

The background of the slide features a large, light blue watermark of the City of Vancouver's coat of arms. The crest includes a crown with four maple leaves, a shield divided into four quadrants (top-left: a ship, top-right: a stag, bottom-left: a sailing ship, bottom-right: an eagle), and a banner at the bottom with the motto "A NE FOR A".

Agenda Item 5

Funding Update

Falkirk Council

Subject: Funding Update

Meeting: Joint Meeting of Pensions Committee and Pension Board

Date: 6 December 2018

Submitted by: Director of Corporate and Housing Service

1. Purpose of Report

- 1.1 This purpose of this report is to advise the Committee and Board of the funding position of the Falkirk Council Pension Fund as at 31 October 2018.

2. Recommendation

- 2.1 **The Committee and Board are asked to note the funding position as at 31 October 2018.**

3. Background

- 3.1 The funding position is established every three years as part of the formal valuation process, however, in the interests of good governance, it is revisited several times during the valuation cycle.
- 3.2 The funding position describes the extent to which the Fund's liabilities are matched by its assets. Assets are the investments held by the Fund, whilst liabilities are the benefits promised to members. A funding level of less than 100% means that assets are less than liabilities and there is a funding deficit. Where the level exceeds 100%, assets are greater than liabilities and a funding surplus exists.
- 3.3 The Fund's strategy is to target a funding level of 100% and to repair any deficit position over a period of 20 years.
- 3.4 Assets are calculated at their market value, whilst liabilities are assessed as the amount of money that the Fund needs to hold now in order to pay all the benefits that members have built up so far.
- 3.5 The value placed on the liabilities is highly dependent on the discount rate used in the calculation. To illustrate the way in which the discount rate works, if the Fund needs to pay out £1000 in the future, it does not need to hold £1000 now, as it would expect to earn a return on its capital. The discount rate is therefore the rate of return that the Fund could expect to earn on its investments.

- 3.6 The discount rate is usually set as the return on government bonds (i.e. gilts) plus an outperformance assumption to reflect a Fund's exposure to assets (i.e. equities) that are expected to deliver a return in excess of gilts.
- 3.7 For the Falkirk Fund, it was agreed at the 2017 valuation that the discount rate should be the return on gilts plus 1.8%.
- 3.8 The funding position as at 31 October, 2018 has been estimated by the Fund's Actuary, Hymans Robertson, taking account of cash flows and investment returns arising since the 2017 valuation. The Hymans report is attached as an appendix to this paper.
- 3.9 Catherine McFadyen from Hymans Robertson is attending the meeting and will be able to provide further comment as required.

4. Funding Update

- 4.1 The updated funding position is set out below, together with the position at the 2014 and 2017 valuations:

	Valuation at 31/03/2014	Valuation at 31/03/2017	Estimate at 31/10/2018
Fund Assets	£1,577m	£2.219m	£2,420m
Fund Liabilities	£1,860m	£2,403m	£2,566m
Surplus/ (Deficit)	(£283m)	(£184m)	(£146m)
Discount Rate	Gilts+1.6%	Gilts+1.8%	Gilts+1.8%
Funding Level	85%	92%	94%

- 4.2 The update shows that the funding level has risen from 92% at the 2017 valuation to 94% at October, 2018. The main factors contributing towards the improved position have been the better than expected returns on assets (compared to the valuation assumption) and the upward movement in gilt yields.
- 4.3 The chart on Page 3 of the Hymans report shows that the funding level has been variable in the period since the 2017 valuation moving between funding levels of 90% and even reaching 100% prior to the market downturn in October, 2018. The volatility is not unexpected, however, given the proportion of the Fund's assets allocated to equities.
- 4.4 The sensitivity chart at the foot of Page 4 of the Hymans report shows that a further modest rise in gilt yields – which may be likely given the direction of US interest rates and the uncertainties around the UK's Brexit arrangements – would move the Fund closer its 100% funding target.
- 4.5 The improved funding position is one of a number of factors that have been taken into account in the review of investment strategy which is being considered in a separate paper on today's agenda.

5. Implications

Financial

- 5.1 There are no immediate financial implications associated with this report. However, the funding level is a relevant factor in both the setting of employer contribution rates and investment strategy.

Resources

- 5.2 No additional resources are required by virtue of this report.

Legal

- 5.3 No legal issues are raised by this report.

Risk

- 5.4 Ongoing monitoring of the funding level is part of the Fund's overall risk framework and demonstrates good governance on the part of Committee and Board.

Equalities

- 5.5 No equalities issues are raised by this report.

