# Meeting of the Group Audit and Risk Committee

4.00 pm on Tuesday, 6 October 2020
via MS Teams

## Agenda

| *No.* | *Item* | *Pages* | *Presenter* |
|---|---|---|---|
| 19. | Pension assumptions | 3 - 22 | RF |

**Date of next meeting**
**4.00 pm on Thursday, 5 November 2020**

**Members:** Duncan Brown (Chair), John Cole, Mark Lemmon and Rob Orr

**Apologies:** Ruth Ireland

**In attendance:** David Phoenix, Natalie Ferer, Richard Flatman, Kerry Johnson, Nicole Louis, Jessie Spencer, James Stevenson, Fleur Nieboer and Gemma Wright

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# South Bank University

# London Pension Fund Authority Pension Fund

## Pension accounting disclosure as at 31 July 2020

## Prepared in accordance with FRS102

**Barnett Waddingham LLP**

7 August 2020

# Contents

# Introduction

We have been instructed by the London Pensions Fund Authority, the administering authority to the London Pension Fund Authority Pension Fund (the Fund), to undertake pension expense calculations in respect of pension benefits provided by the Local Government Pension Scheme (the LGPS) to employees of South Bank University (the Employer) as at 31 July 2020. We have taken account of current LGPS Regulations, as amended, as at the date of this report.

This report is addressed to the Employer and its advisers; in particular, this report is likely to be of relevance to the Employer's auditor.

These figures are prepared in accordance with our understanding of Financial Reporting Standard 102 (FRS102).

This advice complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100).

The figures quoted will form the basis of the balance sheet and funding status disclosures to be made by the Employer as at 31 July 2020 in respect of its pension obligations under the LGPS. The projected pension expense calculations for the year to 31 July 2021 may be used for the purpose of any interim financial reporting during the year to 31 July 2021. However, it may subsequently be necessary to adjust these projections following the occurrence of any material events such as curtailments, settlements or the discontinuance of the Employer's participation in the Fund.

Further information relating to our treatment of GMP is included on page 9 of this disclosure.

The results in this report include an allowance to reflect the Court of Appeal judgement in respect of the McCloud and Sargeant cases which relate to age discrimination within the Judicial and Fire Pension schemes, respectively. This allowance was described in the previous accounting report and incorporated into the accounting results as at 31 July 2019. These results, including the allowance, have been rolled forward and remeasured to obtain the accounting results as at 31 July 2020.

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. The consultation closes on 8 October 2020 and the final remedy will only be known after the consultation responses have been reviewed and a final set of remedial Regulations are published. We do not believe there are any material differences between the approach underlying our estimated allowance and the proposed remedy. A more detailed analysis at this stage would require a significant volume of member data which is not yet available. Therefore we have not included any further adjustment in light of the ongoing consultation in this report.

FRS102 also requires the disclosure of any other employer provided pension benefits which are not paid from the Fund itself: examples include additional pensions paid on retirement under the Discretionary Payment Regulations. We have only valued such additional liabilities, which would not be covered in the formal LGPS valuation, to the extent that they have been notified to us and are as disclosed in the Valuation data section of this report.

# Characteristics of defined benefit plans and associated risks

The LGPS is a defined benefit statutory scheme administered in accordance with the Local Government Pension Scheme Regulations 2013 and currently provides benefits based on career average revalued earnings. 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. There are currently uncertainties in relation to LGPS benefits due to the McCloud and Sargeant judgement and the 2016 cost cap process. The Government has published its consultation on a remedy for the McCloud and Sargeant judgement and at the same time announced the unpausing of the 2016 cost cap process which will take into account the remedy for the McCloud and Sargeant judgement. These are yet to be finalised and therefore it remains uncertain what changes may be made to LGPS benefits as a result.

The administering authority for the Fund is the London Pensions Fund Authority. The LPFA Board oversees the management of the Fund whilst the day to day fund administration is undertaken by the Local Pensions Partnership. Where appropriate some functions are delegated to the Fund's professional advisers.

As administering authority to the Fund, the London Pensions Fund Authority, after consultation with the Fund Actuary and other relevant parties, is responsible for the preparation and maintenance of the Funding Strategy Statement and the Investment Strategy Statement. These should be amended when appropriate based on the Fund's performance and funding.

