

## **PENSION FUND COMMITTEE – 2 DECEMBER 2022**

### **FUNDING STRATEGY STATEMENT**

**Report by the Director of Finance**

#### **RECOMMENDATION**

**The Committee is RECOMMENDED to**

- a) review the responses to the consultation exercise,**
- b) amend the draft documents to specify a standard likelihood of 90% for cessation calculations, and**
- c) approve the final version of the Funding Strategy Statement to support the 2022 Valuation exercise.**

#### **Introduction**

1. At the delayed Committee meeting in October, the Committee considered the draft Funding Strategy Statement which have been produced by Hymans Robertson alongside officers from the Fund. The document sets out the key principles as agreed by the Fund, to set the framework for the 2022 Valuation exercise.
2. It was noted that whilst there had not been significant changes to the principles as set out in the document, there had been a significant change to the way the document was presented, which involved a slimmed down version of the Funding Strategy Statement itself, with some of the more detailed arrangements removed and included in standalone policy documents.
3. Under the Local Government Pension Scheme Regulations 2013, any significant change to the Funding Strategy Statement was to be subject to consultation with the Funds key stakeholders. Due to the delay in the Committee Meeting following the death of the Queen, the Chairman of the Committee had agreed that the consultation exercise could be launched in advance of the Committee consideration of the draft papers to ensure there was sufficient time to complete the consultation and report the results back to this Committee. In the event the Committee made no changes of the draft documents.

#### **Consultation Results**

4. The consultation exercise was launched on 6 October 2022 with a closing date of 18 November 2022. A copy of the consultation letter is included as Annex 1 to this report.

5. The regular forum for scheme employers held on 19 October 2022 was devoted to the consultation, and those scheme employers in attendance received a presentation which covered the purpose of the Funding Strategy Statement, the key changes made in this latest version and the 10 questions set out in the consultation letter and the information relevant to each question.
6. By the close of the consultation period, 8 responses had been submitted. These came from the following scheme employers:
  - Oxford City Council
  - Single Response on behalf of South Oxfordshire District Council and Vale of White Horse District Council
  - A2 Dominion
  - Aspirations Academy
  - The Pope Francis Catholic Multi Academy Company
  - Oxfordshire Local Enterprise Partnership
  - The Thera Trust
  - Community Integrated Care
7. Two further responses were received on Monday 21 November as this report was being finalised. These came from:
  - Abingdon & Witney College
  - Yorkshires Cleaning Services
8. The responses were largely supportive in nature of the proposed changes. More detail on the responses to each of the 10 consultation questions is set out below. Three of the responses received indicated support to the proposed documents as a whole and did not provide responses to the specific questions.

Q1. Do respondents agree that the structural changes to the documents have improved the accessibility, readability and useability of the documents?

6 of the 7 responses explicit agreed with the statement as set out in the question. The final respondent only provided a response in respect of question 5

Q2. Is there an appropriate split between the high-level principles and policies set out in the core document which will require formal consultation to change, and the detailed arrangements set out in the satellite policy documents which can be amended at the discretion of the Pension Fund Committee?

4 of the respondents who provided a specific answer to this question indicated their agreement. One respondent supported the change but felt only time would tell if the split was fully appropriate and emphasized the need to keep the core document under review. The final response was broadly supportive but felt that there was still potential to simplify the

core document further by moving part of the detailed risk assessment to an appendix or a standalone document.

- Q3. Do you support the use of a risk-based approach utilising a standard time horizon and variable level of certainty as the basis for future contribution calculations? If not, please provide details of proposed alternative approach and reasoning for decision.

5 of the 6 respondents who provided a specific answer to this question, supported the change in approach to using a standard time period, with one of these responses noted it provided greater clarity and allowed for better comparisons to be drawn between the position of the various employers within the Fund. The final response raised the question of whether the recovery period should be varied in line with the size of any deficit to ensure that rates could be held as stable as possible.

- Q4. Do you support the additional flexibility included in the Funding Strategy Statement in respect of the funding of FE Colleges?

3 of the respondents supported the additional flexibility whereas 3 others felt the question was not applicable to them as they were not an FE College. The one FE College who did respond to the consultation was supportive of the approach as a whole and welcomed the recognition of the reduction of risk in the event that ONS changed the classification of the FE Sector.

- Q5. Do you support the risk-based approach to cessation valuations as an alternative to the current low risk, gilts only basis?

