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31 December 2023
Funding Update

London Borough of Ealing Pension Fund

March 2024

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31 December 2023 Update – Key Considerations

Returns outlook

Gilt yields have risen materially over the last 12 months, which has led to many stochastic models pointing to a significant increase in expected future investment returns, and therefore the valuation discount rate. If such higher discount rates are applied mechanically without adjustment, this results in potentially material funding improvements being recognised at the current time - despite high inflation increasing pension costs and low asset returns. Such funding improvements for LGPS Funds are being widely reported in the press.

However current conditions are volatile, creating more uncertainty and more “model parameter risk”. This would suggest an increase in prudence margin/likelihood of success is needed when setting discount rates using these models, at least until the outlook begins to look more stable.

In line with the objective for prudence and cost stability, and as previously agreed with the Fund, we have carried out the funding update allowing for some but not all of the upward movement in yields. We have allowed for around 25% of the Fund’s assets to be correlated with gilt yield movements, which takes into account the broad asset strategy adopted. In addition, we’ve taken into account other factors that have led to changes in expected returns separately from yield movements (such as changes in credit spreads). However, the current financial conditions provide much more flexibility in where to position the discount rate, and so we have also shown a sensitivity of a further 0.5% p.a. increase on past service investment returns.

The position will be considered in detail as part of the funding strategy work in the lead in to the 2025 valuation, taking into account views on economic outlook, contribution affordability and sustainability for employers at that time. We have not sought to pre-empt this work at this stage in the valuation cycle.

Life Expectancy

In June 2023, CMI released outcomes of their 2022 investigation. Relative to the funding assumptions underlying the 2022 valuation calculations, a small reduction in liabilities and future service rate is expected as a result. Whilst it is early days, indications for the CMI 2023 analysis are for a further fall in projected life expectancy and further details will be known once this is released in the next few months.

31 December Update – Whole Fund

	31 March 2022 Valuation	31 December 2023 Update (Like for Like)	31 December 2023 Update (Updated Discount Rate / Mortality)	31 December 2023 Update (+0.5% Discount Rate Sensitivity)
Assets	£1,546m	£1,570m	£1,570m	£1,570m
Liabilities	£1,617m	£1,857m	£1,708m	£1,572m
Funding Level	96%	85%	92%	100%
Surplus / Deficit	-£71m	-£287m	-£138m	-£2m
Primary Contribution Rate	18.6%	18.6%	16.8%	16.8%
Real Discount Rate - Past Service	CPI+1.35%	CPI+1.35%	CPI+1.75%	CPI+2.25%
Real Discount Rate - Future Service	CPI+2.00%	CPI+2.00%	CPI+2.25%	CPI+2.25%
Life Expectancy Assumption	2022 val baseline CMI 2021 1.75%	2022 val baseline CMI 2021 1.75%	2022 val baseline CMI 2022 1.75%	2022 val baseline CMI 2022 1.75%

Comment

- The 31 December 2023 liability figures allow for changes in known inflation to December 2023 (which drive the April 2024 increase).
- The 31 December 2023 figures are estimated taking into account a combination of actual investment returns (as provided by the Fund) and actual contribution and benefit cashflows to 31 March 2023 and then estimated thereafter to 31 December 2023.

Future investment returns

- Under the agreed mechanistic approach for updating the discount rate, the reported funding level has fallen to 92%. However, as referenced on previous slide whilst there is a need to balance model parameter risk, the current financial conditions do provide much more flexibility on where to position the discount rate.
- The rise in gilt and bond yields since 31 March 2022 also means that the Fund may be able to deliver the long-term investment return required for the funding strategy with lower investment risk and this is an area to discuss with the Fund's investment adviser if not already covered.
- The full stochastic model for future returns will be used for the purpose of setting contribution outcomes for the next valuation. This will show the likelihood alongside the return assumption so that the Fund can consider this in conjunction with the funding position when determining the contribution strategy.
- **Further consideration will be given to discount rates (and the impact of investment strategy changes), inflation, life expectancy as part of an interim review exercise to be undertaken in the Autumn, as part of planning for the 2025 actuarial valuation.**

What’s happened since 31 March 2022 - summary

Mini-Budget

The challenging economic environment since the valuation date has impacted asset returns. The Fund’s assets are estimated to have returned c2.5% since 31 March 2022. This compares to the long-term required return from the funding strategy of c8% over the period.

Higher interest rates/inflation

Allowance for a higher 2023 Pension Increase was built into 2022 valuation outcomes, but high inflationary environment has continued. The 2024 Pension Increase will be c6.7% and this is built into the numbers in this presentation.

The higher interest rate environment reduces the cost of investing in low risk assets. More generally across the LGPS this has led to an interest in early termination/de-risking from some employers.

