



Appendix A

# London Borough of Sutton Pension Fund

Funding update report as at 31 March 2018

**Barnett Waddingham LLP**

7 August 2018



## Contents

Introduction.....	3
Assets.....	3
Changes in market conditions – market yields and discount rates .....	4
Results .....	5
Final comments.....	6
Appendix 1 Financial position since previous valuation.....	7
Appendix 2 Data and assumptions .....	8
Data .....	8
Assumptions.....	8

## 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:

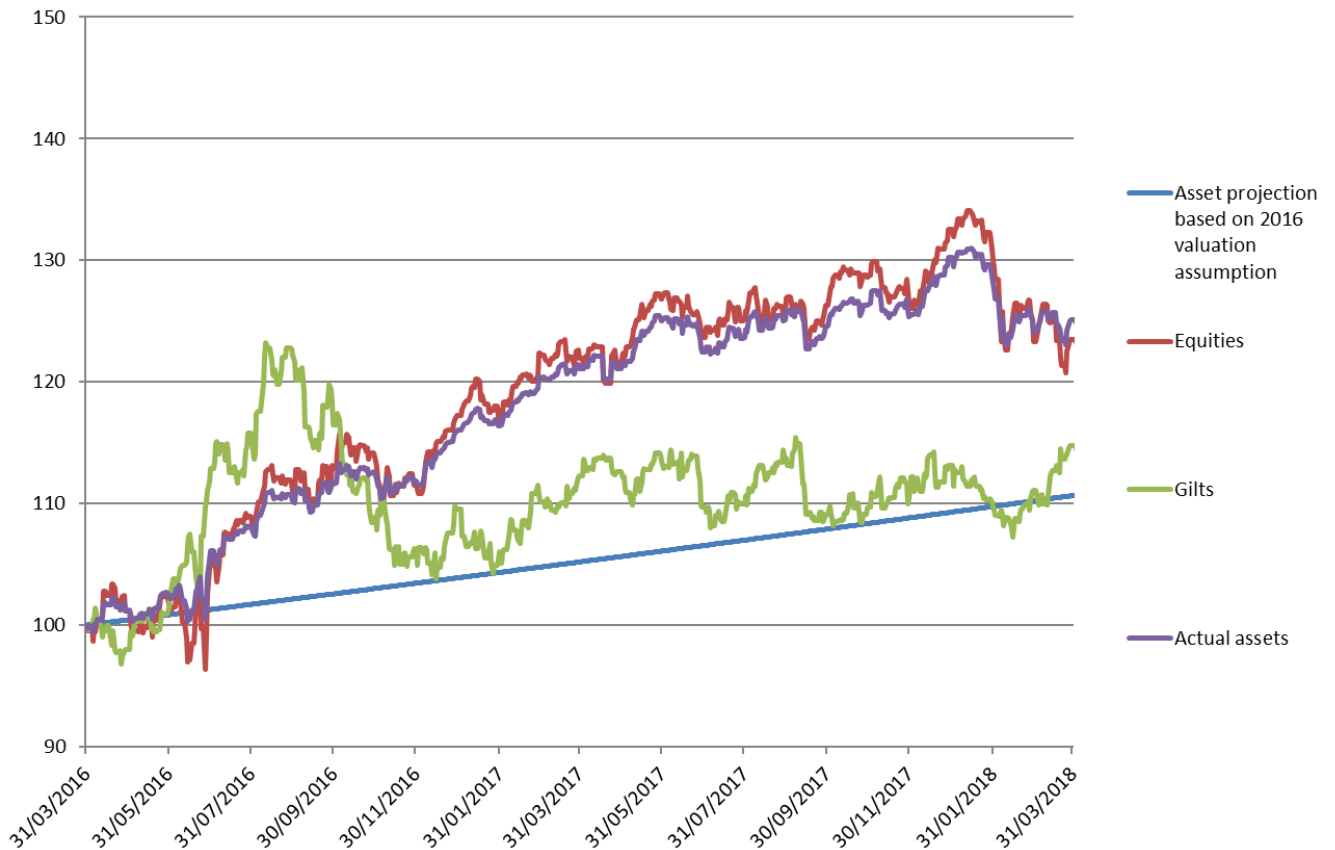
Assets (market value)	31 Mar 2018		31 Mar 2017		31 Mar 2016	
	£000s	%	£000s	%	£000s	%
Equities	402,259	62.8%	392,859	63.5%	278,604	55.0%
Gilts	74,927	11.7%	74,547	12.1%	30,393	6.0%
Bonds	96,153	15.0%	92,420	14.9%	0	-
Property	50,285	7.9%	48,821	7.9%	75,983	15.0%
Cash and accruals	16,776	2.6%	9,752	1.6%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

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:

### Change in Asset Values



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.

A handwritten signature in black ink that reads 'Melanie Durrant'.

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



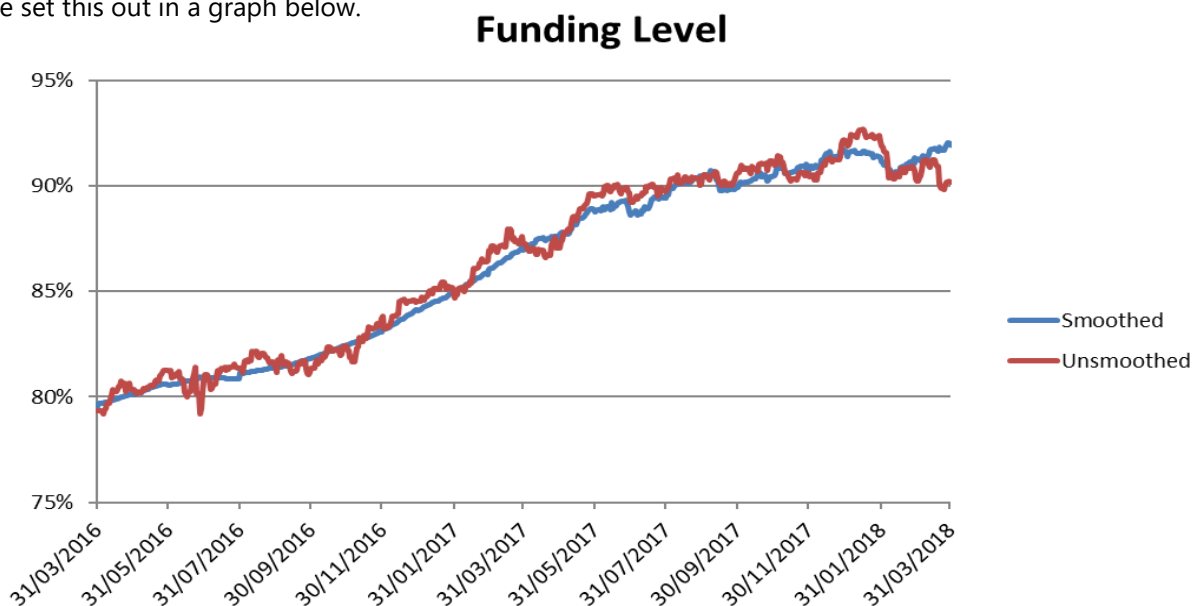
## Appendix 1 Financial position since previous valuation

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%.

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 satisfied 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.





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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