LONDON BOROUGH OF CAMDEN	WARD: All
REPORT TITLE: Employer Contribution Strategy	
REPORT OF: Executive Director Corporate Services	
FOR SUBMISSION TO: Pension Committee	**DATE:** 21 September 2022

SUMMARY OF REPORT:

This report considers the contribution strategy for the Council as the major employer in the Pension Fund, amongst 27 other much smaller employers. It considers the current stabilisation strategy that is applied to the Council (rates move within a window capped by +1% and a floor of -1%) and presents analysis from the Fund's actuary for seven different contribution strategies to be applied from 1 April 2023 in 4 different models.

Local Government Act 1972 – Access to Information
No documents required to be listed were used in the preparation of this report.

Contact Officer: Nigel Mascarenhas
Head of Treasury and Financial Services
Finance
Corporate Services
Dennis Geffen Annexe
Camley Way
London. N1C 4DG

Telephone: 0207 974 1904
Email: nigel.mascarenhas@camden.gov.uk

RECOMMENDATIONS:

The Committee is asked to agree that the Fund accepts the Councils proposal to reduce contributions by £10m in total over the next three financial years (23/24 – 25/26).

Signed by

Director of Finance ……………**Agreed**…………

Date ……………**12/09/2022**………

1. BACKGROUND

1.1. The Funding Strategy Statement (FSS) determines how different employers are treated within the Fund. In setting contributions the Fund balances affordability, transparency, stability and prudence in terms of funding requirements.

1.2. The FSS was last agreed at the March 2020 meeting and all employers in the Fund were consulted.

1.3. There are 28 active employers in the Fund (including the Council). The Council is by far the largest and main employer in the Fund with c85% of the Fund's liabilities at the last valuation (this was pre the Improvement and Development Agency leaving the Fund and so will have increased this time). This report considers how the Council's contributions should be set in-line with FSS principles.

1.4. The Fund's actuary (Hymans Robertson) approaches measurement of contribution rates for different employers by considering three constituent parts:

- The **funding target** is based on a set of assumptions about the future (e.g. investment returns, inflation, pensioners' life expectancies). The asset outperformance assumption of gilts plus 2.1% and the salary growth (Consumer Price inflation +0.5%) were reported at the last Committee meeting following analysis by Hymans Robertson. This demonstrates the Fund's approach to using relevant but also stable and prudent assumptions;
- The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform.
- The **probability** of achieving the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

1.5. For the Council, as the largest employer by far in the Fund, the funding target is not influenced by cessation as it has a very stable and secure operational basis over the long term. The time horizon for deficit recovery is 17 years. Hymans have shown the 14 year position to show how deficit recovery has progressed since the last triennial valuation 3 years ago.

1.6. The probability of achieving the funding target (Likelihood of Success or LoS) for employers is set between 66% to 80% (i.e. between a two in three up to a four in five chance that the employer will be fully funded over any modelled deficit recovery period). A higher probability is required for employers who are judged to have a riskier financial and/or fund participation basis). During the contribution work conducted by Hymans at the last triennial valuation period they increased the probability for the Council of achieving fully funded status (100% funding) from 66% to 70%. This is a tougher target for the Council to meet. At the last valuation the Likelihood of Success for the agreed strategy was 82% in 17 years' time. Any strategy pursued this time by the Council should aim to give similar results for continuity and prudence.

1.7. There is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and employers' needs to experience stable contribution rates which are not volatile from year to year and jeopardise the efficient running of these employers' businesses. The Administering Authority (the Fund) takes a view on the financial standing of each employer, i.e. its ability to meet its funding commitments and the relevant time horizon.

1.8. As part of their contribution rate modelling for the Council, Hymans Robertson have also considered downside risk (i.e. a fall in the funding level in particularly poor market scenarios).

1.9. The Fund will permit options such as stabilisation for large, stable employers, such as the Council, i.e. where contribution increases or decreases are limited from one year to the next. This is permitted in the expectation that the employer will still be able to meet its obligations in the long term without needing to consider employer viability.

1.10. Section 3.3 of the FSS presents a table which details the different approaches used for different types of employer in the Fund (note b in particular covers the stabilisation policy). The Council is the only employer who is stable enough to be able to use stabilisation. This limits changes to employer contributions changes to a range.

1.11. In deciding upon an appropriate Council contribution strategy, on a stabilised basis, the Fund will wish to ensure that:

a. suitably high likelihood (70%) of being fully funded within the time horizon

b. a time horizon of suitable length is considered

c. downside risk is not too high (a funding level of at least 50% in the worst market conditions)

d. contributions not expected to have to rise too significantly in the future.

