Agenda Item

Subject	Valuation 2019 - Update	Status	For Publication
Report to	Authority	Date	12 September 2019
Report of	Fund Director		
Equality Impact Assessment	Not Required	Attached	No
Contact Officer	George Graham Fund Director	Phone	01226 772887
E Mail	ggraham@sypa.org.uk		

1 Purpose of the Report

1.1 To update members on the process of delivering the Fund's 2019 valuation and seek agreement to the key next steps in the process.

---

2 Recommendations

2.1 Members are recommended to:

a. **Endorse the employer engagement process and timetable set out in this report;**

b. **Approve the adoption of a primary objective in relation to this and future valuations of maintaining stability in contribution rates as defined in the body of this report, while noting the potential difficulties caused by the McCloud case and other external factors;**

c. **Approve the proposed policy position that Multi-Academy Trusts are automatically treated as a single employer;**

d. **Confirm that for employers remaining in deficit the maximum allowable deficit recovery period should be 16 years and the default position on deficit recovery should be as set out in para 5.8;**

e. **Approve the inclusion of the employers set out in para 5.11 within the ill health captive arrangement;**

f. **Endorse the approach set out from para 5.14 to employer risk management.**

---

3 Link to Corporate Objectives

3.1 This report links to the delivery of the following corporate objectives:

Customer Focus

To design our services around the needs of our customers (whether scheme members or employers).

The valuation process is the most significant opportunity available to the Authority for engagement with the whole employer base and provides an opportunity to design a funding strategy which achieves the twin objectives of achieving stable and affordable contribution rates

Listening to our stakeholders

To ensure that stakeholders' views are heard within our decision making processes.

The views of employers are fundamental to arriving at a Funding Strategy which can be delivered for the benefit of both scheme members and employers.

Investment Returns

To maintain an investment strategy which delivers the best financial return, commensurate with appropriate levels of risk, to ensure that the Fund can meet both its immediate and long term liabilities.

The potential level of investment returns over the long term is a fundamental debate within the valuation process.

Effective and Transparent Governance

To uphold effective governance showing prudence and propriety at all times.

Reporting in this way and taking steps to ensure that employers can engage with the Authority ensures that the valuation process is as transparent as possible and therefore more likely to secure employer "buy in".

4 Implications for the Corporate Risk Register

4.1 The actions outlined in this report impact on the various investment and funding risks identified in the Corporate Risk Register, and the actions in relation to the Funding Strategy and Investment Strategy are intended to reduce these risks.

5 Background and Options

5.1 The Authority is required to undertake an actuarial valuation of the Pension Fund every three years in order to establish employer contribution rates for the next three years. The valuation is undertaken by the Fund Actuary (Mercer) and contributes towards a Funding Strategy setting out how the liabilities of the Fund will be met over the long term. This report addresses a range of issues related to the Valuation process which need to be considered prior to the results becoming available. More detail on how the process is undertaken and the implications of the major policy decisions which will ultimately be required will be provided to members at the forthcoming seminar.

Employer Engagement

5.2 The Valuation Process provides an opportunity for the Authority to continue to progress the change in the way in which it engages with employers over major policy issues, in line with the intentions laid out in the recently approved restructuring proposals for the Pensions Administration Service.

5.3 During previous Valuation processes while significant effort has been made to engage with the District Councils less focus has been placed on the other employers. Given the significant change in the overall funding level and the various other changes that are either proposed or likely to occur going forward it is important that the views of all types of employer are heard. To this end the process illustrated at Appendix A is proposed which gives specific groups of employers the opportunity to engage with the Fund collectively around the most significant issues arising from the valuation and the proposed changes to the Funding Strategy while also providing opportunities to engage on an individual basis around their own results. This will be accompanied by regular electronic updates via the employer portal.

Valuation and Funding Strategy Objectives

5.4 The overall position of the Fund has changed significantly since the last valuation with this valuation likely to see something around a fully funded position, noting that this will not be the case for many employers who had significant deficits at the 2016 Valuation, including many academies. This means that the previous key objective of the funding strategy which was to ensure the recovery of the deficit in a given period is no longer as relevant in all cases. It is therefore important to agree what the key objectives of the Funding Strategy should be going forward in order to ensure that the benefits of this significant step forward in overall funding are not to be lost.

5.5 After eliminating the deficit feedback from employers indicates that achieving stability (and hence predictability) in contributions is the key ask. Clearly contributions cannot be frozen forever, however it should be possible, all other things being equal to target maintaining contributions within a relatively narrow range of a central point, and it is proposed that this is set as the core objective of the Funding Strategy going forward.

5.6 While aiming to achieve contribution stability is a sensible goal there are a range of pressures in the system which work against it and it will be necessary to discuss with employers the degree of compromise necessary between these issues and the desire for contribution stability. The most obvious such issue is the impact of the McCloud judgement, which is not yet known in detail, but which will be an additional pressure on contribution rates. The choice exists to make some provision for dealing with this impact now in order to reduce the scale of the impact later, but this will need to be discussed with employers in terms of affordability, and is not something the Authority can insist on. Clearly, given the inevitability of the increased liabilities which will flow from McCloud, it is the prudent course of action given the fact that there is a small amount of flexibility added into the position through the likely removal of the current deficit contributions for many employers.