Contributions are set every three years as a result of the actuarial valuation of the Fund required by the Regulations. The next actuarial valuation of the Fund will be carried out as at 31 March 2022 and will set contributions for the period from 1 April 2023 to 31 March 2026. There are no minimum funding requirements in the LGPS but the contributions are generally set to target a funding level of 100% using the actuarial valuation assumptions.

On the Employer's withdrawal from the Fund, a cessation valuation will be carried out in accordance with Regulation 64 of the LGPS Regulations 2013 which will determine the termination contribution due by the Employer, on a set of assumptions deemed appropriate by the Fund Actuary.

In general, participating in a defined benefit pension scheme means that the Employer is exposed to a number of risks:

- Investment risk. The Fund holds investment in asset classes, such as equities, which have volatile market values and while these assets are expected to provide real returns over the long-term, the short-term volatility can cause additional funding to be required if a deficit emerges;
- Interest rate risk. The Fund's liabilities are assessed using market yields on high quality corporate bonds to discount future liability cashflows. As the Fund holds assets such as equities the value of the assets and liabilities may not move in the same way;
- Inflation risk. All of the benefits under the Fund are linked to inflation and so deficits may emerge to the extent that the assets are not linked to inflation; and
- Longevity risk. In the event that the members live longer than assumed a deficit will emerge in the Fund. There are also other demographic risks.

In addition, as many unrelated employers participate in the London Pension Fund Authority Pension Fund, there is an orphan liability risk where employers leave the Fund but with insufficient assets to cover their pension obligations so that the difference may fall on the remaining employers.

All of the risks above may also benefit the Employer e.g. higher than expected investment returns or employers leaving the Fund with excess assets which eventually get inherited by the remaining employers.

# Valuation data

## Data sources

In completing our calculations for pension accounting purposes we have used the following items of data, which we received from the London Pensions Fund Authority:

- The results of the valuation as at 31 March 2019 which was carried out for funding purposes and the results of the 31 July 2019 FRS102 report which was prepared for accounting purposes;
- Estimated whole Fund income and expenditure items for the period to 31 July 2020;
- Fund investment returns for the period to 30 June 2020 and market returns (estimated where necessary) thereafter for the period to 31 July 2020;
- Estimated Fund income and expenditure in respect of the Employer for the period to 31 July 2020;
- Details of any new early retirements for the period to 31 July 2020 that have been paid out on an unreduced basis, which are not anticipated in the normal employer service cost; and
- Details of any settlements for the period to 31 July 2020.

Although some of these data items have been estimated, we do not believe that they are likely to have a material effect on the results of this report. Further, we are not aware of any material changes or events since we received the data. The data has been checked for reasonableness and we are happy that the data is sufficient for the purposes of this advice.

## Employer membership statistics

The table below summarises the membership data, as at 31 March 2019 for members receiving funded benefits, and as at 31 July 2018 for any members receiving unfunded benefits.

| Member data summary | Number | Salaries/Pensions £000s | Average age |
|---|---|---|---|
| Actives | 847 | 22,012 | 44 |
| Deferred pensioners | 1,785 | 3,052 | 41 |
| Pensioners | 689 | 4,604 | 72 |
| Unfunded pensioners | 290 | 728 | 78 |

The service cost for the year ending 31 July 2020 is calculated using an estimate of the total pensionable payroll during the year. From the contribution information provided by the employer, the estimated total pensionable payroll during the year is £25,038,000.  The projected service cost for the year ending 31 July 2021 has been calculated assuming the payroll remains at this level over the year.

## Scheduled contributions

The table below summarises the minimum employer contributions due from South Bank University to the Fund over this inter-valuation period. The calculated cost of accrual of future benefits is 15.4% of payroll p.a.

| Minimum employer contributions due for the period beginning | 1 Apr 2020 | 1 Apr 2021 | 1 Apr 2022 |
|---|---|---|---|
| Percent of payroll | 15.4% | 15.4% | 15.4% |
| plus monetary amount (£000s) | 1,330 | 1,379 | 1,429 |

The Employer shall pay the monetary element of their rate by 30 April 2020, 30 April 2021 and 30 April 2022 respectively.

