WIRRAL COUNCIL

PENSIONS COMMITTEE

21 MARCH 2017

SUBJECT:	**ACTUARIAL VALUATION 2016**
WARD/S AFFECTED:	**ALL**
REPORT OF:	**MANAGING DIRECTOR DELIVERY**
RESPONSIBLE PORTFOLIO HOLDER:	
KEY DECISION?	**NO**

1.0 EXECUTIVE SUMMARY

1.1 This report informs Members of the triennial actuarial valuation results for the Fund as at 31 March 2016. The position presented follows in-depth discussions between the Fund Actuary (Mercer), officers and constituent employers in relation to the core financial and demographic assumptions.

1.2 The statutory purpose of the valuation is to set a funding plan that strikes a balance between Fund solvency, long-term cost efficiency of the scheme and affordable employer contributions for the financial period 1 April 2017 to 31 March 2020.

1.3 In order to undertake the valuation, the Actuary must have regard to the draft funding assumptions and policies adopted by the Fund. These include the deficit repair plan and investment strategy.

1.4 All contributory policies and statutory statements to support the valuation process are covered under separate reports at this Committee meeting.

2.0 BACKGROUND AND KEY ISSUES

2.1 The Local Government Pension Scheme Regulations 2013 provide the statutory framework for the valuation process. The regulations require an actuarial assessment of the Fund's assets against the current value of the pension liabilities, with a corresponding funding level to be declared every three years.

Valuation Results

2.2 The previous valuation of the Fund as at 31 March 2013 disclosed a past service deficit of £1,869 million and funding level of 76%.

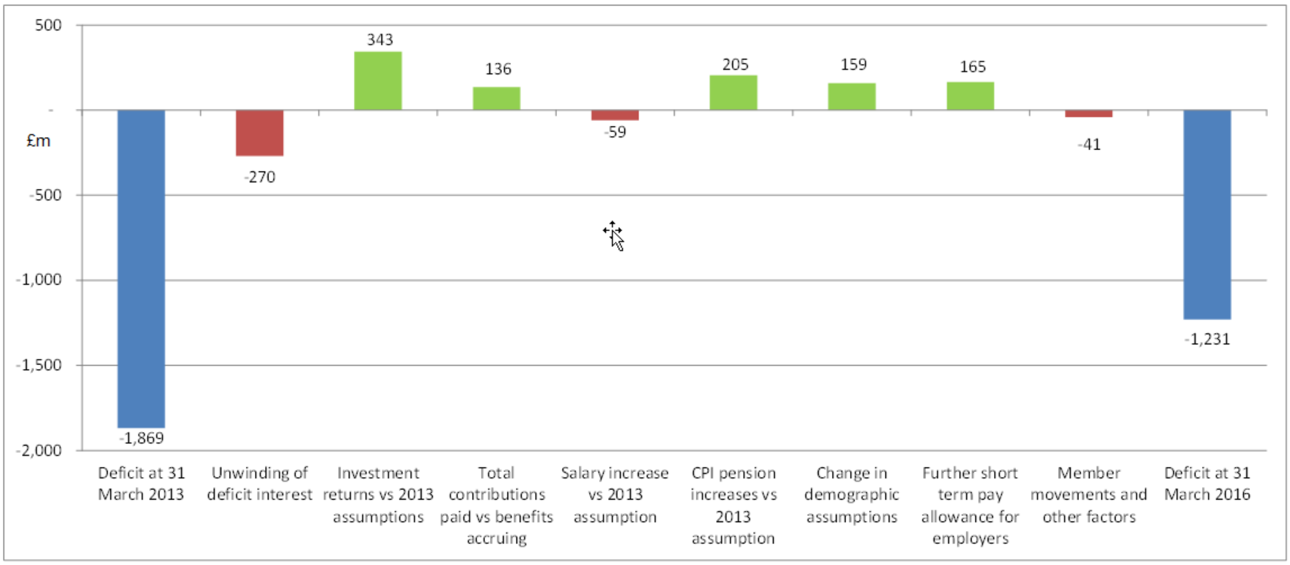
The current valuation at 31 March 2016 disclosed a past service deficit of £1,231m; the reduction to the deficit coupled with positive investment returns led to an increased funding level of 84.8%.

2.3 The asset, past service liabilities and Funding level for the whole Fund at 31 March 2016 is summarised as follows:

	£ million	£ million
Market value of assets		6,850
Value of benefits in respect of: - Current active members - Preserved (deferred) pensioners - Pensioners, widow(ers) and dependants	 2,935 1,385 3,761	
Total accrued liabilities		8,081
Past service deficit		1,231
Funding level		84.8%

A reconciliation of the deficit position during the inter-valuation period is set out below and provides a commentary on the principal factors that influenced the reduction in the deficit:

Figure 2.3.1 - Analysis of Change in Deficit Position



- **Investment returns:** Over the three years in question, the Fund returned 21%, well in excess of the 14.4% assumed at the 2013 valuation. This additional 6.6% equated to a gain/profit of £343m.

