East Sussex County Council Pension Fund

Funding update report as at 31 March 2023

Barnett Waddingham LLP

24 May 2023

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Introduction

East Sussex County Council, as administering authority for the East Sussex County Council Pension Fund (the Fund), has asked that we carry out an annual monitoring assessment of the Fund as at 31 March 2023. 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 13 May 2021 the Government issued a ministerial statement on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases relating to age discrimination. The statement confirms that changes will be made to the LGPS Regulations to compensate members directly affected by the change to career average benefits from 1 April 2014. The Government's intention is that regulations will come into force on 1 October 2023, and draft regulations are expected later in 2023. At the Fund's 31 March 2022 valuation, the cost of the McCloud remedy was estimated and incorporated into the value of liabilities.

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.

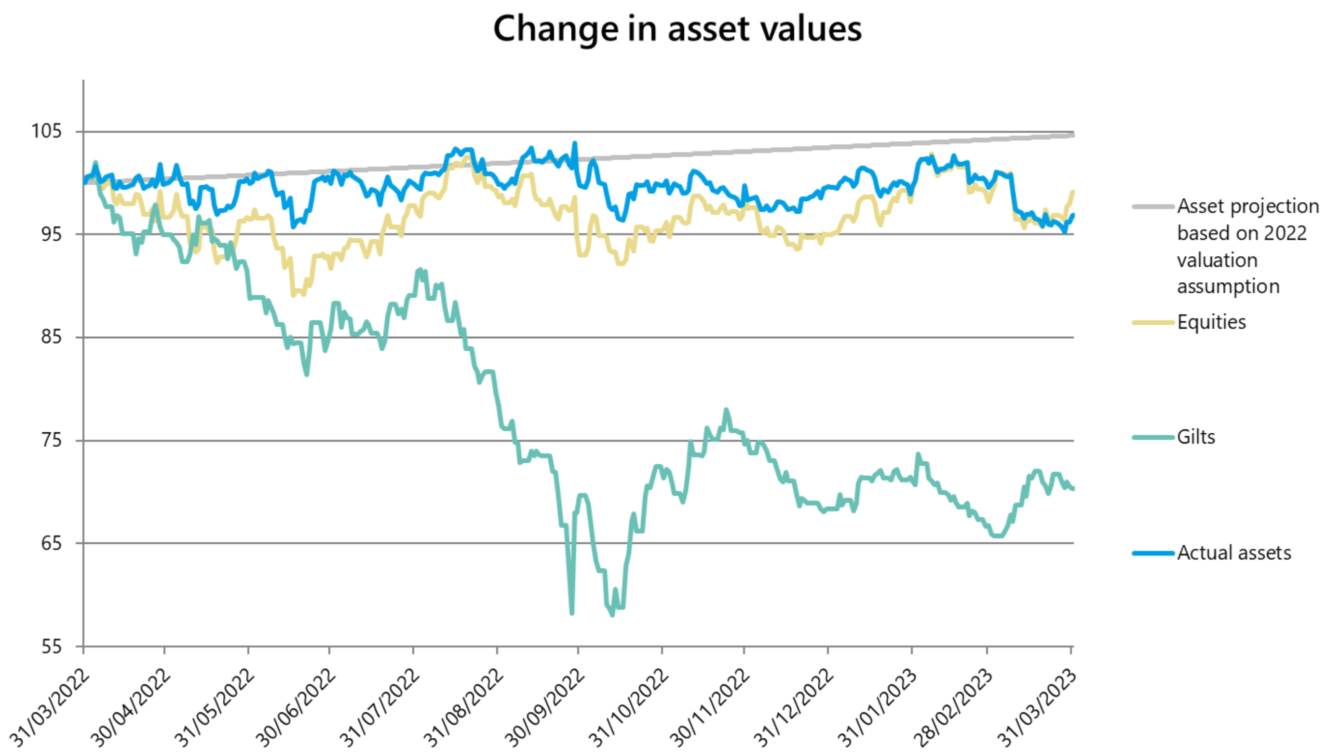
Assets

The estimated (unsmoothed) asset allocation of the East Sussex County Council Pension Fund as at 31 March 2023, based on data received from East Sussex County Council, is as follows:

Assets (market value)	31 March 2023		31 March 2022	
	£000s	%	£000s	%
Equities	3,219,201	71%	3,445,081	73%
Bonds	553,606	12%	611,239	13%
Property	733,175	16%	530,822	11%
Cash	54,520	1%	100,525	2%
Total assets	**4,560,502**	**100%**	**4,687,667**	**100%**

The investment return achieved by the Fund's assets in market value terms for the year to 31 March 2023 is estimated to be -2.9%.

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 2023 in market value terms is less than where it was projected to be at the previous valuation.

For funding purposes, we use a smoothed value of the assets rather than the market value. The financial assumptions that we use in valuing the liabilities are 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 2023. 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 consistent with those set by the Fund actuary for the purpose of the 31 March 2022 actuarial valuation, updated where necessary to reflect market conditions. Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report.

