**Pension Committee**

**Wednesday, 26 September 2018**

**7.00 pm at the**

**Civic Offices, St Nicholas Way, Sutton SM1 1EA**

**SECOND DISPATCH**

To all members of Pension Committee:-

*The following papers, which were not available for dispatch with the agenda, are attached. Please bring them with you to the meeting:-*

**9. INTERIM ACTUARIAL VALUATION OF THE PENSION FUND AS AT 31 MARCH 2018** (Pages 1 - 14)

This report outlines the results of the interim valuation of the Council's Pension Fund as at 31 March 2018 carried out by the Fund's Actuary, Barnett Waddingham (Appendix A).

Niall Bolger
Chief Executive
18 September 2018

Enquiries to: Sharon Major, Committee Services Officer Tel: 020 8770 4990 | Email: committeeservices@sutton.gov.uk

Copies of reports are available in large print on request

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Sutton

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| **Report to:** | Pension Committee | **Date:** | 26 September 2018 |
| **Report title:** | Pension Fund Interim Valuation | | |
| **Report from:** | Gerald Almeroth, Strategic Director – Resources | | |
| **Ward/Areas affected:** | Borough Wide | | |
| **Chair of Committee:** | Councillor Jill Whitehead | | |
| **Author(s)/Contact Number(s):** | Lyndsey Gamble, Head of Investment, Risk and Commercial Finance, 0208 770 5358 | | |
| **Corporate Plan Priorities:** | • Making Informed Choices | | |
| **Open/Exempt:** | Open | | |
| **Signed:** | G.Al | **Date:** | 17 September 2018 |

## 1. Summary

1.1. This report outlines the results of the interim valuation of the Council's Pension Fund as at 31 March 2018 carried out by the Fund's Actuary, Barnett Waddingham (Appendix A).

## 2. Recommendations

The Pension Committee is recommended to:

2.1. Note the outcome of the interim valuation.

## 3. Background

3.1. The Full actuarial valuations of the Pension Fund are required by statute every three years to set the minimum levels of employer's contribution rates. The last full valuation was as at 31 March 2016.

3.2. In the years between full valuations the Actuary is asked to carry out interim valuations which assess the approximate financial position of the Fund. As part of this assessment key factors such as asset values are updated from the last full valuation. However not all factors are updated at this stage and some calculations are approximate and so the results are only indicative of the underlying position.

## 4. Issues

4.1. As with all actuarial valuations the interim valuation compares the estimated assets of the Fund with the estimated liabilities for future payment of pensions that the Fund will need to meet.

4.2. The table below shows the results of the interim valuation as at 31 March 2018 alongside the results of the last full valuation as at 31 March 2016.

| | **31 March 2016** | **31 March 2018** |
|---|---|---|
| | **£m** | **£m** |
| **Market value of assets** | 503 | 658 |
| **Liabilities** | 632 | 716 |
| **Deficit** | 129 | 58 |
| | | |
| **Funding level** | 80% | 92% |

4.3. Investment return achieved by the Fund's assets in market value terms for the year is 3.3%. The return achieved since the previous valuation is estimated to be 25.1% which is significantly higher than that assumed within the valuation.

4.4. Whilst the actual investment returns earned by the Fund directly affect the value of the Fund's assets, the value of the liabilities is dependent on the assumptions used to value the future benefits payable. Each of the assumptions used by the Actuary, projected pension and salary increases and discount rate, has served to increase the value of the liabilities. However, the assumption which has the greatest impact on the valuation of liabilities is the real discount rate, the higher the real discount rate, the lower the value of liabilities. Since it is lower at 31 March 2018 than it was a year earlier this increases the value of liabilities used for funding purposes. This increase will offset some of the strong asset performance from the Fund but still results in overall improved position for the Fund.

4.5. The results of the interim valuation indicate that:

- The current projection of the funding level as at 31 March 2018 is 92% and the average required employer contribution would be 22.5% assuming the deficit is to be paid by 2035;
- This compares with the reported funding level of 79.5% and average required employer contribution of 26.0% of payroll at the 31 March 2016 funding valuation;

4.6. The next full triennial valuation will be carried out next year and will be looking at the funding position as at 31 March 2019. This interim valuation is a helpful guide to the current position of the fund leading up to this exercise.

