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<tr><td>TITLE:</td><td colspan="2">ACTUARIAL VALUATION 2010</td></tr>
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1 THE ISSUE

1.1 The actuary has calculated the contribution rates effective 1 April 2011 for the majority of the employing bodies within the Fund. Those outstanding are for bodies where special circumstances apply.

1.2 In due course (before 31 March 2011) the actuary will prepare the actuarial valuation report which will be circulated to all employing bodies. In the meantime, the employing bodies have been notified of their revised rates.

1.3 The aim of the 2010 valuation was to maintain stable employer contribution rates where possible, and the Funding Strategy Statement (FSS), which was approved by the Committee in September 2010, set out the parameters as to how this objective would be met.

1.4 By utilising the flexibility allowed within the FSS, the outcome has been that employer contribution rates have remained relatively stable and it is anticipated that this puts the Fund in a good position to maintain stability of rates in the future.

1.5 This report examines the outcome of the valuation process for the whole fund and highlights the principal changes which have occurred since the 2007 valuation (see section 5).

2 RECOMMENDATION

2.1 **That the Committee notes the outcome of the 2010 Actuarial Valuation.**

3 FINANCIAL IMPLICATIONS

3.1 The budget provides for the actuarial costs of the triennial valuation.

4 BACKGROUND

4.1 The Local Government Pension Scheme (LGPS) Regulations require LGPS funds to have an actuarial valuation every three years. The 2010 valuation has a base date of 31 March 2010 with new employer rates effective from 1 April 2011.

4.2 This valuation is taking place amid significant cost pressures within the public sector. In addition The Hutton Commission is reviewing the provision of public service pensions which could result in significant changes to the scheme structure in the future; however, the timing of any implementation is as yet uncertain.

4.3 Therefore the actuary has structured the valuation having regard to the FSS, the budgetary pressures facing all scheme employers and the potential for future changes in the scheme to generate savings in the medium term.

5 ACTUARIAL VALUATION OUTCOME

5.1 The aim of the 2010 valuation is to maintain stable contribution rates where possible. The Fund monitors its funding level during the intervaluation period and at 31 March 2010 the funding level, after updating the 2007 valuation for market changes, had deteriorated to an estimated 73%. However, the government's decision in June 2010 to index pension increases to CPI rather than RPI (effective from April 2011) had a significant impact on the liabilities. Therefore the basis for the 2010 valuation was not as bad as was initially expected.

5.2 The key initial outcomes of the valuation are as follows:

	2010	2007	Change
Deficit	£552m	£459m	+24%
Funding Level	82%	83%	-1%
Value of assets	£2,459m	2184	+13%
Value of Liabilities	£3,011m	2643	+15%
Average employers contribution rate	**17.2%**	**16.6%**	**+0.6%**
Average future service rate	11.8%	11.7%	+0.1%
Average past service rate	5.4%	4.9%	+0.5%
Past service recovery period (years)	20	20	

5.3 If the deficit recovery period was held at 20 years then the average employers' contribution rate would have increased by 0.6%. However, the 2010 FSS, which sets out the plan for meeting all liabilities and recovering the deficit, allows where possible, an extension in the deficit recovery period which enables employer contribution rates to remain as stable as possible. The FSS also stated that any future cost savings that fall to the employer as a result of changes to the scheme must initially be used to bring the recovery period back to the 2007 position. **At the overall Fund level, the deficit recovery period consistent with an average employer contribution rate of 16.6% is c. 22 years.**

5.4 The main drivers of the valuation outcome are:

Assets

The investment return over the 3 years to 31 March 2010 was 3.2% per annum compared to an expected return in the 2007 valuation of 6.5% p.a.. This shortfall in investment returns increased the deficit by c. £303m.

Liabilities -

(i) RPI / CPI change

Indexing pensions to CPI rather than RPI reduced projected inflation by 0.5% which reduced liabilities by c. £161m.

