

London Borough of Camden Pension Fund

Review of LB Camden Contribution Strategy

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For and on behalf of Hymans Robertson LLP



Executive summary – 1 of 2 – Main results

- This paper sets out a summary of the results of contribution rate modelling for the London Borough of Camden for contributions coming into effect from 1 April 2023. For the full results analysis please see the separate paper produced for officers, dated June 2022 (which also includes the background to the assumptions used and other explanatory material).
- The results are generally positive and suggest that the current rate is broadly at or above the “right level”. We have modelled a variety of scenarios which suggest the current “stabilisation” approach remains appropriate, i.e. limiting changes in Council contribution rate from one year to the next.
- Stepped reductions of 1% of pay each year (i.e. a total reduction of 3% of pay by the end of the triennial period) give acceptable results as do targeted reductions totalling c.£10m and c.£15m over the three years. It should be appreciated there is a reasonable chance that reductions would need to be reversed later.
- These rates will remain in draft until the Funding Strategy Statement consultation is concluded later in the year.

Executive summary – 2 of 2 – Other issues

- Our modelling allows for increasing inflation concerns as well as a variety of market evolutions in the coming years.
- We also tested the impact of an immediate & permanent market shock (10% fall in assets) and this doesn't change any of our conclusions.
- The results shown in this paper are shown based on a funding target discount rate using a margin of 2.0% pa above the risk-free rate as the calculations were carried out prior to a decision being made on assumptions for the 2022 formal actuarial valuation. In June, the Fund decided to change the funding target discount rate to use a margin of 2.1% pa above the risk-free rate. However an increase in this rate would not affect our conclusions.
- We have also stress tested the recommendations under three climate change scenarios which show that the recommended strategies are sufficiently resilient to climate risk (these results are shown in the full report to officers dated June 2022).
- We have generally used the long-term target investment strategy. We can model alternative strategies if these were ever being considered, to check whether any changes could invalidate any of the conclusions on contributions.

Addressee & purpose

Use the menu bar above to navigate to each section.

Addressee & Purpose

This paper has been requested by, and is addressed to, the London Borough of Camden **in its capacity as Administering Authority** to the London Borough of Camden Pension Fund (“the Fund”).

The modelling results contained within are in respect of the London Borough of Camden (“the Council”), **in respect of its participation as an employer** in the Fund.

As part of the 2019 formal valuation of the Fund, the long-term funding strategy for the Council was reviewed. The results of this review were formalised in the Funding Strategy Statement (“FSS”) at that time.

The purpose of this report is to summarise the results of modelling carried on the previously agreed funding strategy for the Council to ensure it remains appropriate given the Fund’s long term funding objectives, its view of funding and investment risk, and progress against its objectives since 2019.

As contributions and investment returns are the sole sources of funding members’ benefits, a long-term funding strategy should be considered in tandem with a long-term investment strategy. Note that this paper has not been prepared for the purpose of reviewing or advising on the Fund’s long-term investment strategy; however we can model potential alternative investment strategies to ensure that any change would not invalidate the chosen funding strategy.

