WIRRAL COUNCIL

PENSION COMMITTEE

3 FEBRUARY 2020

SUBJECT:	**2019 ACTUARIAL VALUATION**
WARD/S AFFECTED:	**ALL**
REPORT OF:	**DIRECTOR OF PENSIONS**
KEY DECISION?	**NO**

1.0 EXECUTIVE SUMMARY

1.1 This report informs Members that the Actuary has completed the calculations for the 2019 actuarial valuation based on membership and cashflow data provided by the Fund as at 31 March 2019.

1.2 The 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 2020 to 31 March 2023.

1.3 The emerging whole fund results presents a funding level of 102% with an associated surplus of £206m and an average employer future service cost of 17.1% of pay.

1.4 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.

1.5 All individual employer results were provided to employers in November setting out their initial valuation results and the potential impact that the McCloud case could have on their results. The results are subject to consideration of employer covenant and where necessary further meetings may take place upon completion of the covenant review. Employers must notify the Fund if they intend to include/exclude the McCloud allowance within their contributions. Where employers do not respond to the Fund, the default will be that the McCloud contributions will be included.

1.6 In order to undertake the valuation, the Actuary must have regard to the draft funding assumptions which have been updated following a formal consultation with all interested parties, which commenced on 4 November with feedback requested by the end of November 2019. The draft Funding Strategy Statement (FSS) has been updated to take account of the feedback from employers.

1.7 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

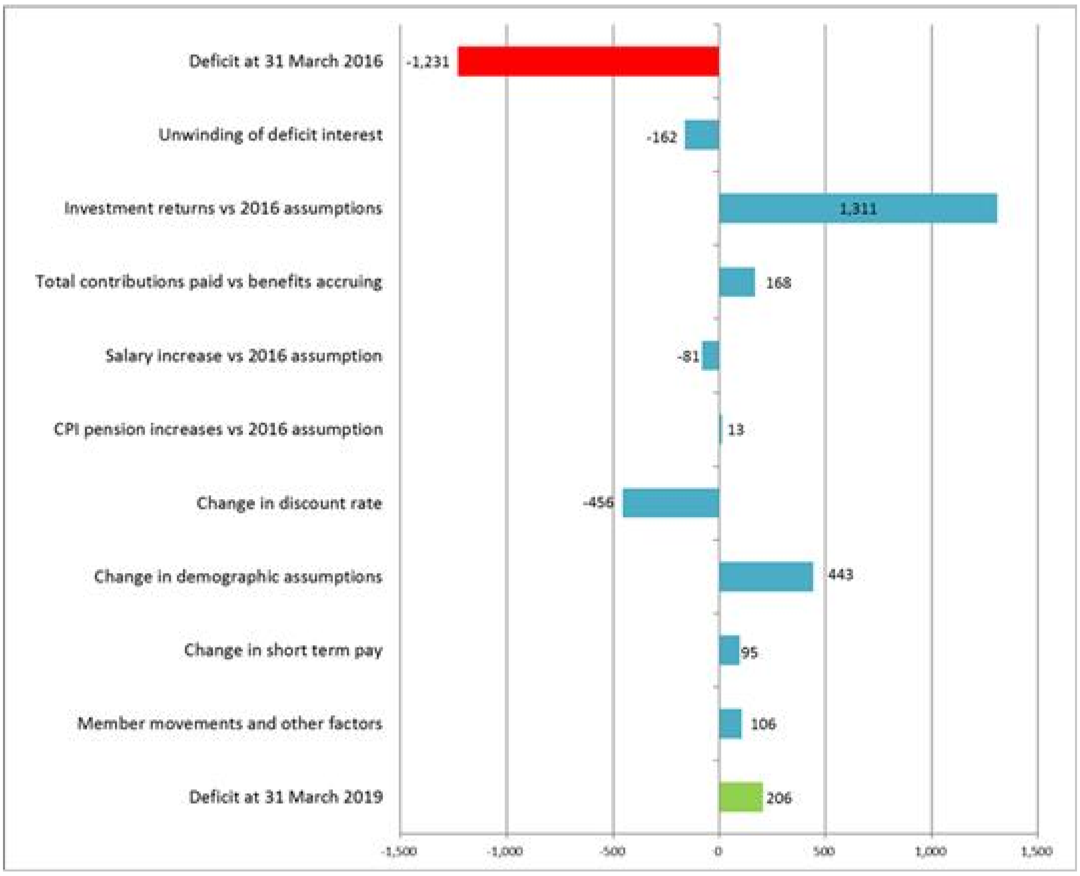
2.2 The whole Fund preliminary valuation results based on the assumptions set out within the draft FSS are set out below, alongside the final results from 2016 valuation for comparison purposes:

