Committee:	Date:
Finance Committee	31 January 2017
Subject: Pension Fund – Actuarial Valuation as at 31 March 2016	**Public**
Report of: The Chamberlain	**For Decision**
Report author: Kate Limna – Chamberlain's Department	

Summary

Administering Authorities of the Local Government Pension Scheme (LGPS) are required to arrange triennial valuations of the Pension Fund in order to establish appropriate employer contribution rates for the following three year period (i.e. from 1 April 2017 to 31 March 2020). The preliminary results of the Pension Fund Actuarial Valuation as at 31 March 2016, undertaken by the Fund's Actuary, Barnett Waddingham LLP, have now been received and are appended (Appendix 1).

Following the adoption of more prudent assumptions, the overall funding level of the Pension Fund has decreased from 85% as at 31 March 2013 to 84% as at 31 March 2016 and the deficit has increased from £128m to £150m.

Three years ago we established a 20 year deficit recovery plan. In order to maintain progress against the deficit funding plan across the remaining 17 years, the employers' contribution rate will need to increase from 17.5% to 21% for the City of London and the admitted and scheduled bodies. Contribution rates for the Museum of London will also increase but by a different amount whilst the City Academy will continue to pay the same rate as previous years.

The Government Actuary's Department will be scrutinising the assumptions used by LGPS actuaries to ensure that employers are taking a sufficiently prudent approach to financing LGPS benefits and results will be published.

Recommendations

Members are asked to agree that:

a) The Pension Fund deficit recovery period is set at 17 years from 2017/18 and:
b) The employers' overall contribution rate be increased to 21% for the financial years 2017/18, 2018/19 and 2019/20.

Main Report

Background

1. Under Regulation 62 of the Local Government Pension Scheme Regulations 2013 (the Regulations), Administering Authorities are required to arrange triennial valuations of the Pension Fund in order to establish appropriate employer contribution rates for the following three year period i.e. from 1 April 2017 to 31 March 2020. The contribution arrangements certified by the Actuary following the valuation must be set to ensure solvency of the Fund and the long term cost

efficiency of the Scheme – i.e. to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the Pension Fund and that contribution rates are set at an appropriate level.

2. The purpose of this report is to advise members of the outcome of the 2016 Pension Fund valuation undertaken by Barnett Waddingham LLP and the consequent impact on the employers' contribution rates for the three years commencing 1 April 2017.

3. The summary report is appended and it will be noted that a full report will follow by the end of the financial year.

Previous Valuation

4. The last formal actuarial valuation of the Fund was carried out as at 31 March 2013.

5. The results of that formal valuation indicated that the assets of the Fund represented 85% of the accrued liabilities as at 31 March 2013 and the total required contribution rate for the period 1 April 2014 to 31 March 2017 was certified as 17.0% of payroll. This average employer contribution rate assumed that the past service funding level would be restored to 100% over a period of 20 years. The rate certified for the Corporation was 17.5% of pay.

Local Government Pension Scheme

6. The Local Government Pension Scheme (LGPS) is a statutory pension scheme. This means that it is very secure as its benefits are defined and set out in Law. In brief the LGPS:
   - provides defined benefits not dependent upon investment performance – ultimately the local authority and local tax payers are the final guarantors
   - is regulated by Parliament and is administered through 89 regional pension funds in England and Wales
   - covers 5 million members nationally.

7. The City of London Pension Fund (the Pension Fund) is part of the LGPS. The Pension Fund is administered in-house by the City of London Corporation on behalf of the participating employers. At the end of March 2016 the Pension Fund had eleven active employers the largest of which is the City of London, followed by the Museum of London. Teachers, judges and police officers have their own pension scheme and are not included in the Pension Fund.

Valuation Process and Assumptions

8. The Regulations for actuarial valuations have changed since the 2013 valuation as has the context surrounding the valuation. Regulation 62 specifies four requirements that the actuary "must have regard to" as follows:
   - The desirability of maintaining as nearly constant a primary rate as possible
   - The current version of the administering authority's funding strategy statement
   - The requirement to secure the solvency of the pension fund and

- The long term cost efficiency of the Scheme (i.e. the LGPS for England and Wales as a whole, so far as relating to the pension fund.