2. METHODOLOGY

2.1. Hymans have modelled seven contribution rate scenarios for the Council and 5,000 future investment return scenarios shown in Appendix A. The contribution rate scenarios are projections of how Council contributions may increase or decrease over time. The scenarios set out below and modelled by Hymans are for the next triennial valuation period. The scenarios modelled are:

- Freeze contributions in 22/23 forever
- Freeze contributions in 22/23 for the next 3 year triennial valuation cycle and then revert to stabilisation (+/-1%)
- Freeze contributions in 22/23 for 3 years and then stabilisation plus a cap of 32.5%
- Step down contributions by 1% in each of the next three years and then stabilisation
- Step up contributions by 1% in each of the next three years and then stabilisation
- Reduce contributions by £10m over three years and then stabilisation
- Reduce contributions by £15m over three years and then stabilisation

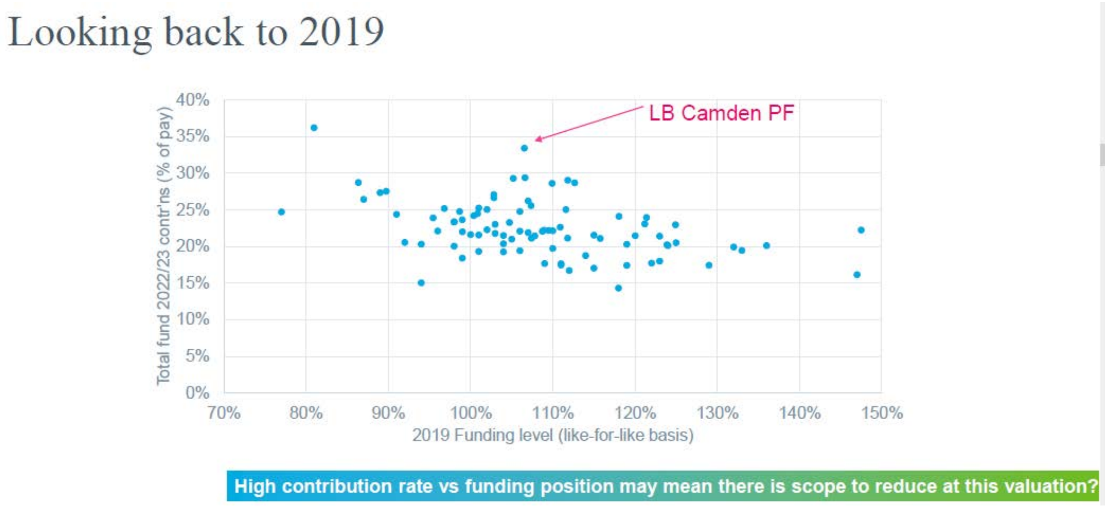
2.2. Hymans have then assessed the long-term impact on the Fund of the Council paying a contribution rate other than the theoretical rate calculated for the Council at each valuation.

2.3. It should be noted that for ease of discussion the Hymans report is split into a public part (Appendix A) and some analysis in Appendix B (which is not for publication as it includes commercially sensitive information and Hymans' intellectual property).

2.4. Their work discusses combined contribution rates that include the primary rate (for future service accrual and ignoring deficit recovery) and the secondary rate (for deficit recovery). In practice in the final valuation the secondary contribution rate is set as a cash contribution from the Council (and indeed for all other employers). This means that irrespective of whether Council headcount increases or decreases the Council stays on track in terms of deficit recovery and changes to staff numbers does not impact on the Council's recovery plan. If this was not the case and a secondary rate percentage was set, then changes to staff numbers up or down would affect the on-cost rate applied to all employee salaries that the employer pays to the Fund. This would mean deficit recovery cash amounts would move up or down according to numbers of staff employed.

3. RESULTS

3.1. The Hymans report shows the Government Actuary's Department (GAD) analysis of all funds results and shows that the Camden fund was very prudent amongst all funds (having the second highest contribution rate in the whole cohort).



3.2. Hymans have run the differing contribution strategies under four scenarios:

- Baseline – taking the 2019 triennial valuation assumptions
- Checking the outcomes in 14 years' time (to show progression since last time)
- Asset shock impacts (a reduction in assets of 10%)
- Including changes to the Discount rate (set at 2% and agreed at the July committee)

3.3. Hymans measure the four scenarios against two measures - Likelihood of Success (probability of being >100% funded at the end of the deficit recovery period) and average funding levels in the worst 5% of modelled scenarios. Hymans say that the results show all scenarios modelled have acceptable outcomes which means that all contribution strategies would be acceptable.

