3.8%	21.1%	5.5%	5.8%
31 Jul 2017	1,018,025	1,072,935	(54,910)	95%	17.1%	3.6%	20.7%	5.5%	5.8%
31 Aug 2017	1,019,138	1,072,345	(53,207)	95%	17.0%	3.5%	20.5%	5.5%	5.8%
30 Sep 2017	1,018,176	1,073,488	(55,312)	95%	16.9%	3.6%	20.5%	5.5%	5.8%
31 Oct 2017	1,021,476	1,077,796	(56,320)	95%	17.0%	3.7%	20.7%	5.5%	5.8%
30 Nov 2017	1,016,663	1,075,941	(59,278)	94%	16.8%	3.9%	20.7%	5.5%	5.9%
31 Dec 2017	1,016,035	1,074,765	(58,730)	95%	16.7%	3.9%	20.6%	5.6%	5.9%
31 Jan 2018	1,017,277	1,074,467	(57,190)	95%	16.6%	3.8%	20.4%	5.6%	5.9%
28 Feb 2018	1,022,139	1,075,015	(52,876)	95%	16.5%	3.5%	20.0%	5.5%	5.8%
31 Mar 2018	1,029,063	1,075,790	(46,727)	96%	16.4%	3.1%	19.5%	5.5%	5.8%
30 Apr 2018	1,031,850	1,076,000	(44,150)	96%	16.3%	3.0%	19.3%	5.5%	5.8%
31 May 2018	1,039,700	1,080,923	(41,223)	96%	16.4%	2.8%	19.2%	5.5%	5.7%
30 Jun 2018	1,045,899	1,084,073	(38,174)	96%	16.4%	2.6%	19.0%	5.5%	5.7%
31 Jul 2018	1,052,194	1,083,691	(31,497)	97%	16.3%	2.1%	18.4%	5.5%	5.7%
31 Aug 2018	1,053,492	1,084,231	(30,739)	97%	16.2%	2.1%	18.3%	5.6%	5.7%
30 Sep 2018	1,057,306	1,084,872	(27,566)	97%	16.1%	1.9%	18.0%	5.6%	5.7%

Appendix 2 Data, method and assumptions

Data

In completing our calculations we have used the following items of data, which we received from London Borough of Hammersmith and Fulham:

- The results of the valuation as at 31 March 2016 which was carried out for funding purposes;
- Estimated whole Fund income and expenditure items for the period to 30 September 2018; and
- Estimated Fund returns based on Fund asset statements provided to 30 September 2018, and Fund income and expenditure as noted above.

The data has been checked for reasonableness and we are happy that the data is sufficient for the purpose of this report.

Full details of the benefits being valued are as set out in the Regulations as amended and summarised on the LGPS website and the Fund's membership booklet. We have made no allowance for discretionary benefits.

Method

To assess the value of the Fund's liabilities as at 30 September 2018, we have rolled forward the value of the liabilities calculated for the funding valuation as at 31 March 2016 using the financial assumptions below and estimated cashflows paid to and from the Fund.

It is not possible to assess the accuracy of the estimated value of the liabilities as at 30 September 2018 without completing a full valuation. However, we are satisifed that the approach of rolling forward the previous valuation data to 30 September 2018 should not introduce any material assumptions in the results provided that the actual experience of the Fund is broadly in line with the underlying assumptions and that the structure of the liabilities is substantially the same as at the latest formal valuation. From the information we have received there appears to be no evidence that this approach is inappropriate.

We have been provided with the Fund assets at various dates but for dates that these are not available, we calculate the Fund assets by rolling forward the previous assets provided allowing for investment returns (estimated where necessary), and estimated cashflows paid to and from the Fund. The latest date that we have been provided with the Fund assets is 30 September 2018.

Assumptions

For the purpose of this exercise it is appropriate to use the method and assumptions consistent with those set by the Fund actuary for the purpose of the 31 March 2016 actuarial valuation, updated where necessary to reflect market conditions.

A summary of the main financial assumptions adopted is set out in the main body of this report.

The main demographic assumptions are:

- The post retirement mortality tables adopted are the S2PA tables with a multiplier of 80% for males and 85% for females. These base tables are then projected using the CMI 2015 Model, allowing for a long term rate of improvement of 1.5% p.a;
- The dependant post retirement mortality tables adopted are the S2PMA tables with a multiplier of 95% for males and the S2DFA tables with a multiplier of 100% for females. These base tables are then projected using the CMI 2015 Model, allowing for a long term rate of improvement of 1.5% p.a;
- Members retire at a single age, based on the average age at which they can take each tranche of their pension; and
- It is assumed that members will exchange 50% of their commutable pension for cash at retirement.

Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report.