# TRIENNIAL VALUATION UPDATE

## Introduction

1. This paper provides the Committee with the opportunity to consider and endorse the proposed funding and contribution strategies for the four Councils in advance of the 2022 triennial valuation.

## Recommendation

2. The Committee endorse:-

   a) The continuation of the Fund's existing funding and contribution strategies for the four Councils and the existing stabilisation parameters, these being: -

      - Cheshire East will continue to step down by 1.5% of pay per annum.

      - Cheshire West & Chester, Halton and Warrington will continue to step down by 1% of pay per annum.

   b) In all cases that stepping down will cease when the employer reaches their 2022 valuation target rate of 20.0% of pay.

## Background

3. The Cheshire Pension Fund (the Fund) will undertake the formal triennial actuarial valuation at 31 March 2022. The valuation is a statutory requirement of the LGPS Regulations and provides a health check of the Fund against an appropriate funding target and a review of its funding plan.

4. The main funding objectives of the Fund (as articulated in its Funding Strategy Statement) are to:

   - establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward.

   - to support the regulatory framework to maintain as nearly constant employer contribution rates as possible, and

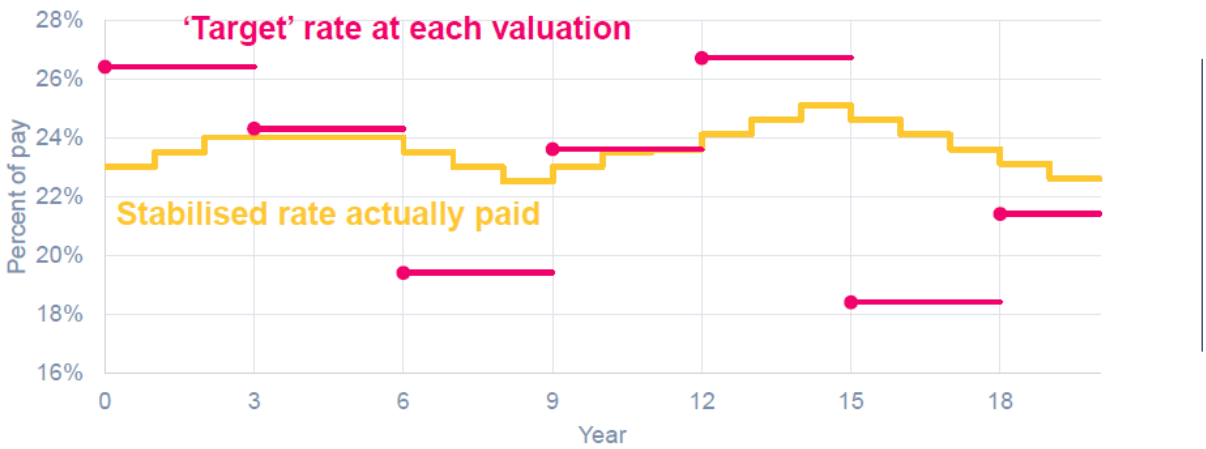
   - to take a prudent longer-term view of funding those liabilities.

5. The Administering Authority is trying to achieve an outcome which balances the potentially conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the approach to funding every employer's liabilities.

6. To achieve this outcome for the Councils specifically, the Fund has (since 2010) adopted a stabilisation mechanism which smooths the budgetary impact of

changes in contribution rates. This approach recognises the four Councils are stable, open and long-term employers in the Fund.

7. The Committee will recall the graph below which illustrates how stabilisation works (figures shown are for illustration only).




8. In adopting a stabilisation approach, the Fund is accepting that employers will pay slightly less than the target contribution rate in “bad” times and will in turn pay slightly more than the target rate in “good” times. In essence, stabilisation averages out an employer’s contribution rate over the long-term.

9. The Committee are reminded that this approach is only open to the stable, tax backed and long-term major employers, as it requires a long-term time horizon and strong employer covenant to justify smoothing the rate changes.

10. The current stabilisation steps for the four Councils are shown in the table below:

Table 1: Current Stabilisation approach

| CEC | CW&C | HBC | WBC |
|---|---|---|---|
| Plus or minus 1.5% of pay | Plus or minus 1.0% of pay | Plus or minus 1.0% of pay | Plus or minus 1.0% of pay |

11. As in previous valuations, in advance of the valuation date, a review has been carried out of the funding strategy for the four Councils.

12. For the four Councils this includes modelling to provide a health check of the current funding strategies and facilitate the Councils to get early sight of their proposed contributions to aid with their budgeting and financial planning.

**Funding updates**

13. Funding positions for all the Councils have improved since 31 March 2019 with the table below summarising the respective position of each Council. Three of the four Councils are now more than 100% funded whilst Cheshire East's funding position has improved to 98%.