9. Under Section 13 of the Public Service Pensions Act 2013, the Government Actuary's Department (GAD) on behalf of the Department for Communities and Local Government will be scrutinising the assumptions used by LGPS actuaries to ensure that employers are taking a sufficiently prudent approach to financing the LGPS benefits and they will be publishing a report to identify any Pension Funds that cause concerns in respect of solvency and long term cost efficiency: GAD's report is not expected to be published until late 2018 as it is based on the final certified contribution rates.

10. For the purposes of this valuation the actuary has, as in the past, adopted an approach which separately considers the benefits in respect of service completed before the valuation date (past service) and benefits in respect of service expected after the valuation date (future service). This approach enables the actuary to focus on:
    - the past service funding level of the Pension Fund, which is the ratio of accumulated assets to liabilities in respect of past service after making allowance for future increases to members' pay and pensions in payments. A funding level in excess of 100% indicates a surplus whilst one of less than 100% indicates a deficit; and
    - the future service funding rate i.e. the level of contributions required from the employing bodies to support the cost of benefits building up in future.

11. The method adopted in the valuation is known as the "Projected Unit Method". The key feature of this method is that in assessing the future cost the actuary calculates the contribution rate which meets the cost of one year of benefit accrued. This is the same method adopted at the previous valuation and is an appropriate method for a Pension Fund which is open to new members.

Funding Model

12. A very similar funding model (the approach used to derive the assumptions) to that used in previous years has been used for the 2016 valuation. The key features are as follows:
    - Future levels of price inflation are based and derived by considering the difference between index-linked gilts and fixed interest gilt yields over the 6 month period straddling the valuation date;
    - Pay increases are assumed to modestly exceed future price inflation;
    - The discount rate used to discount future payments to and from the Pension Fund and so determine the value placed on the liabilities reflects a prudent view of the expected net return that will be earned by the actual investment strategy adopted by the Pension Fund; and
    - Rather than take the market value of the assets at the valuation date, the actuary has used a figure based on the average market values over the 6 month period straddling the valuation date.

13. The slight change at this valuation is that the discount rate has been derived as the "best estimate" of future returns less an explicit prudence allowance. At

previous valuations the discount rate was a prudent view of future returns with an implicit allowance for prudence. This more prudent calculation has led to an increase in liabilities.

Review of Initial Assumptions

14. Members (Clare James, Randall Anderson and Paul Martinelli) and Officers (the Chamberlain, the Deputy Chamberlain and the Corporate Treasurer) have reviewed and challenged the assumptions used by the actuary and some minor adjustments have been made.

Current Pension Fund Position

15. The deficit recovery plan at the last revaluation was set at 20 years. However the overall funding level of the Pension Fund has decreased from 85% as at 31 March 2013 to 84% as at 31 March 2016 and the deficit has increased from £128m to £150m.

16. In order to maintain the deficit recovery plan which should now be at 17 years officers have looked at a number of options including increasing the employers contribution from 17.5% to 21% i.e. an increase of 3.5% and making a lump sum contribution. An increase in the employers' contribution rate would apply to the City of London and the admitted and scheduled bodies. Contribution rates for the Museum of London and the City Academy will also increase but by different amounts. To make a lump sum contribution to the pension fund would require £64m - requiring use of reserves across City Fund, City's Cash and Bridge House Estates. However this action being after the valuation event, would not improve the deficit or the funding level being considered by GAD and this course of action has therefore been discounted.

17. An increase of 3.5% per annum in employers contribution equates to approximately £4.3M (based on 2016/17 estimates) and is included in the medium term financial plan being considered at the Joint Meeting of Resource Allocation Sub Committee and Committee Chairman on 19 January 2017.

Conclusion

18. The overall funding level of the Pension Fund has decreased from 85% as at 31 March 2013 to 84% as at 31 March 2016 and the deficit has increased from £128m to £150m. In order to maintain the funding deficit of 17 years the employers' contribution rate will need to increase from 17.5% to 21% for the City of London and the admitted and scheduled bodies. Contribution rates for the Museum of London will also increase but by a different amount whilst the City Academy will continue to pay the same rate as previous years.

Appendices
Appendix 1 – Summary Report – Actuarial Valuation as at 31 March 2016

Caroline Al-Beyerty, Deputy Chamberlain
T: 020 7332 1164, E: caroline.al-beyerty@cityoflondon.gov.uk

Kate Limna, Corporate Treasurer
T: 020 7332 3952, E: Kate.limna@cityoflondon.gov.uk