South Bank University may pay further amounts at any time and future periodic contributions, or the timing of contributions may be adjusted on a basis approved by us.

## Early retirements

We requested data on any early retirements in respect of the Employer from the administering authority for the year ending 31 July 2020.

It is our understanding that there were no new early retirements over the year which were not allowed for at the previous accounting date.

## Assets

The return on the Fund (on a bid value to bid value basis) for the year to 31 July 2020 is estimated to be 4%. The actual return on Fund assets over the year may be different.

The estimated asset allocation for South Bank University as at 31 July 2020 is as follows:

| Asset breakdown | 31 Jul 2020 | | 31 Jul 2019 | |
|---|---|---|---|---|
| | £000s | % | £000s | % |
| Equities | 90,498 | 55% | 88,078 | 54% |
| Target Return Portfolio | 37,490 | 23% | 41,054 | 25% |
| Infrastructure | 11,389 | 7% | 9,264 | 6% |
| Property | 15,275 | 9% | 14,726 | 9% |
| Cash | 10,120 | 6% | 8,527 | 5% |
| **Total** | **164,772** | **100%** | **161,649** | **100%** |

We have estimated the bid values where necessary. Please note that the individual percentages shown are to the nearest percentage point for each asset class and may not sum to 100%. The final asset allocation of the Fund assets as at 31 July 2020 may be different from that shown due to estimation techniques.

Based on the above, the Employer's share of the assets of the Fund is approximately 3%.

# Actuarial methods and assumptions

## Valuation approach

### Valuation of the Employer's liabilities

To assess the value of the Employer's liabilities at 31 July 2020, we have rolled forward the value of the Employer's liabilities calculated for the funding valuation as at 31 March 2019, using financial assumptions that comply with FRS102.

The full actuarial valuation involved projecting future cashflows to be paid from the Fund and placing a value on them. These cashflows include pensions currently being paid to members of the Fund as well as pensions (and lump sums) that may be payable in future to members of the Fund or their dependants. These pensions are linked to inflation and will normally be payable on retirement for the life of the member or a dependant following a member's death.

It is not possible to assess the accuracy of the estimated value of liabilities as at 31 July 2020 without completing a full valuation. However, we are satisfied that the approach of rolling forward the previous valuation data to 31 July 2020 should not introduce any material distortions in the results provided that the actual experience of the Employer and the Fund has been 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.

### Valuation of the Employer's assets

To calculate the asset share we have rolled forward the assets allocated to the Employer at 31 March 2019 allowing for investment returns (estimated where necessary), contributions paid into, and estimated benefits paid from, the Fund by and in respect of the Employer and its employees.

### Experience items allowed for since the previous accounting date

As a result of allowing for actual experience, which may be different from that assumed previously, an experience item may be observed in the reconciliation to 31 July 2020. The effect of allowing for the actual experience is shown in Appendix 3.

### Guaranteed Minimum Pension (GMP) Equalisation

As a result of the High Court's recent Lloyds ruling on the equalisation of GMPs between genders, a number of pension schemes have made adjustments to accounting disclosures to reflect the effect this ruling has on the value of pension liabilities. It is our understanding that HM Treasury have confirmed that the judgement "does not impact on the current method used to achieve equalisation and indexation in public service pension schemes". More information on the current method of equalisation of public service pension schemes can be found here.

On 22 January 2018, the Government published the outcome to its *Indexation and equalisation of GMP in public service pension schemes* consultation, concluding that the requirement for public service pension schemes to fully price protect the GMP element of individuals' public service pension would be extended to those individuals reaching State Pension Age (SPA) before 6 April 2021. HM Treasury published a Ministerial Direction on 4 December 2018 to implement this outcome, with effect from 6 April 2016. Details of this outcome and the Ministerial Direction can be found here.

Our valuation assumption for GMP is that the Fund will pay limited increases for members that have reached SPA by 6 April 2016, with the Government providing the remainder of the inflationary increase. For members that reach SPA after this date, we have assumed that the Fund will be required to pay the entire inflationary increase. Therefore we do not believe we need to make any adjustments to the value placed on the liabilities as a result of the above outcome.