Sustainability/Environmental Impact

- 5.6 No sustainability/environmental issues are raised by this report,

6. Conclusion

- 6.1 The funding level has improved from a level of 92% at the 2017 valuation to 94% at the end of October, 2018. The funding position has been taken into account in formulating the proposed investment strategy for the Fund.

Director of Corporate & Housing Services

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Date: 27 November, 2018

Appendix - Hymans Robertson – Funding Update as at 31 October 2018

List of Background Papers - None

Falkirk Council Pension Fund

Funding and risk report as at 31 October 2018

HEADLINE

31 October 2018	Ongoing funding
Assets	£2,420m
Liabilities	£2,566m
Surplus/(deficit)	(£146m)
Funding level	94.3%

Summary

This funding update is provided to illustrate the estimated development of the funding position from 31 March 2017 to 31 October 2018, for the Falkirk Council Pension Fund ("the Fund"). It is addressed to Falkirk Council in its capacity as the Administering Authority of the Fund and has been prepared in my capacity as your actuarial adviser.

At the last formal valuation the Fund assets were £2,219m and the liabilities were £2,403m. This represents a deficit of £184m and equates to a funding level of 92%. Since the valuation the funding level has increased by c2.3% to 94.3% as detailed in the table above.

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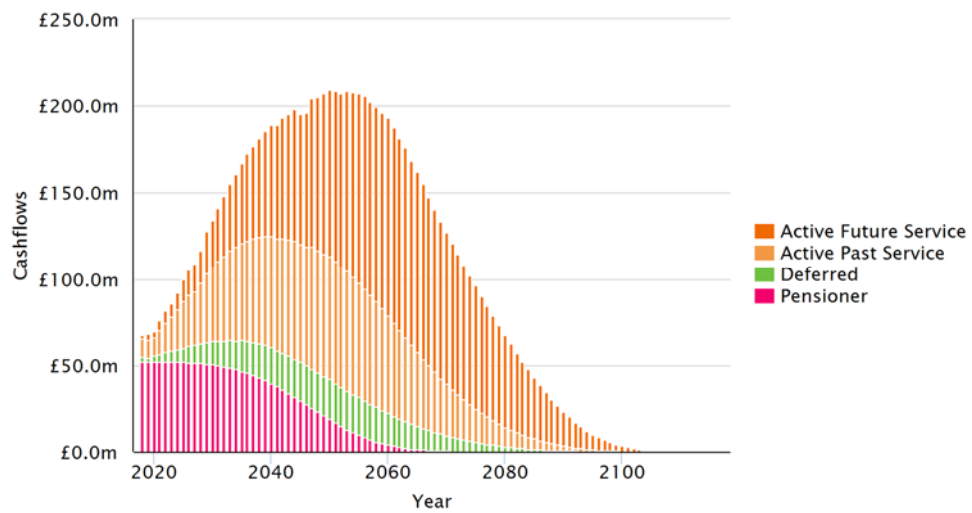
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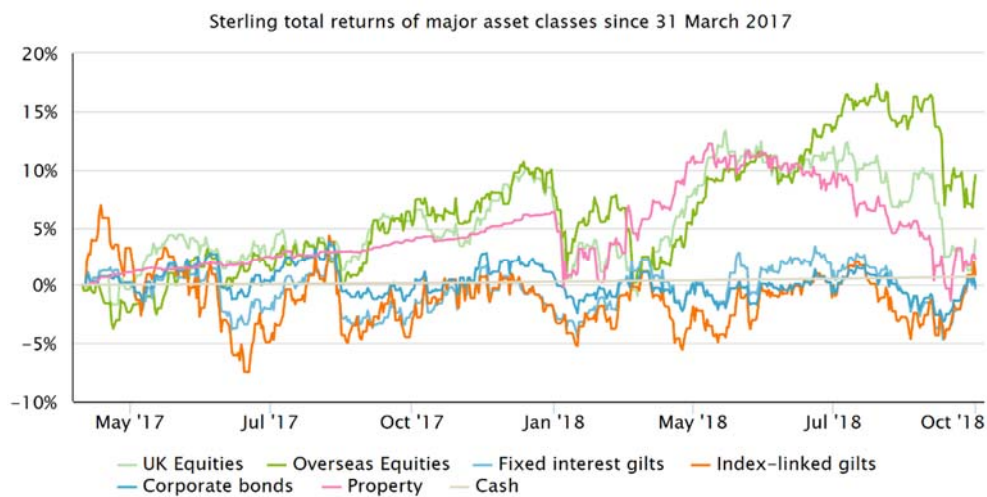
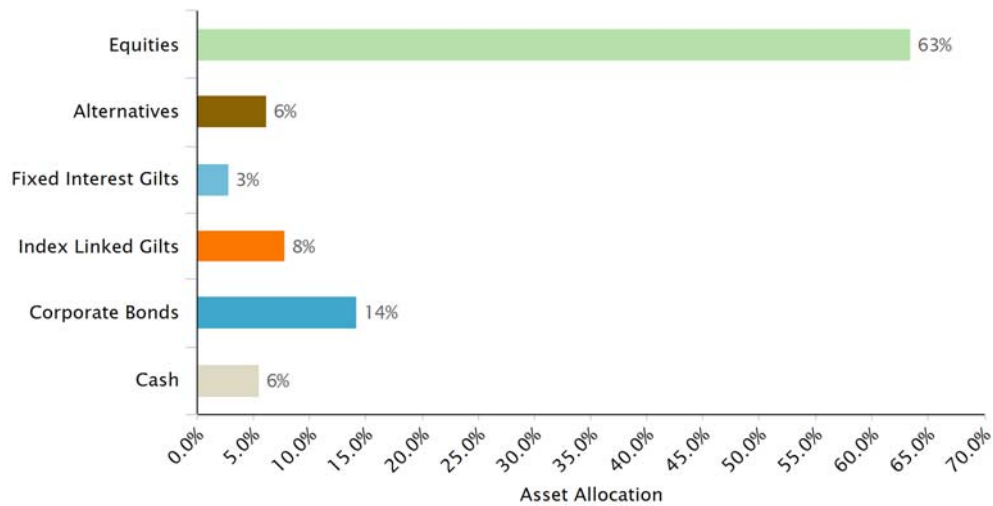
31 October 2018	Ongoing funding
Assets	£2,420m
Liabilities	£2,566m
Surplus/(deficit)	(£146m)
Funding level	94.3%