	2016	2019
MARKET VALUE OF ASSETS	£6,850m	£8,883m
TOTAL ACCRUED LIABILITIES	£8,081m	£8,667m
(DEFICIT) / SURPLUS	(£1,231)m	£206m
FUNDING LEVEL	84.8%	102%
AVERAGE EMPLOYER FUTURE SERVICE CONTRIBUTION RATE	15.1% of pay	17.1% of pay

These results will be subject to change as the valuation is completed for each employer. In particular, any changes to the assumption for short term pay and the impact of some weaker covenant employers being assessed on the medium or lower risk bucket assumptions. The final results will be disclosed within the 2019 valuation report.

Analysis of the change in position during the inter-valuation period is set out below and provides a commentary on the principal factors that influenced the improvement in the funding position:

Analysis of Change Since 2016



a) **Positive investment returns** – The total investment return for the Fund was c32% for the three-year period to 31 March 2019. This was significantly higher than the expected return based on the assumptions adopted at 2016 (expected return of c13% for the 3 years to 2019) and so resulted in a gain of £1,311m for the Fund.

b) **Contributions paid –** The total contributions paid into the Fund were higher than the cost of the benefits that were accrued by members, this therefore improved the funding position by £168m.

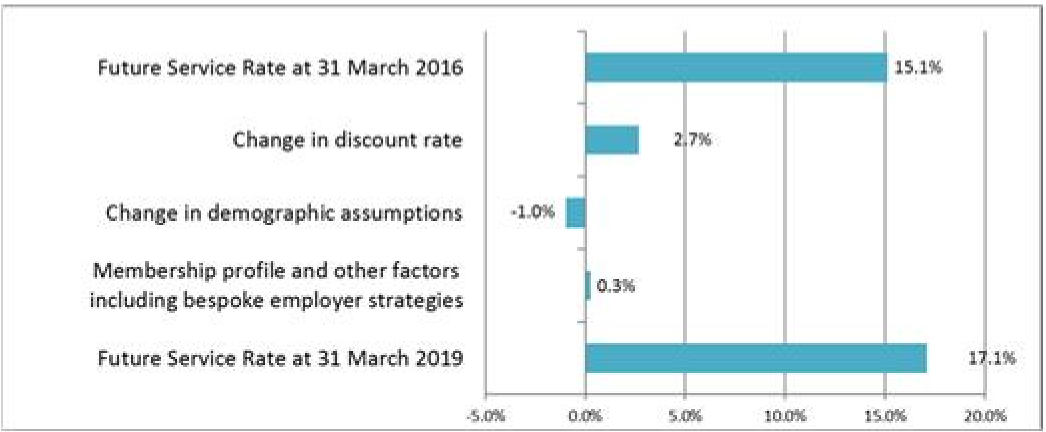
c) **Change in discount rate** – The Actuary performed expected return analysis in order to determine the appropriate discount rate that should apply to the 2019 valuation. The discount rate is expressed as the "real" expected asset return above CPI. Due to the strong investment returns in recent years, the outlook is lower for returns in the future and therefore a lower "real" past service discount rate was adopted for the calculations (reducing from CPI plus 2% at 2016 to CPI plus 1.75% at 2019). This therefore increases the value of the liabilities and worsens the funding position by £456m.

d) **Change in demographic assumptions** – The Actuary performed a review of the demographic assumptions as part of the 2019 valuation, based analysis of the Fund's membership. The outcome was that there had been a slowdown in the expected rate of improvement in life expectancy and so a revision to the life expectancy assumption was required. For example, the valuation assumes that a male aged 45 now will live to 87.4 compared to 89.8 in 2016. This change in assumptions has improved the funding position by £443m which has largely offset the impact of the change in the discount rate.

e) **Member movements and other factors** – As well as membership changes over the 3 years, this item also includes the impact of the data quality project that the Fund has put significant resource into since 2016 (in order to improve the accuracy of the results for employers and to abide by tPR's data quality requirements), overall these have improved the funding position by £106m.

