East Sussex County Council

Pension Fund

Funding update report as at 31 March 2021

Barnett Waddingham LLP

10 June 2021

Contents

Introduction

East Sussex County Council, as administering authority for the East Sussex County Council Pension Fund (the Fund), has asked that we carry out monitoring assessment of the Fund as at 31 March 2021. The purpose of this assessment is to provide an update on the funding position.

The Fund participates in the Local Government Pension Scheme (LGPS). The LGPS is a defined benefit statutory scheme administered in accordance with Local Government Pension Scheme Regulations 2013 (the Regulations).

We have taken account of current LGPS Regulations (as amended) as at the date of this report.

On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases in relation to age discrimination. The consultation closed on 8 October 2020 and a ministerial statement on 13 May 2021 confirmed that revised regulations would be issued, likely later this year. The Government also announced the unpausing of the 2016 cost cap process and that it would take into consideration the McCloud remedy. At the time of producing this report the outcome of these matters is still to be agreed so the exact impact they will have on LGPS benefits is unknown. An allowance has been made within the discount rate for the current uncertainties in LGPS benefits, details of which can be found in the Changes in market conditions – market yields and discount rates section.

The information in this report is addressed to and is provided for use by East Sussex County Council as the administering authority to the Fund. This report may be shared with other interested parties but it does not constitute advice to them.

This report complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 300: Pensions (TAS 300) as issued by the Financial Reporting Council (FRC).

We assess the funding position on a smoothed basis which is an estimate of the average position over a six month period spanning the reporting date. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures are projected numbers and likely to change up until three months after the reporting date. The smoothed results are indicative of the underlying trend.

Assets

The estimated (unsmoothed) asset allocation of the East Sussex County Council Pension Fund as at 31 March 2021, based on data received from East Sussex County Council, is as follows:

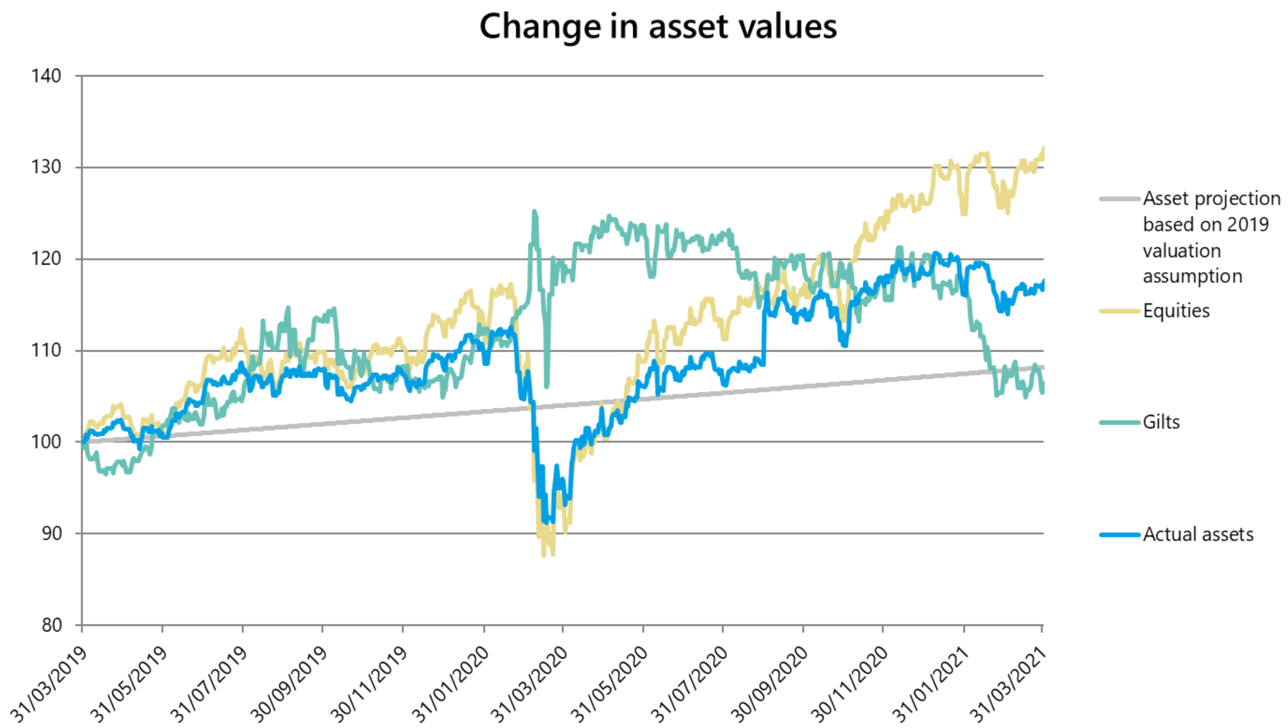
Assets (market value)	31 March 2021		31 March 2019	
	£000s	%	£000s	%
Equities	3,227,118	76%	2,392,487	66%
Bonds	627,339	15%	755,359	21%
Property	319,533	8%	340,346	9%
Cash	70,882	2%	144,670	4%
Total assets	**4,244,872**	**100%**	**3,632,863**	**100%**