Table 2: Updated Funding positions

| 31 March 2019 (£m) | CWAC | HBC | WBC | CEC |
|---|---|---|---|---|
| Total liabilities | 1,480 | 583 | 765 | 1,451 |
| Asset share | 1,422 | 603 | 740 | 1,353 |
| Surplus/(deficit) | (58) | 20 | (25) | (99) |
| Funding level | 96% | 103% | 97% | 93% |
| **31 March 2021 (£m)** | **CWAC** | **HBC** | **WBC** | **CEC** |
| Total liabilities | 1,601 | 632 | 833 | 1,461 |
| Asset share | 1,631 | 688 | 849 | 1,436 |
| Surplus/(deficit) | 30 | 56 | 16 | (25) |
| Funding level | 102% | 109% | 102% | 98% |
| | | | | |
| Improvement | +6% | +6% | +5% | +5% |

**2021 Review of the stabilisation mechanism**

14. As noted earlier, the Fund actuary has undertaken extensive modelling of the current funding strategy and stabilisation approach for the four Councils. Stabilised scenarios and fixed rate scenarios were modelled to help understand the longer term funding position and implications for stabilisation i.e. on average will rates tend upwards or downwards in future

15. In terms of time horizon, the funding position was considered after 20 years, and at 17 years to test the sensitivity of the results to changes in time horizon.

16. Funding outcomes were measured against the likelihood of success i.e., how likely will the employer be fully funded at the end of the time horizon?

17. The actuary also considered downside risk which examines how robust the strategy is in the worst-case scenarios i.e., how low could the funding level get by the end of the time horizon?

18. Also, given the increase in volatility in investment markets, the likelihood of success and downside risk were considered in the event of an asset shock to

gain confidence that a funding strategy is robust in the event of a sharp shock to asset values.

19. The actuary recommends that the current stabilisation mechanism and parameters are still appropriate for all Councils and balance the potentially conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the approach to funding.

**Setting rates payable for 2023-2026**

20. As well as reviewing whether the stabilisation parameters are still appropriate, the modelling exercise also sought to set the contribution rates payable by each Council for the period 1 April 2023 – 31 March 2026.

21. Given the improvement in funding position since 2019 for every council, the modelling confirmed that contributions rates could be reduced at this valuation in line with the existing stabilisation parameters.

22. The modelling has identified the target rate for each Council (i.e. the cost of future LGPS benefits) as 20% of pay. This rate is similar to the primary rate calculated at the 2019 valuation and the modelling confirmed that this remains an appropriate long-term rate to fund the cost of future LGPS benefits and no open, long term employer should pay less than this rate.

23. In conclusion the table below summarises the impact of keeping the stabilising parameters as per the current Funding Strategy Statement and reducing contribution rates in line with the existing stabilisation parameters to a target rate of 20.0% of pay.

Table 3: Proposed contribution rates for 2023-2026

| | Assumed 2022/23 * | 2023/24 | 2024/25 | 2025/26 |
|---|---|---|---|---|
| | % of pay | % of pay | % of pay | % of pay |
| Cheshire East | 28.2% | 26.7% | 25.2% | 23.7% |
| Cheshire West & Chester | 21.6% | 20.6% | 20.0% | 20.0% |
| Halton | 21.5% | 20.5% | 20.0% | 20.0% |
| Warrington | 22.1% | 21.1% | 20.1% | 20.0% |

**employer rates are total equivalent % of pay rates ignoring prepayments, based on current monetary contributions and payroll. Rates shown are those in payment in 2022/23 and include expenses of 0.6% of pay*

24. Although the table quotes total contribution rates expressed as a percentage of pay, the Committee will recall that an employer's contribution rate is made up of two elements:

- **The primary rate** - the estimated cost of future benefits being built up each year, after deducting members' own contributions and including an allowance for the Fund's administration expenses. This is expressed as a percentage of members' pensionable pay; plus

- **The secondary rate** - an adjustment for the difference between the Primary rate above, and the total contribution the employer needs to pay. In broad terms, the Secondary rate is in respect of benefits already accrued at the valuation date. The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

**Links to Investment Strategy**

25. The modelling undertaken by the Actuary included the consideration of several different investment strategies. In addition to the strategic asset allocation model endorsed by the Committee for Open Employers in September 2021, three alternative strategies were modelled as set out in the table below:

Table 4: Alternative Investment strategies modelled for Councils

| Asset Class | Sep 2021 Committee Approved Asset Allocation % | Option 1 % | Option 2 % | Option 3 % |
|---|---|---|---|---|
| Equities | 24.0 | 24.0 | 24.0 | 27.0 |
| Private Equity | 5.0 | 5.0 | 7.5 | 7.5 |
| Infrastructure | 5.0 | 7.5 | 7.5 | 7.5 |
| Absolute Return | 6.0 | 6.0 | 6.0 | 3.0 |
| Multi Asset Credit | 15.0 | 15.0 | 15.0 | 15.0 |
| Emerging Market Debt | 5.0 | 5.0 | 5.0 | 5.0 |
| Property | 7.5 | 7.5 | 7.5 | 7.5 |
| Index Linked Gilts | 25.0 | 22.5 | 20.0 | 20.0 |
| Private Debt – Lower Rate | 2.5 | 2.5 | 2.5 | 2.5 |
| Private Debt – Stable Return | 5.0 | 5.0 | 5.0 | 5.0 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** |

26. This modelling concluded that the alternative strategies produced only marginal changes to the likelihood of funding success for the Councils and therefore there was no need to change from the strategic asset allocation model endorsed by the Committee in September 2021.

27. This outcome will therefore be fed into the revised Investment Strategy Statement and Responsible Investment Policy to be considered by Committee in February/March 2022.

28. As briefed in earlier reports, it is anticipated that additional modelling of alternative investment strategies for the Academies employer group will be required in early 2022 to explore if a different mix of growth and defensive assets may improve their chances of meeting their funding objective. This again will be reported to Committee in early 2022