3.4. In each of the four scenarios modelled the seven contribution strategies have the same ranking and order. The table below gives the data points for the slide which takes in to account the change of the discount rate this time (slide 22) as most appropriate:

Scenario	**Likelihood of being fully funded 17 years**	**Average of worst 5% of funding levels 17 years**
Step up 1%	85%	59%
Freeze 3yrs	83%	56%
Reduce £10m	**81%**	**54%**
Step down 1%	81%	54%
Freeze forever	81%	51%

Freeze 3yrs and then a cap	81%	51%
Reduce £15m	80%	52%

3.5. Given it would be ideal if the contribution strategy chosen this time had approximately the same Likelihood of Success (82%) and average of worst 5% of outcomes (57%) as last time the Council does not propose to use the bottom three strategies.

3.6. However, given that the contribution rates were so high compared to all other LGPS funds at the 2019 valuation it does mean that the level of prudence built-up in our contributions and funding level can be reduced slightly during the next triennial valuation window without impacting on prudence.

3.7. Therefore, the Council has focussed on the “reduce £10m” and “step down 1%” contribution strategies. In all four modelling scenarios these two results give virtually the same results (the dots for both strategies are in the same place on each graph).

3.8. This report puts forward the recommendation from the Council, acting in its capacity as the largest employer in the Fund, to reduce contributions by £10m over the next three year triennial valuation period and sees this as a continuation of the prudence embedded in the 2019 and previous valuations whilst allowing the Council to reduce rates slightly to fall back in to line with other LGPS funds and their contribution rates.

3.9. Hymans have also modelled the contribution strategies with reference to **climate change risk**. They have modelled three scenarios which have been used before to present to Committee:

- Green revolution – concerted policy action to address climate change
- Delayed transition – no significant action in the short term
- Head in the sand – no policy action over a prolonged period

3.10. The analysis shows that in all three scenarios the distribution of key variables widens whether that is CPI inflation or global equity returns. It also shows that there is an increased volatility with a much higher chance of significant equity shocks due to climate change. The likelihood of success in all three scenarios is only marginally below the base case although the delayed transition and head in the sand scenarios have higher funding ratios as the green revolution has the greatest short-term disruption as markets adapt to new climate conditions sooner rather than later. Hymans conclude that all seven contribution strategies are still acceptable as the climate scenarios still show a Likelihood of Success greater than 70% (their threshold).

4. RESPONSIBLE INVESTOR COMMENT

4.1. The Fund’s actuary has performed analysis on three climate change scenarios: green revolution, delayed transition and head in the sand to understand the impact of climate change on the Council’s contribution strategy in this context. In all modelled scenarios the distribution of key variables such as inflation and returns widens which demonstrates increased volatility in an increasingly uncertain world. The modelling does however show that the likelihood of success is still above 70% which is the acceptable minimum threshold.

5. ENVIRONMENTAL IMPLICATIONS

5.1. The Climate emergency will impact on investment strategy and increasingly presents risks in strategies, mandates and company business models which may impact on future value. The Fund is very conscious of these risks and tracks them in its risk register and lobbies managers and companies to ensure these risks are understood and managed. The actuary is also mindful of these risks and has modelled this in the Contribution Strategy report on the same agenda.

6. FINANCE COMMENTS OF THE EXECUTIVE DIRECTOR CORPORATE SERVICES

6.1. Hymans Robertson, the Fund’s actuary, has modelled seven different contribution strategies under 4 different scenarios. Hymans set out that all contribution strategies would be acceptable. It is important that this valuation continues with the level of prudence built into previous triennial valuations. However, in light of the higher contributions paid over the last triennial valuation cycle compared to other LGPS Funds, the Council, as the main employer in the Fund, can maintain a similar level of prudence and likelihood of success and have a similar outcome in the worst 5% of outcomes by reducing rates by 1% in each year. This balances prudence with affordability.

7. COMMENTS OF THE BOROUGH SOLICITOR

7.1. The requirement for a Triennial Valuation is set out in the Local Government Pension Scheme (Administration) Regulations 2008. Members of the Pension Committee have legal responsibilities for the prudent and effective stewardship of LGPS funds and in more general terms, a clear fiduciary duty in the performance of their functions. This report gives Members the opportunity to agree the Council’s contribution strategy to ensure that the Pension Fund achieves its aims of being fully funded and being able to finance its liabilities under the scheme.

8. APPENDICES

APPENDIX A – Contribution Modelling results
APPENDIX B - Part II Council Contribution Modelling (**NOT FOR PUBLICATION)**