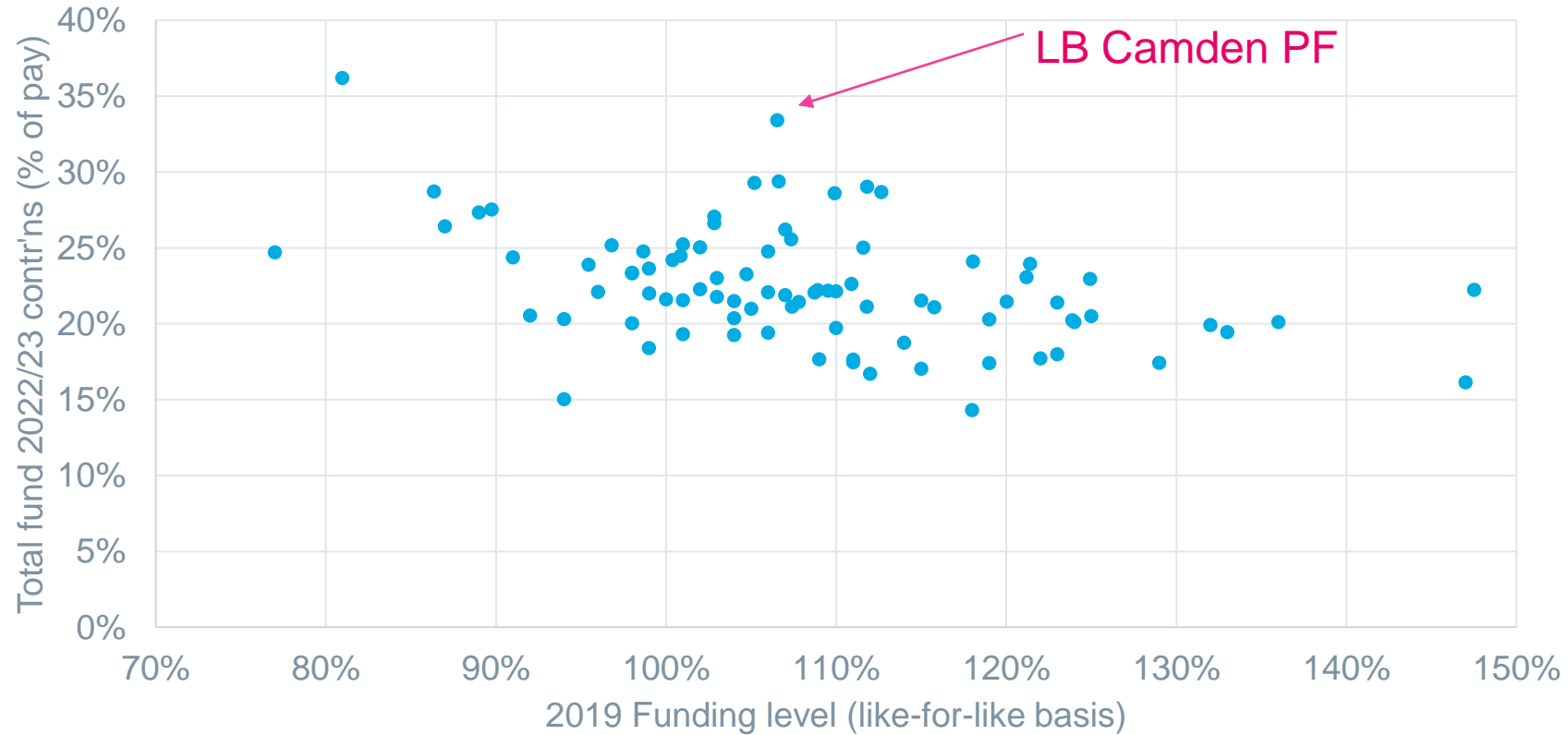
Any changes to the agreed funding strategy should be documented in the FSS and consulted with employers, in line with Local Government Pension Scheme (LGPS).

This paper has been produced for the Administering Authority of the Fund. We accept no liability to third parties and/or for any other purpose than above, unless expressly accepted in writing.

This paper does not meet the Technical Actuarial Standards as it is a summary document, however our full formal advice to officers does meet the TAS requirements.

Context for results

Looking back to 2019



High contribution rate vs funding position may mean there is scope to reduce at this valuation?

Results

Model inputs: Contribution Scenarios

For each scenario, we have modelled the contribution rate expressed solely as a percentage of pay. In practice this would be converted into an appropriate split of % and £ elements, in broad terms Primary Contributions (the cost of ongoing accrual) being expressed as a % of pay, with the remainder as £ (to protect the Fund against falling payroll giving rise to falling contributions).

When referring to the “22/23” level of contributions, we are referring to what the Council contribution would have been in that year (32.5% of pay).

We were also asked to model rates which are expected to give rise to reductions of c.£10m and c.£15m over the three years, relative to the 22/23 level of contributions (pre-prepayment). e.g. for the £10m scenario, the rates fall by c.1% cumulatively pa (i.e. by 1% in year 1, 2% in year 2, 3% in year 3) relative to the freeze rates, totalling c.6% reduction over the three years, which amounts to c.£10m when applied to the Council pensionable payroll of c.£170m.

The contribution patterns modelled make allowance for the likely increases to members’ benefits arising from the McCloud case, but not any changes which could result from the national LGPS Cost Management mechanism.

We have also modelled contribution rate being “fixed forever”, so that we can consider the long-term cost of benefits, and also (if necessary) isolate the differences in outcomes when investment strategy is varied.

The contribution strategies are detailed on the following slide.

Model inputs: contribution scenarios

Rate Pattern	2021-22	2022-23	2023-24	2024-25	2025-26	Thereafter
Freeze 22/23 forever	31.8%	32.5%	32.5%	32.5%	32.5%	Fixed @ 32.5%
Freeze 22/23 3y	31.8%	32.5%	32.5%	32.5%	32.5%	+/- 1%
Freeze 22/23 3y plus cap	31.8%	32.5%	32.5%	32.5%	32.5%	+/- 1% Cap at 32.5%
Step down 1%	31.8%	32.5%	31.5%	30.5%	29.5%	+/- 1%
Step up 1%	31.8%	32.5%	33.5%	34.5%	35.5%	+/- 1%
Reduce £10m	31.8%	32.5%	31.6%	30.6%	29.6%	+/- 1%
Reduce £15m	31.8%	32.5%	31.1%	29.6%	28.1%	+/- 1%