## Demographic/Statistical assumptions

We have adopted a set of demographic assumptions that are consistent with those used for the most recent Fund valuation, which was carried out as at 31 March 2019. These assumptions have been updated from those adopted at the last accounting date. The post retirement mortality tables have been constructed based on Club Vita 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., smoothing parameter of 7.0 and an initial addition to improvements of 0.5% p.a.

This has been updated since the last accounting date where the demographic assumptions were based on those adopted for the Fund's 31 March 2016 valuation, with the exception of the base table projections where the CMI_2018 Model was used with a smoothing parameter of 7.0 and no initial addition to improvement rate. The impact of updating the demographic assumptions is set out in the Change in demographic assumptions figure in Table 1 of Appendix 3.

The assumed life expectations from age 65 are shown in the table below. We have shown the life expectancies at 31 July 2020 weighted by liability and unweighted. The life expectancies shown at 31 July 2019 are unweighted. In future years we will show the life expectancies weighted by liability only.

| Life expectancy from age 65 (years) | 31 Jul 2020<br>Weighted by liability | 31 Jul 2020<br>Unweighted | 31 Jul 2019<br>Unweighted |
|---|---|---|---|
| **Retiring today** | | | |
| Males | 21.9 | 21.3 | 20.3 |
| Females | 24.2 | 24.0 | 23.3 |
| **Retiring in 20 years** | | | |
| Males | 23.2 | 22.7 | 22.1 |
| Females | 25.8 | 25.5 | 25.2 |

We have also assumed that:

- Members will exchange half of their commutable pension for cash at retirement;
- Members will retire at one retirement age for all tranches of benefit, which will be the pension weighted average tranche retirement age; and
- The proportion of the membership that had taken up the 50:50 option at the previous valuation date will remain the same.

## Financial assumptions

The financial assumptions used to calculate the results are as follows:

| Assumptions as at | 31 Jul 2020 | 31 Jul 2019 | 31 Jul 2018 |
|---|---|---|---|
| | % p.a. | % p.a. | % p.a. |
| Discount rate | 1.35% | 2.10% | 2.65% |
| Pension increases | 2.25% | 2.40% | 2.35% |
| Salary increases | 3.25% | 3.90% | 3.85% |

These assumptions are set with reference to market conditions at 31 July 2020.

Our estimate of the Employer's past service liability duration is 22 years. This has been calculated based on membership data provided for the most recent full valuation of the Employer's liabilities at 31 March 2019. This may differ from the estimated duration at the previous accounting date.

An estimate of the Employer's future cashflows is made using notional cashflows based on the estimated duration above. These estimated cashflows are then used to derive a Single Equivalent Discount Rate (SEDR). The discount rate derived is such that the net present value of the notional cashflows, discounted at this single rate, equates to the net present value of the cashflows, discounted using the annualised Merrill Lynch AA rated corporate bond yield curve (where the spot curve is assumed to be flat beyond the 30 year point). This is consistent with the approach used at the previous accounting date.

Similar to the approach used to derive the discount rate, the Retail Prices Index (RPI) increase assumption is set using a Single Equivalent Inflation Rate (SEIR) approach, using the notional cashflows described above. The single inflation rate derived is that which gives the same net present value of the cashflows, discounted using the annualised Merrill Lynch AA rated corporate bond yield curve, as applying the BoE implied inflation curve. As above, the Merrill Lynch AA rated corporate bond yield spot curve is assumed to be flat beyond the 30 year point and the BoE implied inflation spot curve is assumed to be flat beyond the 40 year point. This is consistent with the approach used at the previous accounting date.

As future pension increases are expected to be based on the Consumer Prices Index (CPI) rather than RPI, we have made a further assumption about CPI which is that it will be 0.80% p.a. below RPI i.e. 2.25% p.a. We believe that this is a reasonable estimate for the future differences in the indices, based on the different calculation methods, recent independent forecasts and the duration of the Employer's liabilities. The difference between RPI and CPI is less than assumed at the previous accounting date. This reflects the movement in market implied RPI inflation that occurred following the UK Statistics Authority's proposal to change how RPI is calculated and subsequent announcements from the Chancellor on the issue.