Surplus/(deficit)	£m
Surplus/(deficit) as at 31/03/2017	(184)
Contributions (less benefits accruing)	(31)
Interest on surplus/(deficit)	(8)
Excess return on assets	45
Impact of change in yields & inflation	32
Surplus/(deficit) as at 31/10/2018	(146)

	31 March 2017	31 March 2018	31 October 2018
Market yields (p.a.)			
Fixed Interest gilts	1.65%	1.63%	1.81%
Index linked gilts	-1.68%	-1.65%	-1.60%
Implied Inflation	3.39%	3.34%	3.47%
AA corporate bonds	2.51%	2.58%	2.76%
Price indices			
FTSE All Share	3,990	3,894	3,904
FTSE 100	7,323	7,057	7,128

PROGRESS





Sensitivity Matrix as at 20 November 2018 for basis Ongoing funding (£m)

		Shift in equity level (using FTSE 100 levels as proxy)						
		4864 -30%	5558 -20%	6253 -10%	6948 0%	7643 10%	8338 20%	9032 30%
Shift in bond yields (% p.a.)	0.6	(429)	(263)	(97)	69	235	401	567
	0.4	(492)	(326)	(160)	6	172	338	504
	0.2	(559)	(393)	(227)	(61)	105	271	437
	0.0	(630)	(464)	(298)	(132)	34	200	366
	-0.2	(706)	(540)	(374)	(208)	(42)	124	290
	-0.4	(787)	(621)	(455)	(289)	(123)	43	209
	-0.6	(873)	(707)	(541)	(375)	(209)	(43)	123
		< 50%	50% - 85%	85% - 95%	95% - 100%	100% - 105%	105% - 115%	> 115%



Reliances and limitations

This report was commissioned by and is addressed to Falkirk Council in their capacity as the Administering Authority and is provided to assist in monitoring certain funding and investment metrics. It should not be used for any other purpose. It should not be released or otherwise disclosed to any third party except as required by law or with our prior written consent, in which case it should be released in its entirety. **Decisions should not be taken based on the information herein without written advice from your consultant.** Neither I nor Hymans Robertson LLP accept any liability to any other party unless we have expressly accepted such liability in writing.

The method and assumptions used to calculate the updated funding position are consistent with those disclosed in the documents associated with the last formal actuarial valuation, although the financial assumptions have been updated to reflect known changes in market conditions. The calculations contain approximations and the accuracy of this type of funding update declines with time from the valuation; differences between the position shown in this report and the position which a new valuation would show can be significant. It is not possible to assess its accuracy without carrying out a full actuarial valuation. This update complies with Technical Actuarial Standard 100.