- **Pension Increases:** At 2013 we assumed CPI would be 2.6% per annum long term, although over the period it was only 3.9%. This results in lower than expected increases in pensions and equates to a gain of £205m.

- **Short term pay:** Assuming pay will increase at 1% per annum for the next four years (in line with government plans, rather than the long term assumption of 1.5% p.a above CPI), has reduced the liabilities at the 2016 actuarial valuation by £165m.

__Valuation Approach and Assumptions__

2.4 Members have previously been informed at the committee meeting on 15 November (minute 131 refers) of the change to the derivation of the discount rate for the 2016 triennial valuation.

The revised approach considers the long term investment strategy along with the expected return on the Fund's assets above CPI with a margin for prudence ("CPI plus" approach). This is a different approach from the previous valuation where the discount rate was set with reference to fixed gilt yields plus a margin to allow for the anticipated outperformance from other asset categories.

2.5 As a starting position to undertake the calculations the market value of the Fund's assets were assessed at the valuation date with the liabilities calculated by discounting the benefits at market–related rates of interest.

There are three Fund specific financial elements of the market value basis, namely the:

- expected rate of CPI inflation, including any adjustments due to current market conditions;
- extent to which we expect the return on the Fund's investments to exceed these assumed levels of CPI inflation (the "real discount rate/rate of return");
- expected rate of Pensionable Pay increases in excess of inflation ("real Pensionable Pay growth").

2.6 The valuation outlook assumes:

- a 2% per annum (pre and post retirement) real discount rate for past service. This is consistent with the corresponding assumption at the 2013 valuation and reflects the Fund's long term expectation of the performance of different asset classes, with an appropriate degree of prudence;
- for future service the assumption is a real discount rate of 2.75% per annum above CPI. The comparable assumption at the 2013 valuation was 3.0% per annum above CPI.
- pay growth of 1% per annum for the first four years, reverting to a long-term real pensionable pay growth of 1.5% per annum above CPI thereafter. The long-term pay growth assumption is consistent with that used in the 2013 valuation.
- CPI inflation of 1.0% below market-implied RPI inflation in line with the 2013 valuation.

2.7 The main financial assumptions adopted are as follows:

	Past Service % pa	Future Service % pa
Investment return (pre & post retirement)	4.2	4.95
Salary inflation	3.7	3.7
Pension increases	2.2	2.2

2.8 There have been changes made to the non–financial assumptions adopted in the previous valuation. Mercer's has undertaken an analysis of its local authority client base, with particular focus on Merseyside Pension Fund's experience relating to mortality, ill health retirements and proportion of married members.

The findings were incorporated into the actuarial valuation calculations with the impact on the whole fund deficit and future service rate as follows:

Figure 2.8. - Demographic Assumptions Update

Analysis	Effect on Deficit (Whole Fund)	Effect on Future Service Rate (Whole Fund)	Comment in relation to Fund
Life Expectancy			Analysis indicates reductions from last time
Ill-Health Retirement			Marginal decrease for future service rate but no material impact for deficit
Withdrawal			Marginal decrease in deficit, no real impact on future service rate
50/50			Minimal impact on deficit but increase to FSR
Commutation			No change from 2013 assumption
Proportion with Partners / Dependants			Marginal impact

2.9 The Fund is proposing to implement an internal insurance arrangement for certain employers to pool the risk of ill health retirement costs where these could have a significant impact on the organisation. This provides more certainty of costs to these employers with the "premium" included within the rates for the inter-valuation period communicated to employers.

2.10 As in the previous valuation, no advance allowance for early retirement (other than ill health) has been included in the calculations. Such retirements will be funded by additional payments (on top of the recommended employer's contribution rate) as and when they occur.

Resultant Contributions

2.11 Employer contributions are calculated in two steps:

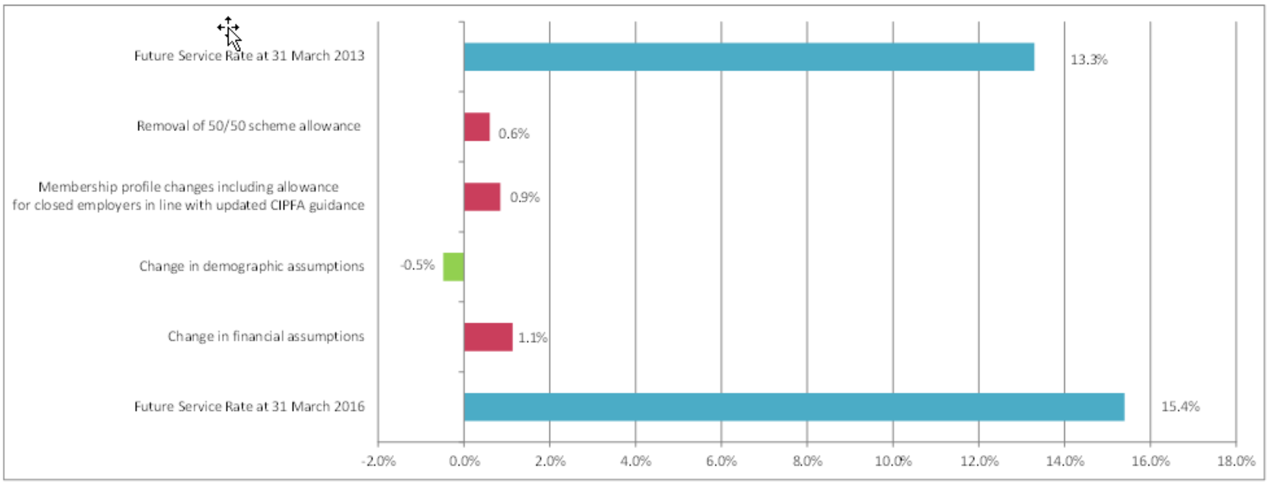
a) Future service contributions (% of pay) - to cover the costs of future benefit accrual by active members and;

