

## Report – Finance Committee

### City of London Corporation Pension Fund Deficit

*To be presented on Thursday, 14<sup>th</sup> January 2016*

*To the Right Honourable The Lord Mayor, Aldermen and Commons  
of the City of London in Common Council assembled.*

#### SUMMARY

At the Court of Common Council meeting on 15 October 2015, Honourable Members asked questions regarding the Pension Fund deficit. It was agreed that the Finance Committee would provide a report on this matter to the Court to clarify the position. This report provides that information. Honourable Members should also be aware that a briefing on the Pension Fund deficit has been scheduled through the Member Development Programme for 11 January 2015 at 4.00pm.

There are two types of valuation applied to the Pension Fund – the accounting valuation and the actuarial valuation. This can cause significant confusion regarding the level of the deficit as multiple figures are given, depending on which valuation method and date are used.

At Court of Common Council in October, Members cited a Pensions deficit of c. £497m. This figure referred to the accounting valuation of the fund, which is calculated only in order to comply with International Accounting Standards. The valuation which is used to make decisions about the fund is the actuarial valuation. The most recent estimate (31 March 2015) of the actuarial valuation of the Pension Fund is a deficit £107m, meaning the Pension Fund is 88.5% funded. This is a better position than the average for Local Government Pension Schemes, which, as at the most recent available figures, average 80% funded. Therefore, there are no specific concerns to highlight to Members.

#### RECOMMENDATION

It is **recommended** that the Court receives this report for information.

#### MAIN REPORT

##### Background

1. Honourable Members will recall that at the Court of Common Council meeting on 15 October 2015, Common Councilmen asked questions regarding the Pension Fund deficit. It was agreed that the Finance Committee would provide a report on this matter to the Court to clarify the position. This report provides that information.
2. In addition to this report, it was agreed that a briefing would be arranged for Members on this matter to allow Members the opportunity to discuss the matter

in detail with Officers. This briefing has been scheduled for 11 January 2015 at 4.00pm, under the Member Development Programme.

3. 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. Changes to scheme rules are discussed at national level by employee and employer representatives, and can only be amended with the approval of Parliament.
4. It should be noted that the LGPS does not apply for City of London Police uniformed staff, but does apply for City of London Police civilian staff.
5. 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 Hutton 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.
6. Since the Hutton 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.
7. 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 March 2016. Should costs increase outside those parameters future changes to the scheme may be required – either less generous benefits, higher employee contributions, or a mixture of both.

### **Valuations**

8. The Pension Fund is subject to two types of valuation – an actuarial (funding) valuation and an accounting valuation (known as the 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 Valuation

9. An actuarial valuation is undertaken every three years by an independent actuary. This is the valuation method which is used to make decisions regarding the fund. 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 Corporation as the administering authority and in line with the LGPS Regulations. The assumptions are challenged robustly by an informal Member and Officer Group.
10. Assumptions are made in areas such as:
  - 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% (a deficit of £128m). 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' at the 2013 valuations was 80%.
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% (a deficit of £107m) and that it was marginally ahead of the 20 year deficit recovery period funding plan.

#### Accounting Valuation

13. The purpose of the accounting valuation is to meet statutory disclosure requirements and international accounting standards. They also allow employer's pensions obligations to be compared with other employers on a consistent basis.
14. The accounting valuation ensures that the assets and liabilities are measured using a method and assumptions which meet the prescriptive requirements of International Accounting Standards (IAS), specifically IAS26 and IAS19. IAS26 is the accounting valuation for the Pension Fund as a whole whilst IAS19 is an accounting valuation for each employer within the Pension Fund and is undertaken using the same methodology as IAS26. Therefore, for the City of

London Corporation IAS19 excludes admitted bodies to the Pension Scheme (such as the Museum of London).

15. 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. 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.

Comparison of valuation techniques

16. The table below provides the Court with a direct comparison of the funding positions of the Pensions Fund based on the various valuation methods and dates referred to above.

<b>As at 31/03/2013</b>	<b>Funding (Actuarial) – Pension Fund</b>	<b>Accounting – Pension Fund (IAS26)</b>	<b>Accounting – Corporation only (IAS19)</b>
Value of Assets	£702M (smoothed market value)	£709M	£647M
Value of Liabilities	£830M	£1,073M	£989M
Deficit	£128M	£364M	£342M

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

17. The table above demonstrates that since 31 March 2013, the value of assets across all three valuation techniques has increased on broadly the same scale (16.7% in the actuarial valuation, 15.1% for the IAS26 valuation and 16.2% for the IAS19 valuation). However, the table above also demonstrates that the valuation techniques cause a significant variation in the value of liabilities (15.7% increase for actuarial valuation, 26% for IAS26 valuation, 26.4% for IAS19 valuation). This is because the actuarial valuation calculates liabilities based on the expected return on investment of the assets held by the fund, while IAS requires that the accounting valuation assumes that all assets are corporate bonds.
18. Therefore, the key deficit figure is the actuarial funding deficit, as this is the deficit which the employer contributions are targeted to fund over the next 20 years or so. As the actuarial funding deficit is based on the expected returns from our investment portfolio it is the most accurate estimate we have.

19. The accounting deficits – whether for the Pension Fund as a whole or for the Corporation – are determined solely to meet accounting requirements and for comparison purposes in published accounts.

**Conclusion**

20. The different valuation calculations create the potential to cause significant confusion, particularly when the accounting valuation indicates a pensions deficit of over £500m. This report should provide the Court with clarity regarding the actual level of the deficit and should reassure the Court that the Corporation's pensions deficit, using the actuarial valuation, is in a better situation than the average member of the LGPS.

All of which we submit to the judgement of this Honourable Court.

DATED this 15<sup>th</sup> day of December 2015.

SIGNED on behalf of the Committee.

**Roger Arthur Holden Chadwick**  
Chairman, Finance Committee