The assets in each class are an approximation, and are not a detailed indication of the breakdown of assets in any pooled investment funds

The asset value of £3,633m at 31 March 2019 is consistent with the value disclosed in the 2019 actuarial valuation report. The asset value of £4,245m was provided by the administering authority on 2 June 2021 and is subject to final audit and revision.

The investment return achieved by the Fund's assets in market value terms for the year to 31 March 2021 is estimated to be 22.0%. The return achieved since the previous valuation (31 March 2019) is estimated to be 16.7% (which is equivalent to 8.0% p.a.). This estimated return is based on Fund cashflows and total asset values rather than investment manager reports.

The following chart shows the changes in equity and bond markets since the previous actuarial valuation and compares them with the estimated actual fund returns and the expected fund returns assumed at the previous valuation:



As we can see the asset value as at 31 March 2021 in market value terms is more than where it was projected to be at the previous valuation.

For funding purposes, we now use a "smoothed" value of the assets rather than the market value. The financial assumptions that we use in valuing the liabilities are also smoothed around the valuation date so that the market conditions used are the average of the daily observations over the six month period around 31 March 2021. Therefore, we value the assets in a consistent way and apply the same smoothing adjustment to the market value of the assets.

Changes in market conditions – market yields and discount rates

The actual investment returns earned by the Fund will affect the value of the Fund's assets. The value of the Fund's liabilities, however, is dependent on the assumptions used to value the future benefits payable.

For the purpose of this exercise it is appropriate to use the method and assumptions set by Barnett Waddingham as the new Fund actuary from 1 January 2021. Details of the derivation of the demographic assumptions can be found in the 2019 actuarial valuation report, and details of the financial assumptions can be found in the Funding Strategy Statement.

The following table shows how the main financial assumptions have changed since the last triennial valuation:

	31 March 2021		31 March 2019	
Assumptions (smoothed)	Nominal	Real	Nominal	Real
	% p.a.		% p.a.	
Pension increases (CPI)	2.7%	-	2.3%	-
Salary increases	3.7%	1.0%	2.3%	0.0%
Discount rate	4.0%	1.3%	4.0%	1.7%

The discount rate assumption is set with reference to the Fund's long term investment strategy and therefore reflects the long term expected return on assets for the Fund. We have included in the discount rate assumption an explicit prudence allowance of 1.1%. This incorporates an allowance for current uncertainties in LGPS benefits (relating to the effects of the McCloud/Sargeant judgement and the cost cap).

The previous Fund actuary, Hymans Roberston LLP, carried out the actuarial valuation as at 31 March 2019 and adopted a long-term salary increase assumption of CPI only i.e. no above inflation, or "real", salary increases. We have instead adopted a long-term salary increase assumption for funding purposes of 1.0% above CPI.

