Committee	Dated:
Finance Committee	15 December 2015
Subject: The Pension Fund Deficit	**Public**
Report of: The Chamberlain	**For Information**

Summary

At the Court of Common Council meeting on 15 October 2015, questions were raised regarding the pension fund deficit and the Chairman of the Finance Committee undertook to provide a report to the Court.

This report briefly advises Members on the two types of valuation – actuarial and accounting – that the Pension Fund is subject to.

The level of the deficit depends on how assets and particularly liabilities are valued. The valuation used to make decisions over the fund is the actuarial valuation.

The actuarial valuation is undertaken triennially. The last valuation was as at 31 March 2013 and the overall funding level for the pension fund was 85% with a deficit recovery period of 20 years. This compares favourably to the average funding level of 80% for all Local Government Pension Schemes for 2013. The average recovery period was similar to the City's.

In addition to the triennial valuation, the City receives an annual funding valuation and as at the 31 March 2015 the overall funding level had increased to 88.5% and was marginally ahead of the 20 year deficit recovery period funding plan.

As the overall funding rate has increased to 88.5% and we are marginally ahead of the 20 year deficit recovery period funding plan, there are no issues of concern to highlight to Members.

Recommendation

Members are asked to note the report.

Main Report

Background

1. At the Court of Common Council meeting on 15 October 2015, questions were raised regarding the pension fund deficit and the Chairman of the Finance Committee undertook to provide a report to the Court.

2. The Local Government Pension Scheme (LGPS) is a statutory pension scheme and is the largest public sector pension scheme in the UK. It is a nationwide pension scheme for people working in local government or other types of employer participating in the scheme. The LGPS in England and Wales is administered locally through 89 local pension funds including the City of London.

3. The LGPS is a statutory funded pension scheme that provides salary-related defined benefits which are not dependent on investment performance. The scheme regulations were made under the Superannuation Act 1972. Changes to scheme rules are discussed at national level by employee and employer representatives, but can only be amended with the approval of Parliament.

4. The LGPS is a registered public service pension scheme under Chapter 2 of Part 4 of the Finance Act 2004. It has achieved automatic registration by virtue of Part 1 of Schedule 36 of that Act because the LGPS was, immediately before 6 April 2006, both a retirement benefits scheme approved under Chapter I of Part XIV of the Income and Corporation Taxes Act 1988 and a relevant statutory scheme under section 611A of that Act.

5. The LGPS is contracted out of the State Second Pension (S2P) because it provides benefits that are as good as most members would receive if they had been in S2P. It meets the Government's new standards under the automatic enrolment provisions of the Pensions Act 2008.

6. In March 2011, Lord Hutton published the independent Public Service Pensions Commission final Report to the Government recommending future changes to public sector pensions. The Report had been commissioned by the Chancellor to review the structure of public service pension provision. The Government had already confirmed its commitment to maintaining some form of defined benefit pension for public service employees. However the Commission were asked to make recommendations on how public service pensions can be made sustainable and affordable in the long term, fair to the public workforce, employers and taxpayers and ensure they are consistent with the economic challenges ahead whilst protecting existing pension rights.

7. Since the Report was published there have been a number of changes to the LGPS including:

   - Increasing pension ages in line with state pensions.
   - Moving from a final salary scheme to a career average. Up until 31 March 2014 the LGPS was a final salary scheme. From 1 April 2014 the scheme has been based on career average, although benefits based on service to 2014 will still be based on final pay.

   Prior to this, since 2008 the employee contribution has been determined by how much an employee is paid. There are 9 different pay bands with contributions rates ranging from 5.5% to 12.5% of pensionable pay. These contribution rates are set by the Government and are reviewed periodically. Prior to 2008, the employee contribution rate was 6% regardless of earnings.

8. To ensure the long term sustainability of the LGPS it is subject to a new cost management process which will monitor the long term cost of the scheme to ensure it stays within agreed parameters as set by the LGPS Advisory Board and HM Treasury. Under this process extra valuations will be carried out at a national level every three years from 31/03/2016. Should costs increase outside those parameters future changes to the scheme may be required – either less generous benefits or higher employee contributions or a mixture of both.

Valuations

9. How large are the liabilities? The Pension Fund is subject to two types of valuation – an actuarial (funding) valuation and an accounting valuation (IAS26 valuation) which are two different measurers of the same liabilities. The difference between the two valuations comes mainly from the financial assumptions adopted to value the liabilities.