Strategy Updates

The Fund has carried out a review of its investment strategy.

The impact of the investment strategy changes will be modelled as part of the 2025 discount rate analysis. In the absence of the final strategy changes being confirmed, the impact of these changes have not been incorporated into this funding update.

31 December 2023 Update – What next?

Contribution affordability/ sustainability

- Based on current market conditions and financial models, there is a greater likelihood of achieving the discount rate set at the valuation date which provides some flexibility for the 2025 valuation. However contribution outcomes will ultimately depend also on the asset experience and whether returns continue to pick up over the next 12 months (as they did over the quarter to 31 December 2023). Biggest driver of total contributions will continue to be future service rate contributions.
- As part of the preparation for the 2025 valuation, a more detailed review of funding will be undertaken later this year.

Surplus management

- Surplus buffer (10%) introduced at 2022 valuation. Surplus management likely to be important for some employers for the 2025 valuation, potentially for the Council too depending on how the position emerges.
- Across the LGPS, major employers are asking Funds to “lock in” their improved funding position, with investment de-risking/partial termination.
- Funds may also start seeing requests for interim rate reviews, especially given financial stability of some Councils – although this is not currently an option in the Ealing Fund.

Climate Risks

- It remains uncertain when regulations governing climate change reporting in LGPS will be effective. The Fund carried out climate scenario analysis as part of the 2022 Actuarial Valuation to better understand the nature of their exposure to climate risk (extract from this is set out in the Appendix).
- Looking ahead, it will be important to ensure that work undertaken in this area, in terms of strategy (and scenario analysis to help formulate this), continues to be joined up with the funding strategy, including linking to potential demographic impacts, contribution outcomes and potential affordability.

In other news – McCloud / General Code

McCloud

- Regulations became effective from 1 October 2023. Initial prioritisation guidance released by DLUHC on 13 October 2023 and Initial implementation guide from LGA issued in November 2023 (first of 3).
- Further statutory guidance awaited on approach Funds should take to implementing the remedy – to be consulted on. GAD guidance has now been issued in relation to certain calculation processes (early/late retirement etc.).
- Software systems are being updated in relation to BAU tasks going forwards for new cases – if complete data available.

General Code / Good Governance

- Final Code published in January 2024 and will become effective from March 2024. Certain areas clarified from draft Code but questions for LGPS remain.
- 51 modules included in the Code but not all will apply to the LGPS although in some areas, there will be an expectation to follow the Code even if no formal requirement i.e. “good practice”.
- Our message is “**Don’t panic**” but work will needed to understand the implications of the Code and to assess what work will be needed (and when) to ensure compliance. We recommend a gap analysis is carried out as a first step
- Expected recommendations from LGPS Good Governance project will also align with many areas of the requirements under the General Code – consultation also expected in 2024 on final recommendations.

In other news – Other Current Issues

Other Regulatory Change

- Abolition of Lifetime Allowance from April 2024. Follows on from increases to Annual Allowance and removal of LTA charges in 2023 Spring Budget which have emerged in 2023/24. Beneficial to members but does pose some administrative challenges and guidance awaited – further change ahead also after the election?
- Further guidance awaited following Government response to "Pooling" consultation – further updates on TCFD reporting requirements also expected.
- Consultations currently expected in 2024 in relation to other regulatory change – historic survivor benefits, forfeiture, refunds etc

Cyber Security

- TPR Guidance updated in December 2023 building on principles set out back in 2018 – align with the "good practice" requirements set out in the General Code module. Greater emphasis on Funds to assess/manage risks than previously – more of a "when" rather than "if" view taken.
- We recommend the Fund officers/committee undertake training and a gap analysis to identify areas for development – consideration of host authority policies and procedures will be important – are these sufficient for the Fund?.

Other

- Dashboards - Whilst final staging date for Pension Dashboards pushed back to 31 October 2026, preparatory work continues and connection dates for some Funds may still emerge earlier than 2026.
- AVCs – Norfolk Framework in relation to AVC providers / consulting will go live in 2024.
- Local Authority – Many of the issues facing the Fund will be similar to those of the Council e.g. climate risk, financial resilience etc. Can any synergies be explored further?

