

From: Chairman Pension Fund Committee
Corporate Director of Finance

To: Pension Fund Committee – 29 March 2023

Subject: Funding Strategy Statement

Classification: Unrestricted

Summary:

This report presents the revised Funding Strategy Statement (FSS) and associated policies for approval by the Committee. The FSS is one of the Kent Pension Fund's key policies, establishing how employers' pension liabilities are best met going forward. The FSS has been reviewed as part of the triennial valuation exercise and updated to ensure the Fund can continue to manage employers' liabilities effectively. The FSS has two associated policies (the Contribution Review Policy and the Deferred Debt and Debt Spreading Agreement Policies) which have also been reviewed. The Fund ran a consultation, open to all employers, between January and March on the FSS and associated policies and has taken account of responses in finalising the policies presented to the Committee for approval.

Recommendation:

The Pension Fund Committee is recommended to note this report and to:

- a) agree the revised Funding Strategy Statement at Appendix 1;
- b) agree the revised Contribution Review Policy at Appendix 2; and
- c) agree the revised Deferred Debt and Debt Spreading Agreement Policies at Appendix 3

FOR DECISION

1 Background

- 1.1 The Funding Strategy Statement (FSS) is one of the Kent Pension Fund's key policies, establishing how employers' pension liabilities are best met going forward. The current version of the FSS was approved by the Committee on 8 September 2021.
- 1.2 Kent County Council as administering authority of the Fund is obligated to maintain and publish a funding strategy under the LGPS Regulations (2013).
- 1.3 The FSS has been prepared on the basis of prevailing guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA) and reviewed by the Fund Actuary.

2 Key Changes

- 2.1 The FSS has been reviewed and updated to reflect changes in the regulations and actuarial advice received as part of the 2022 triennial valuation exercise. Although the statement has been updated throughout, there are several proposed key changes summarised below:

Contribution prepayments (page 13)

- 2.2 The revised FSS confirms that employers are able to prepay their employer contributions with agreement from the administering authority but that they will not be offered any discount in exchange for early payment of either primary or secondary contributions.

Cessation valuations methodology (page 17)

- 2.3 Further clarity has been introduced around the methodology for calculating cessation valuations in situations where an employer exits the Fund and where there is no other employer in the Fund willing to accept responsibility for the residual liabilities of the exiting employer. In this scenario, liabilities are valued on a so-called “full cessation” basis, which contrasts with the “ongoing cessation” valuation basis used for setting contribution rates for active employers. The FSS now specifies that in such circumstances the Fund will value such liabilities on a *prudent ongoing* basis:

“The assumptions adopted will be consistent with the current ongoing funding position, but with additional prudence included in order to take into account potential uncertainties and risk e.g. due to adverse market changes, additional liabilities arising from regulatory or legislative change and political/economic uncertainties. The additional level of prudence will be set by considering the distribution of funding levels under a large number of economic scenarios, with the aim being to gain a reasonable level of confidence that the Fund will be able to meet its benefits obligations to the relevant members in future.” *Funding Strategy Statement*

- 2.4 The proposed change means that the Fund Actuary will no longer calculate minimum risk cessation valuations with reference to gilt yields, an approach which can introduce instability into the cessation valuation process, particularly during periods where gilt yields are volatile. A reliance on gilt yields (which is not directly related to Fund’s actual investment strategy) can make it harder to achieve stable exit positions, and can therefore obstruct the ambition to ensure sufficient resources are available to meet all liabilities (including residual liabilities following an employer’s exit from the Fund) as they fall due.
- 2.5 In contrast, under the proposed methodology, the link to the Fund’s actual investment strategy would be maintained by applying a constant margin for prudence to the Fund’s discount rate, meaning that assets and liabilities should move in similar directions leading to more stable full cessation positions.
- 2.6 Officers have asked the Fund Actuary to undertake a stochastic modelling exercise (a form of probability analysis) to determine an appropriate level of

prudence to incorporate within full cessation valuations. The results of the assessment are shown below, contrasted with the results for the current (gilts-based) full cessation approach and the ongoing cessation valuation approach. The outcome of the stochastic modelling exercise indicates that the Fund could use a prudence level of 4.0%, for a success probability of 90%.