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

Assumptions (smoothed)	31 March 2023		31 March 2022	
	Nominal	Real	Nominal	Real
	% p.a.		% p.a.	
Pension increases (CPI)	2.46%	-	2.90%	-
Salary increases	3.46%	1.00%	3.90%	1.00%
Discount rate	4.82%	2.36%	4.60%	1.70%

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 higher than at the 31 March 2022 valuation, reducing 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 2023 is 121% and the average required employer contribution would be 16.5% of payroll.
- This compares with the reported (smoothed) funding level of 122.8% and average required employer contribution of 20.2% of payroll at the 31 March 2022 funding valuation.

The discount rate underlying the smoothed funding level as at 31 March 2023 is 4.8% p.a. The investment return required to target the funding level to 100% by 31 March 2042, if employers were to pay the primary rate only, would be 3.8% p.a.

Since the previous report the 2022 triennial valuation has been completed and the assets and liabilities calculated as part of this valuation have been allowed for in the results of this report.

We have also allowed for the 10.1% pension increase order as at 31 March 2023 to reflect the increases applied to the CARE pensions, deferred pensions and pensions in payment in April 2023. The increase associated with this, however, has been more than offset by a reduction in the long-term inflation assumption. This short-term high inflation and longer term lower inflation is broadly consistent with what was assumed at the 2022 formal valuation.

Over the year to 31 March 2023, investment returns have been lower than assumed at the 2022 valuation, with an actual return of around -2.4% compared with an assumed return of 4.6%, which has led to a reduction in the funding level at the reporting date.

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 2022 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 2%, and increasing the CPI inflation assumption by 0.5% will reduce the funding level by about 17%.

Smoothed results	Assets	Liabilities	Surplus / (Deficit)	Funding level	CARE ongoing cost	Past service ctbn	Total ctbn	Discount rate	Return required to restore funding level
Valuation date	£000s	£000s	£000s	%	% of pay	% of pay	% of pay	% p.a.	% p.a.
31 Mar 2022	4,618,065	3,760,344	857,721	123%	20.2%	(9.2%)	11.0%	4.6%	3.6%
30 Apr 2022	4,664,308	3,704,131	960,177	126%	19.5%	(9.6%)	9.9%	4.6%	3.5%
31 May 2022	4,698,524	3,663,466	1,035,058	128%	19.0%	(10.5%)	8.5%	4.7%	3.4%
30 Jun 2022	4,808,662	3,593,884	1,214,778	134%	18.3%	(12.5%)	5.8%	4.8%	3.3%
31 Jul 2022	4,582,619	3,512,612	1,070,007	130%	17.4%	(11.3%)	6.1%	4.9%	3.5%
31 Aug 2022	4,623,697	3,479,727	1,143,970	133%	17.0%	(12.2%)	4.8%	4.9%	3.5%
30 Sep 2022	4,866,214	3,468,740	1,397,474	140%	16.7%	(15.0%)	1.7%	4.9%	3.2%
31 Oct 2022	4,757,029	3,467,026	1,290,003	137%	16.6%	(13.9%)	2.7%	4.9%	3.3%
30 Nov 2022	4,623,850	3,450,941	1,172,909	134%	16.4%	(12.7%)	3.7%	5.0%	3.5%
31 Dec 2022	4,772,380	3,462,419	1,309,961	138%	16.3%	(14.3%)	2.0%	4.9%	3.3%
31 Jan 2023	4,653,549	3,505,249	1,148,300	133%	16.6%	(12.5%)	4.1%	4.8%	3.4%
28 Feb 2023	4,708,354	3,511,785	1,196,569	134%	16.6%	(13.1%)	3.5%	4.8%	3.3%
31 Mar 2023	4,543,399	3,748,414	794,985	121%	16.6%	(8.7%)	7.9%	4.8%	3.8%

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 2022 which was carried out for funding purposes;
- Actual whole Fund income and expenditure items for the period to 31 March 2023; and
- Estimated Fund returns based on Fund asset statements provided to 31 March 2023, 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 2023, we have rolled forward the value of the liabilities calculated for the funding valuation as at 31 March 2022 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 2023 without completing a full valuation. However, we are satisifed that the approach of rolling forward the previous valuation data to 31 March 2023 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 2023.

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 2022 actuarial valuation, updated where necessary to reflect market conditions.

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

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. The temporary dividend yield adjustment made at the valuation date to account for market distortion following the COVID-19 pandemic, has been fully removed with effect from 31 March 2023. Consistent with the method adopted for the 31 March 2022 valuation, we have included in the discount rate assumption an explicit prudence allowance of 1.1%.

The post retirement mortality assumptions are:

- for members, base tables constructed using Club Vita analysis;
- for dependants, base tables constructed using Club Vita analysis.

These base tables are then projected using the CMI 2021 Model, allowing for a long-term rate of improvement of 1.25% p.a, a smoothing parameter of 7.0, an initial addition parameter of 0.0% p.a., and a weighting parameter of 5% for 2020 and 2021.

The other key demographic assumptions are:

- members retire at a single age, based on the average age at which they can take each tranche of their pension at; and; and
- it is assumed that members will exchange 50% of their commutable pension for cash at retirement.

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