Actuarial (Funding Valuation)

10. An actuarial valuation is undertaken every three years by an independent actuary. The purpose of the actuarial valuation is to review the financial position of the Pension Fund and to set the level of future contributions required from each employer so that the assets will be sufficient to meet future pension payments. The assumptions used in the valuation are set by the Actuary following discussions with the City as administering authority and in line with the LGPS Regulations and will include:

    - Future levels of price inflation
    - Pay increases
    - Retirement age and longevity
    - Expected returns on investments (which then is reflected in the discount rate applied to liabilities)

11. The last actuarial valuation was undertaken as at 31 March 2013 and the results were reported to the Finance Committee at its meeting on 21 January 2014. At that time the overall funding level was 85% and Members agreed that the deficit recovery period should be maintained at 20 years from 2014/15 and employers' overall contribution rate should be maintained at 17.5% for the financial years 2014/15 to 2016/17.The next triennial valuation will be undertaken as at 31 March 2016 with any revised employer contributions coming into force on 1 April 2017. The average published funding level for all LPGS's at the 2013 valuations was 80% and the average recovery period was not dissimilar to that adopted by the City.

12. In addition to the triennial actuarial valuation, the Financial Investment Board (which oversees the appointment of and monitoring of investment managers to the Pension Fund) receives on an annual basis a funding update. The last funding update which was as at 31 March 2015 indicated that the overall funding level had increased to 88.5% and that it was marginally ahead of the 20 year deficit recovery period funding plan.

13. For funding valuations the discount rate to be applied to the liabilities is based on the expected investment return of the assets actually held by the Fund and reflects the long term investment return that the Pension Fund can hope to achieve.

Accounting Valuation

14. The purpose of the accounting valuation is to meet statutory disclosure requirements where the assets and liabilities are measured using a method and assumptions which meet the prescriptive requirements of International Accounting Standard (IAS) 26. IAS26 is the accounting valuation for the Pension Fund as a whole whilst IAS 19 is an accounting valuation for each employer within the Pension Fund and is undertaken using the same methodology as IAS 26. The accounting standards require organisations to recognise liabilities for pension benefits as they are earned even if the payment of such benefits will be many years into the future. Compliance with the standards allows employer's pension obligations to be compared with each other on a consistent basis. Accounting deficits are usually larger than funding deficits and are more volatile because the prescribed discount rate applied to the liabilities assumes that all the assets are corporate bonds. Unlike the actuarial valuation, the discount rate does not take account of expected returns from the actual investment strategy.

15. The table below sets out the funding and accounting valuations as at 31 March 2013 (the last triennial valuation) and 31 March 2015 for the Pension Fund whilst the final column sets out the accounting valuation for the City of London Corporation only (i.e. excluding the Museum of London and the other admitted bodies).

As at 31/03/2013	**Funding – Pension Fund**	**Accounting – Pension Fund (IAS 26)**	**Accounting – City of London (IAS 19)**
Value of Assets	£702M (smoothed market value)	£709M	£647M
Value of Liabilities	£830M	£1,073M	£989M
Deficit	£128M	£364M	£342M

As at 31/03/2015	**Funding – Pension Fund**	**Accounting – Pension Fund**	**Accounting – City of London**
Value of Assets	£819M (smoothed market value)	£816M	£752M
Value of Liabilities	£926M	£1,352M	£1,250M
Deficit	£107M	£536M	£498M

16. Members should note that:

- Whilst the values of assets are broadly similar, the values of liabilities vary significantly due to the difference in the calculation of the discount rates as outlined in paragraphs 13 and 14.
- For every 0.1% increase/decrease in the corporate bond rate, the deficit decreases/increases by around £22M.
- The key deficit figure is the funding deficit as this is the deficit that the employer contributions are targeted to fund over the next 20 years or so. As the funding deficit is based on the expected returns from our investment portfolio, it is the most accurate estimate we have.
- The accounting deficits – whether for the Pension Fund as a whole or for the Corporation – are only determined to meet accounting requirements and for comparison purposes in published accounts.
- The assumptions used in the actuarial calculations are challenged robustly by an informal Member and Officer Group.
- As the overall funding rate has increased to 88.5% and we are marginally ahead of the 20 year deficit recovery period funding plan, there are no issues of concern to highlight to Members.

Training

17. A Pension Deficit Seminar for Members was held on Friday 10th July and a further seminar has been arranged for Monday 11 January 2016 at 4pm. Members are advised to contact the Town Clerk's Department if they would like to attend.

Conclusion

18. The difference in the calculation of the discount rate causes significant variations in the valuation of liabilities. For a funding valuation, the calculation of the discount rate to be applied to the liabilities is based on the expected investment returns of assets held by the Fund, whereas for an accounting valuation, the discount rate assumes that all the assets are corporate bonds. The key deficit figure for decision making is the funding deficit of £107m, as this is the deficit that the employer contributions are targeted to fund over the next 20 years or so. As the overall funding rate has increased to 88.5% and we are marginally ahead of the 20 year deficit recovery period funding plan, there are no issues of concern to highlight to Members.

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