## 5. Impacts and Implications

Financial

5.1. The financial implications are addressed within the report.

Legal

5.2. There are no legal implications arising from this report.

## 6. Appendices and Background Documents

| Appendix Letter | Title |
|---|---|
| A | Interim Valuation Report |

| Background Documents |
|---|
| None |

| Audit Trail | | |
|---|---|---|
| Version: | Final | Date: 17 September 2018 |
| **Consultation with other officers** | | |
| **Officer** | **Comments Sought** | **Comments checked by** |
| Finance | Yes | Lyndsey Gamble |
| Legal | No | N/A |
| Equality Impact Assessment required? | No | N/A |

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Appendix A

# London Borough of Sutton Pension Fund

## Funding update report as at 31 March 2018

**Barnett Waddingham LLP**

7 August 2018

BARNETT WADDINGHAM
beyond the expected

# Contents

# Introduction

London Borough of Sutton, as administering authority for the London Borough of Sutton Pension Fund (the Fund) has asked that we carry out an annual monitoring assessment of the Fund as at 31 March 2018. The purpose of this assessment is to provide an update on the funding position.

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 Sutton 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.

In addition, we assess the funding position on an unsmoothed basis where assets are taken at market value and discount rates are taken as the spot rates at the reporting date.

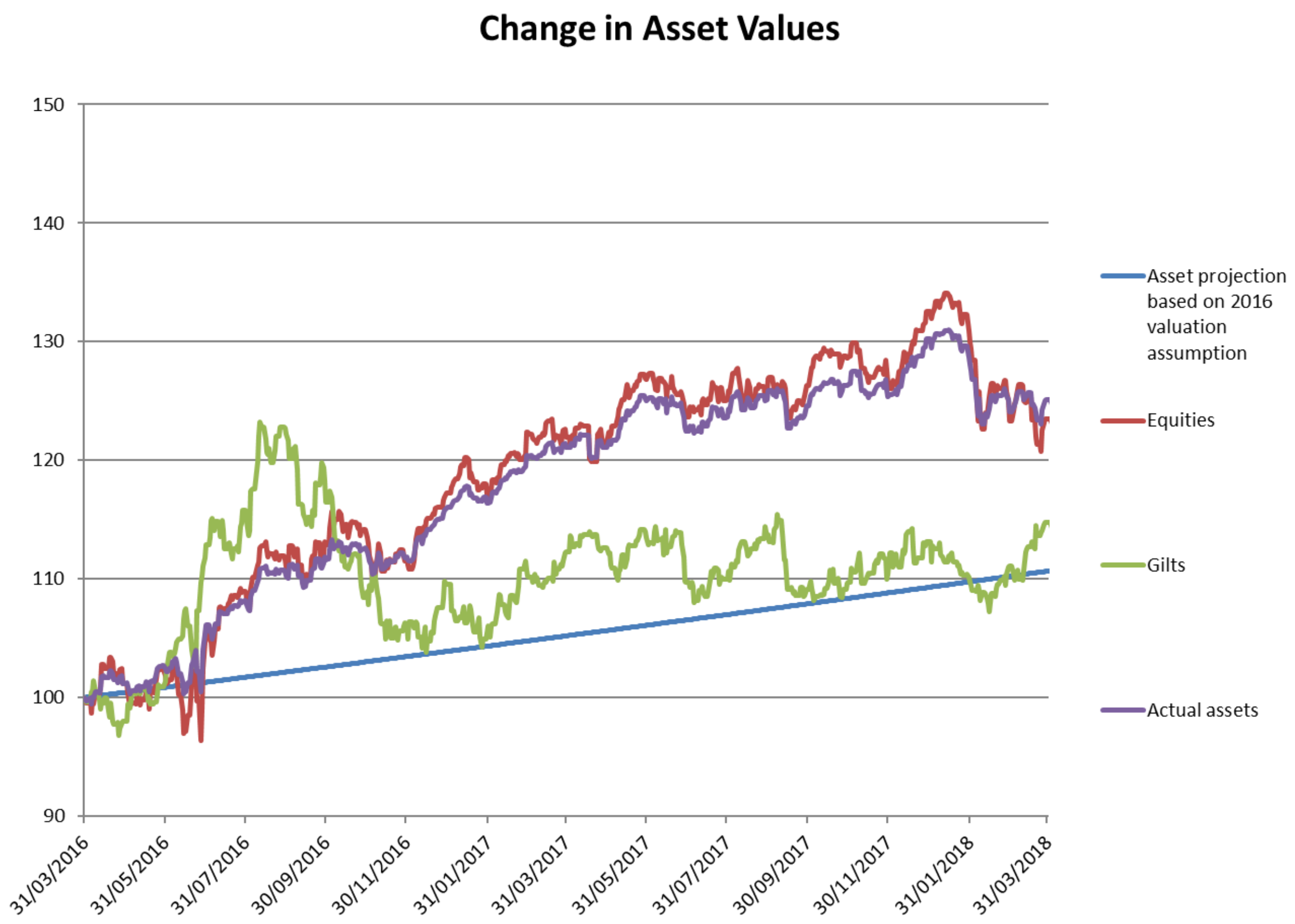
# Assets

The estimated (unsmoothed) asset allocation of the London Borough of Sutton Pension Fund as at 31 March 2018, based on data received from London Borough of Sutton, is as follows:

| Assets (market value) | 31 Mar 2018 | | 31 Mar 2017 | | 31 Mar 2016 | |
|---|---|---|---|---|---|---|
| | £000s | % | £000s | % | £000s | % |
| Equities | 402,259 | 62.8% | 392,859 | 63.5% | 278,604 | 55.0% |
| Gilts | 74,927 | 11.7% | 74,547 | 12.1% | 30,393 | 6.0% |
| Bonds | 96,153 | 15.0% | 92,420 | 14.9% | 0 | - |
| Property | 50,285 | 7.9% | 48,821 | 7.9% | 75,983 | 15.0% |
| Cash and accruals | 16,776 | 2.6% | 9,752 | 1.6% | 121,572 | 24.0% |