Future Service Contributions

2.3 The whole Fund future service contribution rate has increased at this valuation from 15.1% to 17.1% of pensionable pay. The material factors which result in the rising costs of future accrual are set out below with commentary:



a) **Change in discount rate** – As detailed above, the Actuary performed expected return analysis in order to determine the appropriate discount rate. Due to the strong investment returns in recent years, the outlook is lower for returns in the future. A lower "real" future service discount rate was adopted for the 2019 valuation (reducing from CPI plus 2.75% at 2016 to CPI plus 2.25% at 2019). As future service contributions relate to active members who will be in the Fund in the medium/long term (and hence their contributions invested over a longer period), the future service discount rate has reduced by more than the past service discount rate. The reduction in the "real" discount rate has increased the future service rate by 2.7% of pay.

b) **Change in demographic assumptions** – As set out above, the Actuary performed a review of the demographic assumptions which has led to an update to the life expectancy assumption. As members are not expected to live as long as anticipated at 2016, this has led to a reduction in the future service rate of 1% of pay which has partially offset the impact of the change in discount rate.

<u>Valuation Assumptions</u>

2.4 The main financial assumptions adopted are as follows:

	Past Service % pa	Future Service % pa
Investment return (pre & post retirement)	4.15	4.65
Salary inflation	3.9	3.9
Pension increases	2.4	2.4

Demographic Assumptions Update

2.5 There have been changes made to the non–financial assumptions adopted in the previous valuation. As referred to above, Mercer 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:

Analysis	Effect on Deficit (Whole Fund)	Effect on Future Service Rate (Whole Fund)	Comment in relation to Fund
Life Expectancy			Updated to reflect results of the latest life expectancy analysis for the Fund. Termination life expectancy higher.
Ill-Health Retirement			General increase in numbers observed across LGPS. MPF at the higher end of observed trend. Maintain assumption.
Withdrawal			No material change so maintain assumption
Commutation			Slight trend upwards in terms of commutation but maintain assumption.
Proportions Married / Dependants			No material change so maintain assumption.

As shown above, the outcome was that there had been a slowdown in the expected rate of improvement in life expectancy and so a revision to the life expectancy assumption was required. The remaining assumptions had not changed materially and so they have not been updated from the 2016 valuation assumption.

Resultant Contributions

2.6 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 or surplus offsets both expressed as £ amounts to arrive at the rate each employer is required to pay to attain the funding target

2.7 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 in regard to the amount of deficit contributions payable and surplus offsets to future service contributions.

2.8 The notional recovery period used for the Fund as a whole is 3 years shorter than the period from the previous valuation, in order to meet the key objectives of maintaining solvency and long term cost efficiency. For the majority of the statutory employers, the recovery period has fallen from 19 years to 16 years. Subject to affordability and other considerations individual employer specific deficit recovery periods also apply and a 3-year reduction has also been applied. Where employers are in surplus at the valuation date consistent principles will apply. Taking account of all the employer specific factors, the implied average period across the Fund is 13 years.

2.9 All individual employer results were provided to employers in November setting out their initial valuation results and the potential impact that the McCloud case could have on their results. Employers must notify the Fund if they intend to include/exclude the McCloud allowance within their contributions. Where employers do not respond to the Fund, the default will be that the McCloud contributions will be included.

2.10 Throughout the valuation process, the Fund has engaged with the Merseyside Finance Directors on the key assumptions and policies to ensure full transparency in the process. During November, the Fund held a number of meetings with employers to discuss their results which included one-to-one sessions with the Fund Actuary with the focus on contribution requirements and affordability. Employers have been informed that the results are subject to consideration of their covenant and that meetings may take place once their covenant has been reviewed (where necessary).

2.11 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.

2.12 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 2020.

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 2019 Triennial Valuation, in order to secure the long-term solvency of the Scheme.

3.2 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 None associated with the subject matter

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

8.1 In discussions with the major councils, the 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 has been a significant consideration.

8.2 Consequently Fund officers have explored various funding models and risk reduction strategies 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 2022.

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 2020 – 31 March 2023.

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.

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BRIEFING NOTES HISTORY

Briefing Note	Date
Interim Valuation 2018	**29 OCTOBER 2018**