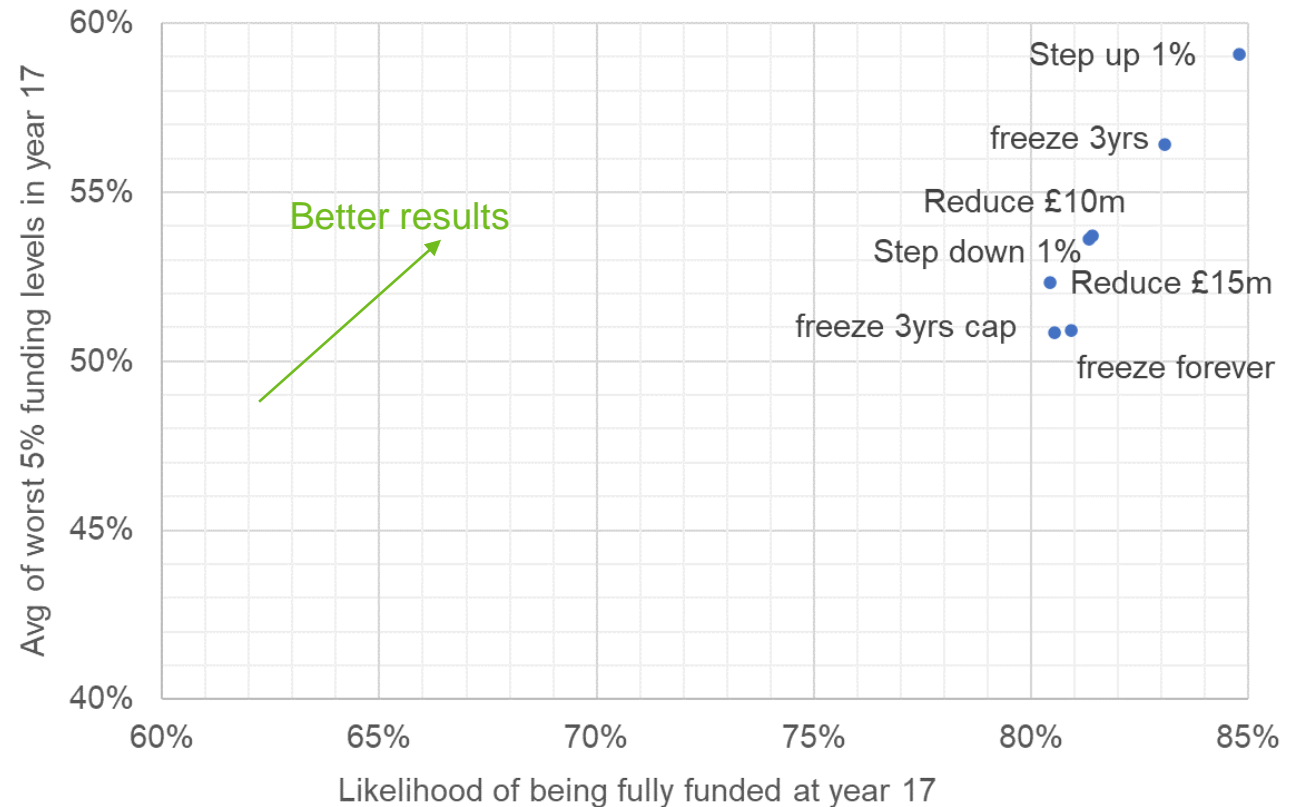
The rates in the table above include expenses of 0.6% of pay. In the model we ignore expenses so the modelled rates are actually 0.6% of pay lower.

Employee contributions of 7.0% of pay are modelled but are assumed to be fixed in % of pay terms.

We can interpolate between modelled strategies to analyse variants of these scenarios.

Results

- This slide shows results using a funding target at the time horizon point (17 years in the future) based on a discount rate **at that time** of 2.0% p.a. in excess of risk-free (gilt) yields **at that time**. Since the modelling the Fund has decided to move to a slightly higher funding target discount rate of 2.1% p.a., following separate advice around the assumptions for the 2022 formal actuarial valuation: this would give a lower funding target at the time horizon, and hence a higher likelihood (and improved downside risk) vs the results shown here
- Compared to freezing rates at their current level for the next three years, reducing rates (obviously) gives worse results, i.e. lower LoS and worse downside risk.
- There is an expectation that rate reductions would need to be unwound in future years, as shown by the fact that all three reduction strategies have similar LoS as “freeze forever” (where rates permanently held at current level)
- Steeper cuts for the first three years (e.g. £15m vs £10m) understandably give lower LoS and worse downside risk, however not significantly so
- However all stabilised strategies give healthy results, with LoS in excess of 80% and downside risk better than 50%
- All strategies are ultimately acceptable at 2022



Modelling results support contribution reductions