b) Deficit contributions (£ amounts) - amounts to recover the 1,231m deficit at 31 March 2016.

2.12 **(a) Future Service Contributions**

The whole Fund future service contribution rate has increased at this valuation from 13.3% to 15.4% of pensionable pay. The material factors which result in the rising costs of future accrual are set out below along with commentary:

Figure 2.12.1 - Analysis of Change in Future Service Rate



- the removal of the 50/50 scheme allowance included within the 2013 future service rate, which lead to a reduction of around 0.6% of pay on average; as take-up by the membership was far below the assumed rate of 10%

- an increase in the average age of the membership from 49.1 to 49.8 year;

- the reduction of the discount rate to reflect a depressed outlook for long-term investment returns.

2.13 **(b) Deficit Contributions**

The deficit needs to be recovered by cash sums, with the annual payments predicated on the size of the deficit and the recovery period.

The deficit recovery period for the whole Fund position is 19 years and the additional cash sum needed to amortise the deficit in 2017/18 is £84m increasing by 3.7% p.a over the inter-valuation period

2.14 The contribution rates for individual employers reflect their own circumstances with regard to their employer status and strength of covenant as these aspects determine the pace of funding and deficit contributions

2.15 Where an employer is managing a deficit, they will be required to maintain current total contribution levels. In circumstances of low cash contributions the recovery period will be reduced to maintain the 2013 funding plan.

2.16 As the valuation is being undertaken against a backdrop of public sector austerity measures, it is intended that employers who face significant increases in contributions may phase payments over a maximum period of three years

2.17 The final valuation position will be declared following approval of both the Funding Strategy Statement and Investment Strategy Statement. Individual employer contributions will be certified with the new rates taking effect from 1 April 2017.

3.0 RELEVANT RISKS

3.1 It is imperative that the Administering Authority takes a prudent view when negotiating the financial and demographic assumptions for the 2016 Triennial Valuation, in order to secure the long term solvency of the Scheme.

However, to achieve a successful outcome to the valuation there is a clear need to consider affordability of contributions and build in flexibility to the funding of employer contributions. There is a tangible risk that certifying unaffordable cash payments will lead to a number of employers exiting the Fund leaving unrecoverable debt.

4.0 OTHER OPTIONS CONSIDERED

4.1 Not relevant for this report.

5.0 CONSULTATION

5.1 Not relevant for this report.

6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS

6.1 None associated with the subject matter.

7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 The extension of the Fair Deal pension protection to community admission bodies presents a significant restriction to their flexibility to outsource contracts.

8.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

8.1 In discussions with the major councils it has become apparent there is a need to consider budgetary constraints faced by employers as a result of reduced public sector funding; and the direct impact of increases to employer contributions on front line services.

8.2 Consequently Fund officers have explored various funding models with employers to stabilise contributions which balance the administering authority's statutory responsibilities with regard to solvency and long term cost efficiency against employer affordability.

8.3 The funding position of the Fund will be kept under regular review during the period to the next formal triennial valuation as at 31 March 2019.

9.0 LEGAL IMPLICATIONS

9.1 There are none arising from this report

10 EQUALITIES IMPLICATIONS

10.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

The differing characteristics and financial strength of employers have been reviewed to ensure that appropriate contribution easements have been applied equitably across all employers to prevent adverse risk falling on any individual employer.

11.0 CARBON REDUCTION AND ENVIRONMENTAL IMPLICATIONS

11.1 There are none arising from this report

12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising from this report

13.0 RECOMMENDATION

13.1 That Members approve the valuation basis and authorise the Fund Actuary to certify the final valuation report containing employers' contributions payable for the period 1 April 2017 – 31 March 2020.

14.0 REASON/S FOR RECOMMENDATION/S

14.1 There is a requirement for Members of the Pension Committee to be kept up to date with legislative developments as part of their decision making role.

REPORT AUTHOR Yvonne Caddock
Principal Pension Officer
Telephone (0151) 242 1333
Email yvonnecaddock@wirral.gov.uk

BRIEFING NOTES HISTORY

Briefing Note	Date
FUNDING STRATEGY STATEMENT / FINAL VALUATION RESULTS	1 JULY 2014
2013 TRIENNIAL ACTUARIAL VALUATION	19 NOVEMBER 2013