South Yorkshire Pension Fund – 2022 FSS review

Purpose and scope

This paper has been commissioned by and is addressed to the South Yorkshire Pensions Authority ("the Authority"), the Administering Authority to the South Yorkshire Pension Fund ("the Fund"). Its purpose is to set out how the key principles of the Funding Strategy Statement ("FSS") may change following the formal triennial review of this alongside the 2022 valuation of the Fund.

Process and consultation

The current FSS requires a formal review of this document every three years and the Authority is currently carrying out this review with support from the Fund Actuary.

The revised FSS will be available in October/November 2022 and a formal consultation period will follow, during which employers will be able to comment on the funding strategy set out (which will apply at the 2022 valuation) and associated policies.

Fundamental changes to the FSS are not expected following the current review. Changes made will be in line with the recent evolution of funding strategy i.e. those required to better manage risk in the Fund and improve the employer experience.

This document sets out the key principles and policies contained in the current FSS and how these are expected to change as a result of this review. I understand that this paper will be shared with employers as part of an initial consultation on the changes in FSS principles.

Key funding principles and suggested changes

The tables below set out the key principles contained in the FSS, and the current expectation with regards to how these may change as part of the 2022 review.

Assumptions

Principle	Current position	Change
Solvency objective	Achieve a 100% solvency level over a reasonable time period.	No change.
Prudence	A prudent approach to meeting solvency target is set.	Prudence will be explicitly measured at the 2022 valuation by measuring the likelihood of the certified contribution rates being sufficient to ensure that benefits can be paid in the future. A minimum likelihood of success (based on Hymans Robertson's market assumptions) of 70% will apply. A higher threshold may apply for certain employers, specifically where there is a weak employer covenant.
Discount rate	Based on the expected return on the Fund assets using the long-term investment strategy. Discount rates are set relative to CPI, separately for pre-retirement (CPI plus 1.5%) and post retirement (CPI plus 2.35%))	A single discount rate will be set based on the level of returns expected to be achieved on the Fund assets (based on the long-term strategy) with a 70% likelihood of success. This leads to a discount rate assumption equal to the risk-free rate plus 2.3% per annum, which is broadly equivalent to that set under the previous funding strategy.

Consumer Price Inflation (CPI) – pension increase rate	Equal to long-term RPI less 1.0% per annum	A revised approach to recognise the distortions caused in the market price of RPI by the planned harmonisation of RPI with CPIH from 2030. The CPI assumption is expected to be higher than that set at the 2019 valuation due to a general increase in inflation expectations
Salary growth	CPI plus 1.25% per annum (which includes allowance for promotional increases)	CPI plus 0.6% per annum, plus a separate age and salary related allowance for promotional increases.
Baseline longevity	Standard mortality tables published by the actuarial profession's Continuous Mortality Investigation (CMI) group adjusted to reflect the characteristics of Fund members	Based on Club Vita tables allowing for the specific characteristics of each individual member. In effect, a separate mortality assumption is set for each member of the Fund based on relevant factors (e.g. lifestyle, affluence etc).
Longevity improvements	Based on the latest future improvements tables provided by the CMI.	No change in approach, leading to the use of the CMI 2022 tables adjusted to reflect expectations of future experience.

Setting contributions

The focus at the 2022 valuation will be in setting total contribution rates that are sufficient to lead to the employer being fully funded at the end of their appropriate time horizon.

Principle	**Current position**	**Change**
Stability for long term secure employers	Desire for as nearly a constant rate as possible	An explicit contribution stability mechanism will be set for each of the long-term secure employers in the Fund (typically the Scheduled Bodies). The mechanism will specify how contributions rates can vary in future by defining a maximum increase/decrease that can apply from one year to the next.
Deficit recovery periods	Maximum periods defined in current FSS with an expectation that these would generally reduce by three years each future valuation	The starting point will be for time horizons at the 2022 valuation to be set in a consistent manner to that defined in the current FSS. Shorter time horizons may apply in certain circumstances depending on the assessed employer covenant strength and in situations where employers are heading to a cessation event.
Phasing of contribution rates	If material increases in contribution rates are required, these increases may be phased in over the three-year period of the R&A.	No change

Reductions in contribution rates	Reduction in contribution rates will not be permitted if the employer is in deficit at the 2022 valuation.	No change.
Delaying introduction of new contribution rates	Where the employer's year-end is not 31 March, the new contributions will be permitted to commence from the beginning of the new financial year (following a formal request from the employer).	New contributions to apply from 1 April 2023

Other funding principles and policies

Principle	**Current position**	**Change**
McCloud	Employers have the choice of paying higher contributions to meet the expected cost of rectifying benefits for the McCloud remedy	Allowance for the McCloud remedy will be included in the measurement of the past service liabilities and (where appropriate) future service contribution rates, for all employers as a matter of course. Therefore, no choice element beyond 2023, and employers who chose to pay the higher rate for the past three years will (all other things being equal) be in a better place than those who didn't.
Contingent assets	The Authority will recognise contingent assets in place when agreeing funding plans with employers	No change
Prepayments	All employers may pre-pay secondary contributions Certain large employers may be permitted to pre-pay Primary contributions (subject to a check at the end of the year to make sure that there has been no underpayment – following which a 'top-up' payment may be required).	No change
Cessations	Policy for calculating cessation debts and exit credits, and for allowing Deferred Debt Arrangements is included in the existing FSS.	This is being reviewed by the Authority and any changes will be set out once the revised draft FSS in available in quarter 4 2022.
Covenant assessment	The Fund will make an objective assessment of covenant strength for each employer	No change

New academies	The approach taken to determine starting asset shares and contribution rates is set out in the existing FSS	No change to the asset allocation approach is expected.
Ill health retirement strains	A captive insurance arrangement is in place for certain (small) employers in the Fund where ill health strains are effectively pooled. All other (larger) employers meet the cost of their own ill health experience.	No changes are expected, but the Authority will carry out a review of the captive insurance arrangement and experience since the 2019 valuation prior to considering if changes are necessary.

New policies

Principle	**Details**
Climate change risk	The Authority will develop a policy for measuring and monitoring the risks associated with climate change, including the effect on funding and investment outcomes.
Pass though	The Authority is reviewing the admissions policy with a view to facilitating pass though for all new admissions created from local authority and academy outsourcings.

Reliances and limitations

This paper has been prepared for the South Yorkshire Pensions Authority for the purpose described above. It has not been prepared for use for any other purpose and should not be so used.

This paper may be shared with participating employers for consultation purposes but should not be considered as advice to the employers.

This paper should not be disclosed to any other third party except as required by law or regulatory obligation or with our prior written consent. We accept no liability where the paper is used by or disclosed to a third party unless we have expressly accepted such liability in writing. Where this is permitted, the paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

Douglas Green FFA– Fund Actuary

Steven Scott FFA – Fund Actuary

May 2022

For and on behalf of Hymans Robertson LLP