The key assumption which has the greatest impact on the valuation of liabilities is the real discount rate (the discount rate relative to CPI inflation) – the higher the real discount rate the lower the value of liabilities. As we see, the real discount rate is the same at the 31 March 2019 valuation, but the expected future increases to pensions in payment and salaries increases the value of liabilities used for funding purposes.

Results

The funding position for each month has been rolled forward from the formal valuation and is shown in Appendix 1. It should be borne in mind that the nature of the calculations is approximate and so the results are only indicative of the underlying position.

The results of our assessment indicate that:

- The current projection of the smoothed funding level as at 31 March 2021 is 106% and the average required primary rate of employer contribution would be 21% of payroll.
- This compares with the reported (smoothed) funding level of 107% and average required primary rate of employer contribution of 18% of payroll at the 31 March 2019 funding valuation.

The Fund remains in surplus although the funding level has decreased slightly, the surplus has reduced, and the cost of benefits has increased due to higher assumed pension increases.

Final comments

There are many factors that affect the Fund's funding position and could lead to the Fund's funding objectives not being met within the timescales expected. Some of the key risks that could have a material impact on the Fund include longevity risk, financial risks (including inflation and investment risk) and regulatory risks. There is more detail on this contained within the Fund's Funding Strategy Statement and the 31 March 2019 actuarial valuation report.

Note that the funding position at a future date will be dependent on the investment performance of the Fund as well as future market conditions which determine the financial assumptions.

We would be pleased to answer any questions arising from this report.

Barry McKay

Barry McKay FFA
Partner
Barnett Waddingham LLP

Appendix 1 Financial position since previous valuation

Below we show the financial position on a smoothed basis for each month since the previous full valuation. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures for the previous three months are projected numbers and likely to change up until three months after the reporting date.

Please note that the results shown below are sensitive to the underlying assumptions. For example, increasing the discount rate assumption by 0.5% will increase the funding level by about 10%, and increasing the CPI inflation assumption by 0.5% will reduce the funding level by about 10%.

Smoothed results	Assets	Liabilities	Surplus / (Deficit)	Funding level	CARE ongoing cost	Discount rate	Return required to restore funding level
Valuation date	£000s	£000s	£000s	%	% of pay	% p.a.	% p.a.
31 Mar 2019	3,619,950	3,386,000	233,950	107%	18.0%	4.0%	3.6%
30 Apr 2019	3,680,222	3,357,576	322,646	110%	17.3%	4.7%	4.2%
31 May 2019	3,739,574	3,376,051	363,523	111%	17.3%	4.7%	4.1%
30 Jun 2019	3,787,535	3,393,752	393,783	112%	17.4%	4.6%	4.1%
31 Jul 2019	3,818,506	3,404,131	414,375	112%	17.4%	4.6%	4.0%
31 Aug 2019	3,871,770	3,421,444	450,326	113%	17.4%	4.5%	3.9%
30 Sep 2019	3,893,034	3,438,836	454,198	113%	17.4%	4.5%	3.8%
31 Oct 2019	3,913,765	3,457,069	456,696	113%	17.5%	4.4%	3.8%
30 Nov 2019	3,928,206	3,479,781	448,425	113%	17.6%	4.4%	3.7%
31 Dec 2019	3,863,138	3,452,356	410,782	112%	17.3%	4.4%	3.8%
31 Jan 2020	3,848,930	3,437,593	411,337	112%	17.0%	4.3%	3.7%
29 Feb 2020	3,831,831	3,432,081	399,750	112%	16.9%	4.3%	3.7%
31 Mar 2020	3,821,363	3,440,740	380,623	111%	16.9%	4.3%	3.8%
30 Apr 2020	3,825,354	3,451,966	373,388	111%	16.9%	4.3%	3.7%
31 May 2020	3,802,753	3,476,615	326,138	109%	17.0%	4.3%	3.8%
30 Jun 2020	3,857,687	3,551,106	306,581	109%	17.5%	4.2%	3.8%
31 Jul 2020	3,907,691	3,627,372	280,319	108%	18.1%	4.2%	3.8%
31 Aug 2020	4,170,954	3,693,384	477,570	113%	18.6%	4.1%	3.5%
30 Sep 2020	4,196,618	3,754,877	441,741	112%	19.0%	4.1%	3.5%
31 Oct 2020	4,216,633	3,812,396	404,237	111%	19.4%	4.0%	3.5%
30 Nov 2020	4,251,642	3,856,086	395,556	110%	19.6%	4.0%	3.5%
31 Dec 2020	4,271,375	3,904,257	367,118	109%	19.9%	4.0%	3.5%
31 Jan 2021	4,293,110	3,956,437	336,673	109%	20.3%	4.0%	3.6%
28 Feb 2021	4,283,270	3,994,927	288,343	107%	20.5%	4.0%	3.6%
31 Mar 2021	4,261,915	4,021,529	240,386	106%	20.6%	4.0%	3.7%