Appendix

2022 Valuation Recap

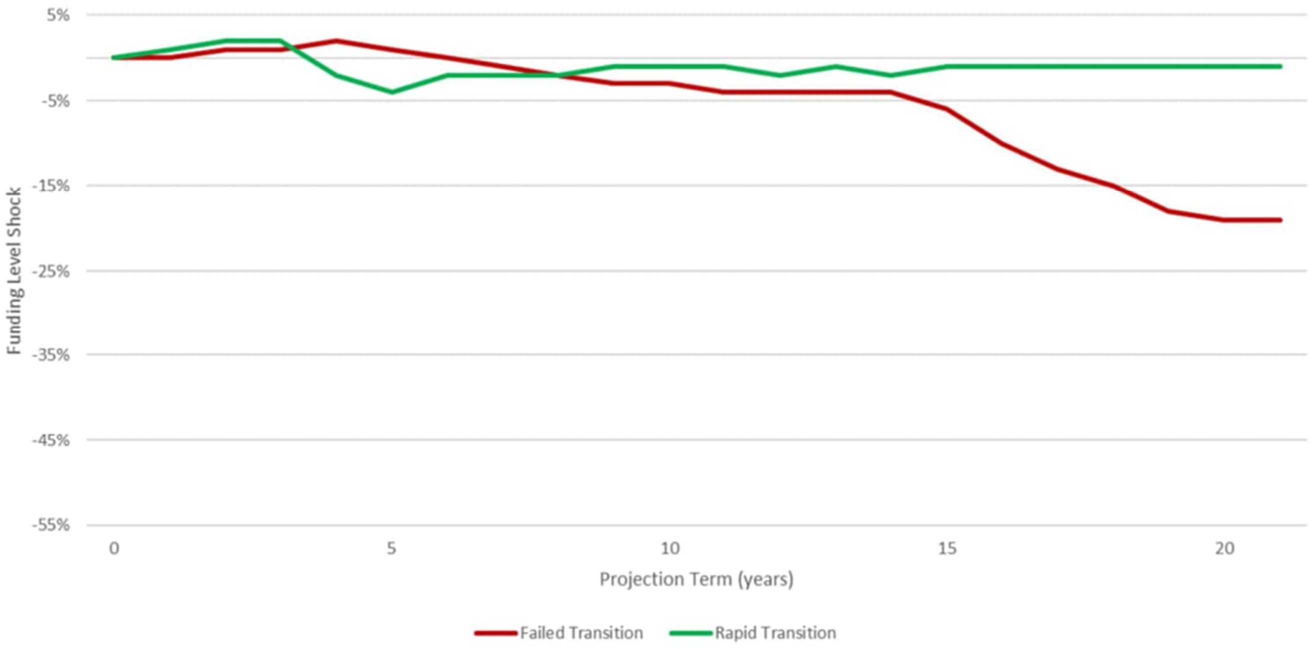
Key results	Whole Fund
Assets	£1,546m
Liabilities	£1,617m
Funding level	96%
Surplus/(deficit)	-£71m
Primary Contribution Rate	18.6%
Recovery Period	11 years (average)
Secondary Contributions - 2023/24 - 2024/25 - 2025/26	 £7.0m £6.8m £7.1m
Real discount rate – past service	1.35% p.a.
Probability of attaining discount rate	70%
Real discount rate – future service	2.00% p.a.
Probability of attaining discount rate	61%
Life Expectancy Assumption	2022 Valuation Baseline – CMI 2021 1.75% LT

Comment

- The secondary contributions certified reflect any prepayment decisions by employers for the period 2023/26 and also reflect any pooling arrangements in place for the purpose of setting contributions e.g. certain academies with the Council.

Extract of climate change analysis from the 2022 valuation

Funding Level Projection – Relative impact



Key points at different time frames :

Over the short term, transition risk dominates. The Rapid Transition is the most impactful scenario. Under this scenario there is a shock which reduces the funding level by about 5% relative to baseline. The Failed Transition funding level is marginally higher than the baseline in the short term due to transition costs not materialising.

As longer term physical damages begin to be priced in, the Failed Transition becomes the most impactful scenario. Extending the projection period out further would provide greater insight into these impacts.

This is an extract from Mercer's more detailed report entitled "Actuarial valuation – climate change scenario analysis" dated March 2023. The analysis relies on a number of assumptions, further detail of the modelling and assumptions used is included in our report and this chart should be considered in conjunction with that report including the notes set out therein.

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Actuarial Advice

- We have prepared this document for the Administering Authority for the purpose of understanding the development of the funding position of the Fund and factors that have influenced this, for information purposes.
- “Technical Actuarial Standard 100: Principles for Technical Actuarial Work” (v2) issued by the Financial Reporting Council applies to this presentation and the associated work, and we confirm compliance with this standard. This presentation should be read in conjunction with our report on the actuarial valuation of the Fund as at 31 March 2022.
- Unless otherwise stated, we have relied on the information and 2022 member data plus other data supplied to us in preparing the information, without independent verification. We will not be responsible for any inaccuracy in the advice that is a result of any incorrect information provided to us.
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