This question generated the greatest comment. All responses were generally supportive. One felt that whilst the approach was potentially fairer, it had the disadvantage of being less transparent, being linked to the complex risk model rather than the old simple model based on gilt yields, and therefore making it difficult for the exiting employer to verify their cessation charge. This response also raised questions on the degree to which the Fund was able to verify the appropriateness of the assumptions used within the model by the Actuary. Finally, this response pointed out that the draft document left the level of risk to be accepted above the level of risk within the on-going was not specified in the draft Statement and felt this should be included in the final document. A second respondent also wished to see a minimum level of risk above the on-going rate to be set out in the final published version, with any decision to vary this downwards to be subject to further consultation to ensure fairness to the remaining scheme employers within the Fund. A third response though felt that there should be a degree of flexibility in the additional level of risk to be applied to allow for the difference circumstances of the exiting employer and the reasons behind their exit.

- Q6. Do you support the decision to base the Funding Strategy Statement on a single investment strategy?

All 6 specific responses to this question supported the decision to maintain a single investment strategy.

Q7. Do you support the decision not to make explicit insurance arrangements for ill-health costs with the Funding Strategy Statement and leave it to the individual employers to make their own arrangements if they so wish (noting the indirect mitigations provided by pooler all smaller employers)?

All 6 specific responses to this question supported the current position, with one response making it clear that they felt it was a scheme employer responsibility to make any additional arrangements.

Q8. Do you support the removal of the requirement to explicitly disclose any additional costs associated with the McCloud remedy from the Funding Strategy Statement?

All responses supported the removal of an explicit disclosure on the costs of McCloud, although one respondent did request that the costs would be disclosed under separate arrangements.

Q9. Do you support the approach that the risks associated with climate change can be incorporated into the wider risks associated with the management of the Fund and as such no explicit approach needs to be set out with the Funding Strategy Statement?

All 6 specific responses supported the position not to include explicit allowance for climate change, but one recommended this position is kept under review given the levels of uncertainty in this area.

9. None of the respondents provided any further comments under question 10 which allowed for any comments on the Funding Strategy Statement not explicitly covered under the consultation questions.
10. The key question arising for this Committee is therefore what further clarifications if any should be added to the proposed arrangements for the calculation of future cessation deficits or surpluses.
11. It is accepted that the draft documents will be improved by the inclusion of a specific approach to the calculation of cessation amounts. It is proposed therefore to amend section D5 in Appendix D to the core Statement to specify that the likelihood score for a low-risk cessation calculation will normally be set at 90%. It is accepted that in exceptional cases, the Fund does need to retain discretion to amend this figure, and that this itself should not be subject to specific consultation. The clause in D5 will be amended accordingly.
12. It is also proposed to amend the table in D3 referred to in one of the responses on question 5 where the margin above the risk-free rate was shown as TBC for the low-risk exit basis. This table does not refer explicitly to a cessation calculation but relates to the normal tri-ennial valuation calculation

where the scheme employer is known to be heading towards a future exit. The aim here is to minimise the gap between the on-going and cessation calculations so that the scheme employer does not face a significant cessation deficit on actual cessation. The margin above the risk-free rate is proposed at 0.2% which is equivalent to the 90% likelihood of success figure.

13. In respect of the comments on the structure of the documents, it is noted that the main section on risk assessment within the core Funding Strategy Statement is already only included as an appendix (Appendix C). In light of this, and the fact that there were no other comments on this point, it is not proposed to make any changes to the draft documents in relation to this issue.
14. In respect of the comments about the need for more flexibility over the deficit recovery period to allow for the size of the deficit and the desire to maintain as near stable contribution rates as possible, the following should be noted. Extending the recovery period to allow any deficit to be recovered over a period greater than 20 years could be questioned by the Government Actuary's Department (GAD) as part of their Section 13 report published every 3 years under the requirements of the Public Service Pensions Act 2013. GAD are required to comment amongst other issues on the solvency of each LGPS Fund and its long-term cost efficiency and extending recovery periods raise flags under both these headings.
15. Whilst a recovery period could be shortened to maintain stable contribution rates, it is also possible to increase the likelihood of success to achieve the same result. This has in fact been proposed as part of the draft results for the Town and Parish Council pool within the 2022 Valuation. Whilst the comments of the respondent are noted, it is possible to deliver their desired outcome of a stable contribution rate in circumstances under the currently proposed arrangements.
16. The revised Funding Strategy Statement including the proposed changes to Appendix D to clarify the level of risk associated with the calculation of cessation payments is included as Annex 2 to this report. As no changes have been proposed to the separate standalone policy documents presented to the Committee meeting in October, these have not been re-attached this time.

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