| **Total assets** | **640,400** | **100%** | **618,398** | **100%** | **506,552** | **100%** |

The investment return achieved by the Fund's assets in market value terms for the year to 31 March 2018 is estimated to be 3.3%. The return achieved since the previous valuation is estimated to be 25.1% (which is equivalent to 11.8% p.a.) which is significantly higher than assumed in the valuation.

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 31 March 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) | 31 Mar 2018 | | 31 Mar 2017 | | 31 Mar 2016 | |
|---|---|---|---|---|---|---|
| | Nominal | Real | Nominal | Real | Nominal | Real |
| | % p.a. | | % p.a. | | % p.a. | |
| Pension increases (CPI) | 2.66% | - | 2.79% | - | 2.40% | - |
| Salary increases | 4.16% | 1.50% | 4.29% | 1.50% | 3.89% | 1.49% |
| Discount rate | 5.27% | 2.61% | 5.19% | 2.40% | 5.20% | 2.80% |

We have allowed for a short-term overlay from 31 March 2016 to 31 March 2020 for salaries to rise in line with CPI. This is consistent with the 2016 valuation.

The 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%.

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 lower at 31 March 2018, increasing the value of liabilities used for funding purposes. This increase will offset some of the strong asset performance we have seen over the intervaluation period but overall we have still seen an improvement in the overall funding position.

# 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 31 March 2018 is 91.9% and the average required employer contribution would be 22.5% of payroll assuming the deficit is to be paid by 2035.
- The current projection of the unsmoothed funding level as at 31 March 2018 is 90.2% and the average required employer contribution would be 23.0% of payroll assuming a deficit is to be paid by 2035.
- This compares with the reported (smoothed) funding level of 79.5% and average required employer contribution of 26.0% of payroll at the 31 March 2016 funding valuation.

The discount rate underlying the smoothed funding level as at 31 March 2018 is 5.3% p.a. The investment return required to restore the funding level to 100% by 2035, without the employers paying deficit contributions, would be 5.8% p.a.

