Division(s): N/A

PENSION FUND COMMITTEE – 3 DECEMBER 2010

PENSION FUND VALUATION 2010

Report by Assistant Chief Executive and Chief Finance Officer

Introduction

1. Under the Pension Fund Regulations, the Administering Authority must arrange for the valuation of the Pension Fund on a three yearly cycle. The requirement is therefore for a Valuation of the Fund as at 31 March 2010, with the Valuation report and the Rates and Adjustment Certificates which set out the individual contribution rates for all of the Fund employers required to be published by 1 March 2011.

2. This report sets out the interim results for the Fund as a whole and highlights some of the key issues taken into account in determining the results, issues to be considered before final results are published and those issues which employers need to consider in implementing the results.

The Interim Results

3. Barnett Waddingham, the Fund's new Actuary has produced interim results for the whole of the Fund. These results are consistent with the Fund's Funding Strategy Statement and use Barnett Waddingham's "Dynamic Gilt Plus" model which aims to smooth out as much of the fluctuation in contribution rates as possible.

4. Based on their 2007 model, the overall employer contribution rate for the Fund would have risen 2.9% of pensionable pay, from 19.9% to 22.8%. A major component of this increase is the impact of the poor return on assets over the three year period between valuations. However, in producing the overall results for the Fund, Barnett Waddingham have made a number of changes to assumptions to those they used in undertaking 2007 Valuations.

5. The first change is to allow for the recent Government announcement to link pension increases to the Consumer Price Index (CPI) rather than the Retail Price Index (RPI). Historically, CPI has run around 0.5% below RPI. This factor alone reduces the average employer contribution rate to 19.8%.

6. The second adjustment to the figures is to assume that the recently announced changes in state retirement age will influence the retirement age from the LGPS. Assuming current members retire one year after their current eligible retirement date further reduces the average employer contribution rate to 18.8%.

7. The third change is to make a short term adjustment in respect of the planned public sector pay freeze. This makes a further reduction in the average contribution rate, reducing the figure to 18.4%.

8. The final change made by the Actuary is based on a review of actual patterns in longevity and ill-health retirements within the Fund. As a result of this review, the Actuary has increased mortality assumptions in the short term, though with improvements in the longer term, as well as increasing the allowance for tier 1 ill health retirements. These changes led to an increase in the average employer contribution rate to 19.0%.

9. In the final result therefore, the average employer contribution rate has reduced by 0.9% of pensionable pay. If the contribution rate was to be maintained at 19.9%, the recovery period could be reduced to 20 years rather than the current 25 years.

10. Whilst the average result will see a reduction of 0.9% in the employer contribution rate, or a 5 year reduction in the recovery period, results for individual employers will vary around this average.

11. Factors which will affect an employer's result relative to the average Fund figure include:

    - Overall membership profile, with the more mature the membership (i.e. greater proportions of deferred and pensioner members, compared to active members), the higher the increase in contribution rate. In such cases, a smaller proportion of the liabilities are impacted by the new assumptions for active members around pay freezes, and later retirement ages.
    - Profile of active membership, with the older the active membership, the higher the increase in contribution rates, as again a smaller proportion of the liabilities are impacted by the new assumptions as a result of known or assumed transitional arrangements.
    - Changes in Membership profile since last valuation. The impact here is more complex. Above average increases in active membership lead to an increased recovery in past service deficits and a larger base against which to recover remaining deficits, which lead to a lower contribution rate. However if the increase in active membership has been as a consequence of above average pay awards this will have increased the past service liabilities and led to increases in contribution rates.
    - Previous Funding Levels. Ironically, those who were better funded at the 2007 valuation will have seen a higher increase in their contribution rates, as they will have suffered more by the poor performance of our investment assets.

12. The Actuary is currently in the process of calculating the contribution rates for the individual employers within the fund and these are being issued as they become available.

Key Issues to be Determined

13. In completing the interim results, the Actuary has taken account of all known factors, as well as probable changes. However at this stage no allowance has been made for any changes resulting from the work of the Independent Public Service Pension Commission chaired by Lord Hutton (see report at Agenda Item 13) nor for any impact of the potential increases in employee contribution rates.

14. In the case of the Hutton Commission, given the fundamental nature of the reforms envisaged as necessary by Lord Hutton, it is likely that there will be no significant impact during the three years covered by this current Valuation.

15. However the potential increases in employee contribution rates are set to be implemented from April 2012. If they are to deliver short term benefits to public spending, then the increased income from the higher employee contributions will need to be matched by an equal reduction in Government funding provided through the local government settlement. This in turn will require reductions in the employer contribution rates if employers are not to be faced with further service reductions to balance budgets.

16. At the present time it is not clear the size, nature and timing of any increases in employee contributions. It is therefore not possible for the Actuary to assess how the changes will impact differently across individual employers, based on variations in their membership profile. The Actuary cannot therefore include reductions on individual employer contribution rates on any accurate basis.

17. In the event that the Government makes clear the basis of the changes either at the time of the local government settlement in early December, or in the budget statement in March 2011, it may be possible for the Actuary to revise the contribution rates before the formal publication of the rates and adjustment certificate. Otherwise the Actuary will either need to include adjustments on the basis of guesswork, or seek a means to issue a revised rates and adjustment certificate for April 2012.

Key Issues for Employers

18. For individual employers, one of the key issues on receipt of their initial contribution rate is the extent they wish to trade amendments in their recovery period for amendments in their contribution rate (subject to the maximum 25 year recovery period as set out in the Funding Strategy Statement), the extent to which they wish to stagger any increases in contribution rate and whether they wish to seek a reduction in contribution rate by the payment of a one off lump sum.

19. The other key issue is the approach to managing the impact of any service reductions on their contribution payments. Normal practice is to publish the contribution rate as a percentage of pensionable pay. Where employers make significant reductions in their pensionable pay bill as part of proposals to

deliver balanced budgets and continue to pay contributions based on the published percentage rate, they will significantly underpay contributions towards their past service deficit.

20. Alternatives open to employers are to have their contribution rate published as a percentage of pensionable pay for future service only and a cash sum for past service deficits or to ensure that where pensionable pay budgets are reduced, money is set aside in reserves equivalent to the past service percentage of pensionable pay.

21. If employers fail to make suitable provision, then they will be faced with significantly higher contribution rates in the 2013 Valuation.

Employers' Forum

22. All employers will have the opportunity to discuss the 2010 valuation process, the interim results and the outstanding issues with the Actuary at the Employers' Forum on 10 December 2010.

RECOMMENDATION

23. **The Committee is RECOMMENDED to note the interim valuation results produced by the Actuary and to consider any issues it would wish to raise with the Actuary at the Employers' Forum.**

SUE SCANE
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Background papers: Nil

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