Valuation Basis	Best estimate return p.a.	Prudence level	Discount rate p.a.	Success probability
Ongoing	6.0%	1.5%	4.5%	71%
Full cessation (current)	6.0%	4.2%	1.8%	91%
Full cessation (proposed)	6.0%	4.0%	2.0%	90%

Demographic risks – self-insurance (page 22)

- 2.7 The FSS now includes a self-insurance arrangement to cover ill-health retirement and death-in-service benefits for all individual employers not a government body (i.e., councils, police, fire) and/or not involved in a pooling arrangement.
- 2.8 Self-insurance has been identified as a cost effective and efficient method for mitigating ill-health requirement and death-in-service risk, which can be significant and have serious financial implications for individual employers. In essence a pool of assets is created from employers' existing contributions which will recompense participating employers for any additional strain costs associated with these events. As such a self-insurance policy removes the risk of an individual employer failing as a result of an unaffordable strain cost arising from ill-health retirement and/or death-in-service, and it does so without increasing employers' contribution rates (which already reflect the expected cost of such risks).

Climate risk (page 23)

- 2.9 A new section has been added to the FSS to address climate risk. Institutional investors have traditionally examined climate risk from the perspective of an asset owner, but climate change can also have profound impacts on the value of pension liabilities (e.g. via inflation, or by changes to mortality).
- 2.10 The Fund Actuary has carried out an initial climate scenario analysis on the assets and liabilities of the Fund in line with key principles agreed with the Government Actuary's Department for the purposes of the 2022 LGPS Valuation. Based on the results of the scenario testing, the Fund Actuary is comfortable with the current level of prudence included in our proposed funding assumptions. The Fund will continue to assess this risk on a regular basis.

3 Consultation

- 3.1 The Fund ran a consultation on the revised FSS (including the proposed changes outlined above) and associated policies from 19 January to 3 March

2023. This consultation period followed on from the briefing surrounding the actuarial valuation exercise itself, which was made available to all employers via the Employer Forum held on 9 December 2022.

- 3.2 The Fund received three responses to the consultation during the consultation window. Officers have carefully considered the responses received, taking advice from the Fund Actuary as necessary, and following on from this process there have been no material changes to the FSS as initially consulted upon, although minor presentation and readability changes have been incorporated in response to feedback.
- 3.3 The Committee is asked to approve the updated Funding Strategy Statement at Appendix 1.

4 Associated Policies

- 4.1 The FSS contains two sub-policies which augment the main FSS by providing further detail on how the Fund will manage specific funding matters.
- 4.2 The **Contribution Review Policy** establishes the Fund's approach for amending contribution rates payable by employers between formal (triennial) funding valuations. The policy has been updated following actuarial and legal advice to further clarify under what conditions a contribution review may, and may not, take place as well as further information on the appeals process.
- 4.3 The **Deferred Debt and Debt Spreading Agreement Policies** sets out the Fund's approach to entering into, monitoring and terminating, agreements with exiting employers to defer and spread (respectively) cessation debts. Minor updates clarifying how these arrangements will be managed have been made following actuarial and legal advice.
- 4.4 The Committee is asked to approve the revised Contribution Review Policy at Appendix 2 and the revised Deferred Debt and Debt Spreading Agreement Policies at Appendix 3.

5 Conclusion

- 5.1 This report has presented the updated Funding Strategy Statement (FSS) and associated policies for approval by the Committee. The FSS is one of the Kent Pension Fund's key policies, establishing how employers' pension liabilities are best met going forward. The FSS has been reviewed as part of the triennial valuation exercise and updated to ensure the Fund can continue to manage employers' liabilities effectively.

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March 2023

Appendices

Appendix 1 – Funding Strategy Statement

Appendix 2 – Contribution Review Policy

Appendix 3 – Deferred Debt and Debt Spreading Agreement Policies