Whilst the funding level has improved and the deficit has reduced, the cost of benefits has increased due to higher assumed inflationary increases from 17.2% as at 31 March 2016 to 18.3% as at 31 March 2018. However the total rate has decreased as a result of lower deficit contributions.

Please note that there was also a high smoothing adjustment as at 31 March 2018 as a result of the volatile market conditions over the six month period straddling the valuation date, this has resulted in a much higher smoothed asset value compared to the market value of the assets. The smoothing effect is to reduce volatility in the funding level and required contributions payable.

# 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.

We should also note that there are several bulk transfers underway at the moment as membership is transferring from the Fund to the Kingston Fund and from the Kingston Fund to the Sutton Fund where the two Funds have been reviewing how they share services. As the majority of these transfers are still underway we have not been able to take into account the full effect of these transfers which we hope to finalise before the next valuation as at 31 March 2019.

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.

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

**Melanie Durrant FIA**
**Associate**
**Barnett Waddingham LLP**

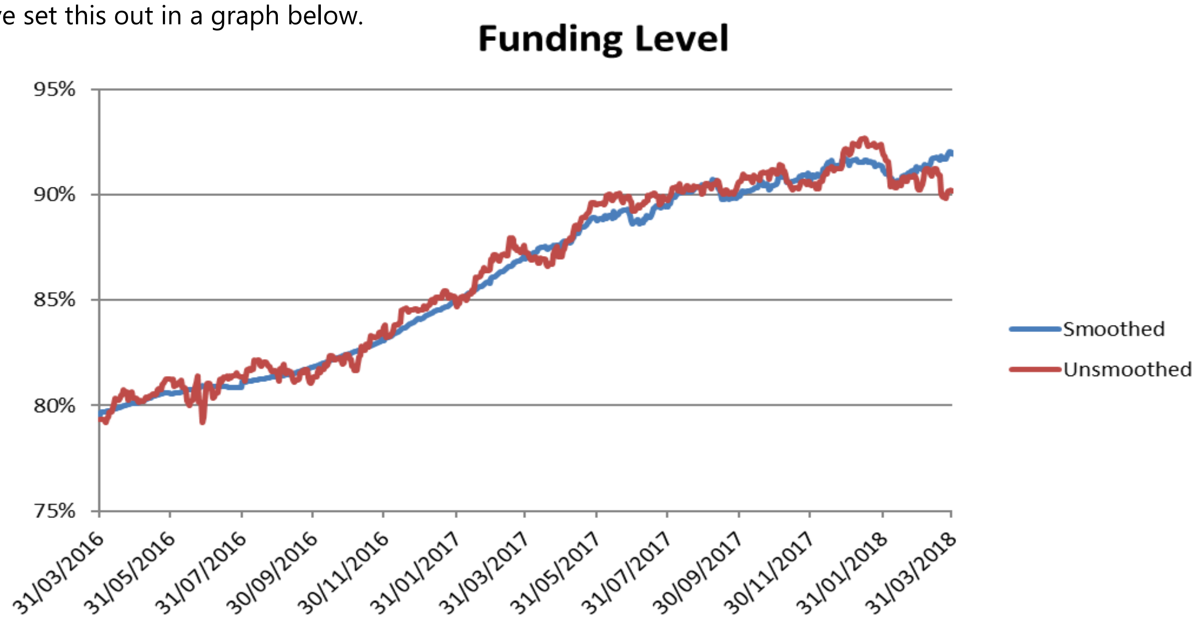
# Appendix 1 Financial position since previous valuation

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.