Salaries are assumed to increase at 1.0% p.a. above CPI. This differs from the salary increase assumption at the previous accounting date and has been updated in line with the most recent funding valuation.

## Past service costs/gains

Past service costs/gains arise as a result of introduction or withdrawal of, or changes to, member benefits. For example, an award of additional discretionary benefits to a member such as added years by a member would be considered a past service cost.

We are not aware of any additional benefits which were granted over the year ending 31 July 2020.

## Curtailments

We have calculated the cost of curtailments arising as a result of the payment of unreduced pensions on early retirement. The Employer may also have to account for non-pension related costs (e.g. lump sum payments on redundancy) but for the avoidance of doubt, we have only calculated the cost of curtailments which affect the Employer's LGPS pension liabilities.

We calculate the cost of curtailments at the point of exit, with interest applied to the accounting date accounted for separately.

Over the year, we understand no employees were permitted by the Employer to take unreduced early retirement that they would not otherwise have been entitled to.

## Settlements

We are not aware of any liabilities being settled at a cost materially different to the accounting reserve during the year.

# Results and disclosures

We estimate that the value of the net liability as at 31 July 2020 is a liability of £162,810,000.

The results of our calculations for the year ended 31 July 2020 are set out in the appendices below:

- Appendix 1 sets out the Statement of financial position as at 31 July 2020;
- Appendix 2 sets out the Statement of profit and loss for the year ended 31 July 2020;
- Appendix 3 details a reconciliation of assets and liabilities during the year;
- Appendix 4 shows a sensitivity analysis on the major assumptions;
- Appendix 5 shows the Remeasurements in other comprehensive income for the year; and
- Appendix 6 contains our estimates of the projected profit and loss account costs for the year ending 31 July 2021. Please note that no allowance has been made for the costs of any early retirements or augmentations which may occur over the year and whose additional capitalised costs would be included in the value of liabilities. It is only an estimate so actual experience over the year is likely to differ. We have not provided balance sheet projections on the basis that they will depend upon market conditions and the asset value of the Fund at the end of the following year.

The figures presented in this report are prepared only for the purposes of FRS102. In particular, they are not relevant for calculations undertaken for funding purposes or for other statutory purposes under UK pensions legislation.

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

**Liam Drysdale FFA**
**Actuary**

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# Appendix 1 Statement of financial position as at 31 July 2020

| Net pension asset as at | 31 Jul 2020<br>£000s | 31 Jul 2019<br>£000s | 31 Jul 2018<br>£000s |
|---|---|---|---|
| Present value of the defined benefit obligation | 317,250 | 260,964 | 232,750 |
| Fair value of Fund assets (bid value) | 164,772 | 161,649 | 143,869 |
| **Deficit / (Surplus)** | **152,478** | **99,315** | **88,881** |
| Present value of unfunded obligation | 10,332 | 10,420 | 10,884 |
| Unrecognised past service cost | - | - | - |
| Impact of asset ceiling | - | - | - |
| **Net defined benefit liability / (asset)** | **162,810** | **109,735** | **99,765** |

The breakdown of the unfunded pension obligation as at 31 July 2020 is given below.

| Split of unfunded obligation as at 31 July 2020<br>Pension commenced: | Before<br>1 Apr 1989 | After<br>1 Apr 1989 | Total |
|---|---|---|---|
| Unfunded pensioners - LGPS | 175 | 1,774 | 1,949 |
| Unfunded pensioners - Other | - | 8,383 | 8,383 |
| **Total** | **175** | **10,157** | **10,332** |

# Appendix 2 Statement of profit and loss for the year to 31 July 2020

| The amounts recognised in the profit and loss statement are: | Year to 31 Jul 2020 £000s | Year to 31 Jul 2019 £000s |
|---|---|---|
| Service cost | 9,490 | 9,904 |
| Net interest on the defined liability (asset) | 2,245 | 2,578 |
| Administration expenses | 210 | 187 |
| **Total loss (profit)** | **11,945** | **12,669** |