BARNETT WADDINGHAM
beyond the expected

Appendix 2 Data, method and assumptions

Data

In completing our calculations we have used the following items of data, which we received from East Sussex County Council:

- The results of the valuation as at 31 March 2019 which was carried out for funding purposes;
- Actual whole Fund income and expenditure items for the period to 31 March 2021; and
- Estimated Fund returns based on Fund asset statements provided to 31 March 2021, and Fund income and expenditure as noted above.

The data has been checked for reasonableness and we are happy that the data is sufficient for the purpose of this report.

Full details of the benefits being valued are as set out in the Regulations as amended and summarised on the LGPS website and the Fund's membership booklet. We have made no allowance for discretionary benefits.

Method

To assess the value of the Fund's liabilities as at 31 March 2021, we have rolled forward the value of the liabilities calculated for the funding valuation as at 31 March 2019 using the financial assumptions below and actual cashflows paid to and from the Fund.

It is not possible to assess the accuracy of the estimated value of the liabilities as at 31 March 2021 without completing a full valuation. However, we are satisifed that the approach of rolling forward the previous valuation data to 31 March 2021 should not introduce any material assumptions in the results provided that the actual experience of the Fund is broadly in line with the underlying assumptions and that the structure of the liabilities is substantially the same as at the latest formal valuation. From the information we have received there appears to be no evidence that this approach is inappropriate.

We have been provided with the Fund assets at various dates but for dates that these are not available, we calculate the Fund assets by rolling forward the previous assets provided allowing for investment returns (estimated where necessary), and actual cashflows paid to and from the Fund. The latest date that we have been provided with the Fund assets is 31 March 2021.

Assumptions

For the purpose of this exercise it is appropriate to use the method and assumptions consistent with those set by the Fund actuary for the purpose of the 31 March 2019 actuarial valuation, updated where necessary to reflect market conditions and the funding approach of Barnett Waddingham as the new Fund actuary from 1 January 2021.

A summary of the main financial assumptions adopted is set out in the main body of this report.

As noted in the Introduction, an allowance has been made for current uncertainties in LGPS benefits (relating to the effects of the McCloud/Sargeant judgement and the cost cap). This is allowed for

At the time of producing this report the outcome of the effects relating to the McCloud/Sargeant judgement are still to be agreed upon. The final remedy in response to the judgement will only be known once a final set of remedial Regulations are published. Furthermore, it is also not known yet what benefit changes in addition to the McCloud remedy (if any) may be made in light of the results of the cost cap process.

The main demographic assumptions are:

- The post retirement mortality assumption adopted for all calculations is based on Club Vita mortality analysis.;
- The dependant post retirement mortality assumption adopted for all calculations is based on Club Vita mortality analysis.

These base tables are then projected using the CMI 2018 Model, allowing for a long-term rate of improvement of 1.25% p.a, a smoothing parameter of 7 and an initial addition parameter of 0.5% p.a. for males and 0.25% p.a. for females.

The other key demographic assumptions are:

- We have adopted the retirement age pattern assumption as used for the purpose of the 2016 LGPS cost cap valuation. Further details are available on request.; and
- It is assumed that 50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2008 (equivalent 75% for service from 1 April 2008).

Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report and Funding Strategy Statement.