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 8%, 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 | 502,831 | 632,161 | (129,330) | 80% | 17.2% | 8.8% | 26.0% | 5.2% | 6.3% |
| 30 Apr 2016 | 512,674 | 640,244 | (127,570) | 80% | 17.5% | 9.4% | 26.9% | 5.1% | 6.2% |
| 31 May 2016 | 524,865 | 651,644 | (126,779) | 81% | 17.9% | 9.4% | 27.3% | 5.0% | 6.0% |
| 30 Jun 2016 | 535,208 | 661,833 | (126,625) | 81% | 18.3% | 9.4% | 27.7% | 4.9% | 6.0% |
| 31 Jul 2016 | 545,451 | 672,304 | (126,853) | 81% | 18.7% | 9.4% | 28.1% | 4.9% | 5.9% |
| 31 Aug 2016 | 554,361 | 681,057 | (126,696) | 81% | 19.0% | 9.4% | 28.4% | 4.9% | 6.0% |
| 30 Sep 2016 | 564,104 | 689,440 | (125,336) | 82% | 19.3% | 9.3% | 28.6% | 5.0% | 6.0% |
| 31 Oct 2016 | 572,933 | 695,035 | (122,102) | 82% | 19.4% | 9.1% | 28.5% | 5.1% | 6.0% |
| 30 Nov 2016 | 580,323 | 698,668 | (118,345) | 83% | 19.5% | 8.9% | 28.4% | 5.2% | 6.1% |
| 31 Dec 2016 | 589,556 | 701,247 | (111,691) | 84% | 19.5% | 8.4% | 27.9% | 5.2% | 6.1% |
| 31 Jan 2017 | 597,155 | 703,349 | (106,194) | 85% | 19.4% | 8.1% | 27.5% | 5.3% | 6.1% |
| 28 Feb 2017 | 606,973 | 707,387 | (100,414) | 86% | 19.5% | 7.7% | 27.2% | 5.2% | 6.0% |
| 31 Mar 2017 | 618,463 | 711,236 | (92,773) | 87% | 19.5% | 7.1% | 26.6% | 5.2% | 5.9% |
| 30 Apr 2017 | 622,478 | 711,255 | (88,777) | 88% | 19.4% | 5.8% | 25.2% | 5.2% | 5.9% |
| 31 May 2017 | 631,653 | 711,525 | (79,872) | 89% | 19.3% | 5.3% | 24.6% | 5.2% | 5.8% |
| 30 Jun 2017 | 629,780 | 710,727 | (80,947) | 89% | 19.1% | 5.4% | 24.5% | 5.2% | 5.8% |
| 31 Jul 2017 | 635,064 | 710,220 | (75,156) | 89% | 19.0% | 5.1% | 24.1% | 5.2% | 5.8% |
| 31 Aug 2017 | 642,086 | 710,028 | (67,942) | 90% | 18.9% | 4.6% | 23.5% | 5.2% | 5.8% |
| 30 Sep 2017 | 639,097 | 710,933 | (71,836) | 90% | 18.8% | 4.9% | 23.7% | 5.2% | 5.8% |
| 31 Oct 2017 | 646,272 | 714,158 | (67,886) | 90% | 18.8% | 4.7% | 23.5% | 5.2% | 5.8% |
| 30 Nov 2017 | 646,260 | 713,297 | (67,037) | 91% | 18.6% | 4.7% | 23.3% | 5.3% | 5.8% |
| 31 Dec 2017 | 652,715 | 712,902 | (60,187) | 92% | 18.5% | 4.2% | 22.7% | 5.3% | 5.8% |
| 31 Jan 2018 | 649,807 | 713,181 | (63,374) | 91% | 18.4% | 4.5% | 22.9% | 5.3% | 5.8% |
| 28 Feb 2018 | 650,767 | 714,514 | (63,747) | 91% | 18.3% | 4.6% | 22.9% | 5.3% | 5.8% |
| 31 Mar 2018 | 658,283 | 716,107 | (57,824) | 92% | 18.3% | 4.2% | 22.5% | 5.3% | 5.8% |

We have set this out in a graph below.



# Appendix 2 Data, method and assumptions

## Data

In completing our calculations for pension accounting purposes we have used the following items of data, which we received from London Borough of Sutton:

- The results of the valuation as at 31 March 2016 which was carried out for funding purposes;
- Actual whole Fund income and expenditure items for the period to 31 March 2018; and
- Actual Fund returns based on Fund asset statements provided to 31 March 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 31 March 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 actual cashflows paid to and from the Fund.

It is not possible to assess the accuracy of the estimated value of the liabilities as at 31 March 2018 without completing a full valuation. However, we are satisifed that the approach of rolling forward the previous valuation data to 31 March 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 actual cashflows paid to and from the Fund. The latest date that we have been provided with the Fund assets is 31 March 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.

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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.

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