# Appendix 3 Asset and benefit obligation reconciliation for the year to 31 July 2020

| Reconciliation of opening & closing balances of the present value of the defined benefit obligation | Year to 31 Jul 2020 £000s | Year to 31 Jul 2019 £000s |
|---|---|---|
| **Opening defined benefit obligation** | **271,384** | **243,634** |
| Current service cost | 9,490 | 7,822 |
| Interest cost | 5,656 | 6,406 |
| Change in financial assumptions | 37,517 | 29,620 |
| Change in demographic assumptions | 618 | (13,510) |
| Experience loss/(gain) on defined benefit obligation | 6,977 | - |
| Liabilities assumed / (extinguished) on settlements | - | - |
| Estimated benefits paid net of transfers in | (5,161) | (5,649) |
| Past service costs, including curtailments | - | 2,082 |
| Contributions by Scheme participants and other employers | 1,829 | 1,707 |
| Unfunded pension payments | (728) | (728) |
| **Closing defined benefit obligation** | **327,582** | **271,384** |

| Reconciliation of opening & closing balances of the fair value of Fund assets | Year to 31 Jul 2020 £000s | Year to 31 Jul 2019 £000s |
|---|---|---|
| **Opening fair value of Fund assets** | **161,649** | **143,869** |
| Interest on assets | 3,411 | 3,828 |
| Return on assets less interest | 2,539 | 12,967 |
| Other actuarial gains/(losses) | (4,150) | - |
| Administration expenses | (210) | (187) |
| Contributions by employer including unfunded | 5,593 | 5,842 |
| Contributions by Scheme participants and other employers | 1,829 | 1,707 |
| Estimated benefits paid plus unfunded net of transfers in | (5,889) | (6,377) |
| Settlement prices received / (paid) | - | - |
| **Closing Fair value of Fund assets** | **164,772** | **161,649** |

The total return on the fund assets for the year to 31 July 2020 is £5,950,000.

# Appendix 4 Sensitivity analysis

| Sensitivity analysis | £000s | £000s | £000s |
|---|---|---|---|
| **Adjustment to discount rate** | **+0.1%** | **0.0%** | **-0.1%** |
| Present value of total obligation | 320,685 | 327,582 | 334,635 |
| Projected service cost | 12,909 | 13,349 | 13,804 |
| **Adjustment to long term salary increase** | **+0.1%** | **0.0%** | **-0.1%** |
| Present value of total obligation | 328,075 | 327,582 | 327,094 |
| Projected service cost | 13,355 | 13,349 | 13,343 |
| **Adjustment to pension increases and deferred revaluation** | **+0.1%** | **0.0%** | **-0.1%** |
| Present value of total obligation | 334,073 | 327,582 | 321,227 |
| Projected service cost | 13,793 | 13,349 | 12,919 |
| **Adjustment to life expectancy assumptions** | **+1 Year** | **None** | **- 1 Year** |
| Present value of total obligation | 338,557 | 327,582 | 316,963 |
| Projected service cost | 13,797 | 13,349 | 12,915 |

# Appendix 5 Remeasurements in other comprehensive income

| Remeasurement of the net assets / (defined liability) | Year to 31 Jul 2020 £000s | Year to 31 Jul 2019 £000s |
|---|---|---|
| Return on Fund assets in excess of interest | 2,539 | 12,967 |
| Other actuarial gains/(losses) on assets | (4,150) | - |
| Change in financial assumptions | (37,517) | (29,620) |
| Change in demographic assumptions | (618) | 13,510 |
| Experience gain/(loss) on defined benefit obligation | (6,977) | - |
| Changes in effect of asset ceiling | - | - |
| **Remeasurement of the net assets / (defined liability)** | **(46,723)** | **(3,143)** |

# Appendix 6 Projected pension expense for the year to 31 July 2021

| Projections for the year to 31 July 2021 | Year to 31 Jul 2021 £000s |
|---|---|
| Service cost | 13,349 |
| Net interest on the defined liability (asset) | 2,158 |
| Administration expenses | 214 |
| **Total loss (profit)** | **15,721** |
| | |
| **Employer contributions** | **5,226** |

Note that these figures exclude the capitalised cost of any early retirements or augmentations which may occur after 31 July 2020. These projections are based on the assumptions as at 31 July 2020, as described in the main body of this report.

The employer contributions in the table above don't include projected payment of unfunded pensions.