(ii) Change in real yields

Real yields, derived from the market are used for the discount rate. Compared to 2007 the nominal yield on UK gilts has remained stable at 4.5% (it was 4.4% at 31 March 2007). However, index linked yields have fallen significantly from 1.3% to 0.7%. The result is that the implied inflation rate (the difference between index linked and gilt yields), used to discount the future value of the liabilities, has risen from 3.1% to 3.8%. However, this implied inflation rate is affected by distortions in the index linked market as there is a demand/supply imbalance in the market due to pension funds and other long term investors seeking to match their inflation related liabilities. As a result, there is an argument that the market derived inflation rate overstates long term inflation and the actuary introduced an Inflation Risk Premium (IRP) of 0.3% to reflect this distortion.

Overall the reduction in real yields, including the IRP adjustment, increased liabilities by c. £97m.

(iii) Longevity

The actuary analysed the life expectancy experienced by the Fund and also used other LGPS fund data and the Continuous Mortality Index data to assess the adequacy of the 2007 longevity assumptions as life expectancy continues to improve. For example, in 2007 the average life expectancy of a male aged 65 was 21.2 years; this has increased to 22.0 years in 2010. In 2007 for a male aged 45 then, the average life expectancy at age 65 was 22.2 years; in 2010 this has increased to 23.4 years for a male aged 45 now.

The longevity assumption is made up of two elements, the current life expectancy (or baseline assumption) and an assumption of future improvement (or deterioration) around the baseline assumption. The baseline life expectancy is based on the Fund's actual mortality experience and the improvement assumption is based on the trend experience over the last ten years of a reduction in death rates of 3-4% p.a.. The actuary also compared the Fund's mortality experience to other LGPS funds and industry wide data. This showed a similar experience which gives greater assurance that the Fund's experience is not out of line with the general trend in life expectancy.

In the absence of any outside influence (including affordability) the Actuary's preferred long term improvement rate should be 1.5% p.a. given the Fund's observed trends (in line with the Continuous Mortality Investigation model of mortality; 1.5% p.a. refers to the death rate, i.e. death rates will reduce by 1.5% p.a.). However, once the final results were assessed and affordability was taken into account, it was recognised that stability of rates would be difficult to achieve if the full improvement rate was incorporated. Given this, the actuary advised that the 1.5% improvement rate should only be applied to past liabilities which should provide greater stability given actual observed trends over time. It is also expected that changes to the scheme structure will more equitably share future increases in longevity costs between employers and employees.

As a result, the increase in life expectancy has added £113m to the liabilities.

(iv) Other demographic factors

Other demographic factors (such as ill health retirement and proportions married) were analysed and the actuarial assumption was altered to reflect the Fund's experience. This led to a reduction in liabilities of c. £81m as the 2007 assumptions overstated the cost of these factors to the Fund.

6 COMMUNICATION WITH EMPLOYING BODIES

6.1 The 2010 actuarial report will be published by 31 March 2011. In the meantime, the employing bodies have been notified of their revised rates and officers are holding meetings with employers where required.

7 ACTUARIAL VALUATION UPDATE

7.1 Since 31 March 2010 the funding level is estimated to have fallen to around 78% adopting consistent assumptions with the 2010 valuation. The impact of the change in real yields (the main driver for liabilities as demographic assumptions are unchanged) in isolation is to increase liabilities by around £100m which more than offsets the rise in asset values of c.2% over the same period.

7.2 The table below shows the change in the financial assumptions:

	31 March 2010	31 September 2010
UK Gilt yield	4.5%	3.9%
Index linked real yield	0.7%	0.5%
Inflation adjustment	0.8%	0.8%
Implied CPI inflation	3.0%	2.6%

8 HUTTON COMMISSION

8.1 This will be discussed elsewhere on the Committee agenda. The Fund as administering authority is preparing its response to the final “Call for Evidence” from the Commission and will circulate this to Committee members for comments prior to submission. All employing bodies have been alerted to the Commission’s latest “call for Evidence” exercise.

9 RISK MANAGEMENT

9.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. In addition it monitors the benefits administration, the risk register and compliance with relevant investment, finance and administration regulations. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

10 EQUALITIES

10.1 An equalities impact assessment is not necessary as report for information only.

11 CONSULTATION

11.1 N/a

12 ISSUES TO CONSIDER IN REACHING THE DECISION

12.1 Report is for information only.

13 ADVICE SOUGHT

13.1 The Council's Monitoring Officer and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Feinstein, Investments Manager 01225 395306
Background papers	Mercers 2010 valuation papers