Multi-Academy Trusts

5.7 Previously the Authority had intended to provide Multi-Academy Trusts (MAT's) with the option of setting a single contribution rate and being treated effectively as a single employer. Having reflected on this with the Actuary, officers' view and recommendation now is that MAT's should automatically be treated as single employers. Some monitoring of individual school positions will still be required as there is the potential for schools to move from one MAT to another but this will be administratively simpler and will also work better with the proposed "deemed" employer provisions relating to functions contracted out by MAT's. The impact of this at individual MAT level will not be known until the valuation is complete but is not likely to be significant in comparison to issues such as McCloud which potentially disproportionately impact on academies because of the composition of their membership in the scheme. Early feedback from MATs suggests that a single employer rate is the preferred option and MATs will have the opportunity to raise any potential concerns during the consultations referred to in Appendix A.

Deficit Recovery

5.8 While overall the Fund is likely to be fully funded there will still be employers who have a deficit, indeed in numerical terms this may be the majority of employers given the previous funding levels for academies. The deficit recovery period is due to shorten at this valuation and previously members had agreed to adopt a position where the benefits of improved funding were shared between the Fund and the employer allowing some acceleration of deficit recovery. This is to be achieved by freezing the cash value of contributions and making the deficit payments the balancing figure between this and the appropriate future service rate. Given that deficits will have reduced as funding levels increase this will tend to mean the remaining deficit will be repaid over a shorter timescale, even accounting for the fact that the future service rate will increase to reflect a dampening of expectations on future investment returns. For academies, for example, this will provide a significantly better situation than the Teachers' Pension Scheme.

5.9 It remains the position that this should be the default approach. However, there will be cases where there are significant affordability issues and some flexibility is likely to be required. Therefore it is recommended that an additional policy is added in this area setting the maximum allowable deficit recovery period at 16 years.

Ill Health Captive

5.10 The Fund maintains what is known as an "ill health captive" arrangement to manage the costs of ill health retirement for employers. This is a form of insurance arrangement funded by an element of the employer contribution rate and serves to reduce the risk of a single ill health retirement having an entirely disproportionate impact on a small employer such as a parish council.

5.11 At this valuation it is appropriate to restate those employers who have to be part of the captive in order to manage these risks. The following employers will automatically become part of the captive arrangement:

- Academies and Multi-Academy Trusts;
- Transferee Admission Bodies
- All Community Admission Bodies
- All Parish and Town Councils
- All other bodies with less than 100 active members

5.12 This approach which slightly extends the number of employers covered will mean that all smaller employers are covered thus simplifying the arrangements and providing improved protection for those employers where ill health retirements present the greatest risk.

5.13 The financial experience of the captive arrangement will be reassessed as part of the valuation process and reflected in setting future contribution rates.

Employer Risk Management

5.14 Different employers present different risks to the Fund. For example while councils are facing significant financial pressures their scale, and ability to raise some income through local taxation mean that the likelihood of them not being able to meet their obligations to the Fund are low. On the other hand a small charity with limited financial resources may find it extremely difficult to meet its obligations. The Authority has an obligation to recognise and manage the risk each employer represents to the Fund in order to protect the interests both of all the other employers (on whom the consequences of any default would fall) and of scheme members.

5.15 The first stage in a structured approach to managing employer risk is to classify employers within broad categories to identify those where further detailed work would be of benefit. There are a number of ways of doing this, but the following broad approach is being adopted:

- Local Authorities – District Councils (including maintained schools), Police, Fire, Combined Authority Group and SYPA. These employers either have the power to raise income through taxation or, in the case of SYPA, costs are entirely met by the Pension Fund.
- Education Sector – F&HE Institutions and Academies. All these employers are ultimately funded by central government, although in different ways and with different forms of support. They do represent similar forms of risk although the likelihood of default can vary significantly between institutions.
- Contractors – These employers can range from large multi-nationals to relatively small local businesses. Where contracts are let by a local authority there tends to be a guarantee, while the situation with contracts let by academies is more variable. However, in all cases the ultimate position is that the council or academy would need (at least in the short term) to take on any service (and hence pension liability) in the event of failure.
- Others – While an extremely varied group this group probably presents the greatest likelihood of default (if possibly the least financial impact). In general such employers have no or limited guarantees and therefore there is a danger that in the event of default liabilities will fall on the remaining employers.

5.16 There are various ways in which the risks posed by different employers can be addressed. For example giving the Authority a charge over a property could provide access to an asset that could be sold to meet liabilities in the event of a default. Such techniques are helpful, if very individual, and therefore resource intensive to put in place. The most significant benefit, however, can be achieved through increasing the certainty of moving to a position of full funding through the Funding Strategy. This can be achieved through shortening the deficit recovery period but also through allocating each group of employers a different mix of assets to reflect the risk they pose to the Fund. Thus the “other” group which presents a higher risk would be notionally allocated a smaller proportion of equities and a higher proportion of fixed income assets as this provides greater certainty of achieving the returns assumed in the valuation process.

Officers will be working with the actuary to include a fully developed framework of this sort within the Funding Strategy and the forthcoming process of engagement will provide employers with an opportunity to comment on aspects of this approach.

5.17 The various steps outlined in this report are precursors to producing an outline Funding Strategy Statement which will form the basis of the consultation with employers during November and December. The outline Funding Strategy Statement can be issued under delegated powers and will be circulated to members when available.

6 Implications

6.1 The proposals outlined in this report have the following implications:

Financial	There are no additional financial implications. The costs associated with the employer engagement process can be accommodated within the existing budget, while the actuarial fees associated with the valuation are provided for.
Human Resources	None
ICT	None
Legal	The Authority is required to consult effectively with regard to changes to the Funding Strategy. The proposals outlined in this report fulfil that requirement.
Procurement	None

George Graham

Fund Director

Background Papers	
Document	**Place of Inspection**