Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**24 MARCH 2017**	**AGENDA ITEM NUMBER** **10**
TITLE:	**ACTUARIAL VALUATION 2016 AND EMPLOYER UPDATE**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Covenant Assessment Example Exempt Appendix 2 – Community Admission Bodies Summary		

1 THE ISSUE

1.1 The Local Government Pension Scheme (LGPS) Regulations require LGPS funds to have an actuarial valuation every three years. The 2016 valuation has a base date of 31 March 2016 with new employer contribution requirements becoming effective from 1 April 2017.

1.2 The Actuary has calculated the contribution rates effective 1 April 2017 for the employing bodies within the Fund. In calculating the contribution rates and deficit recovery payments, the Actuary has taken the Funding Strategy Statement (FSS) into account.

1.3 The Actuary will finalise the actuarial valuation report before 31 March 2017 which will be circulated to all employing bodies. In the meantime, the employing bodies have been notified of their revised contribution requirements for the period 1 April 2017 to 31 March 2020.

1.4 This report examines the outcome of the valuation process for the whole fund and highlights the principal changes which have occurred since the 2013 valuation.

1.5 There are a significant number of Admission Bodies in the Fund. Given the significant pressure on their financial position, these bodies, though small in number and in monetary terms, pose a risk to the Fund in terms of recovering the pension liabilities. This report updates the Committee on the Admission Bodies currently in the Fund.

1.6 The Actuary will answer questions on the valuation outcome at the Committee meeting.

2 RECOMMENDATION

The Committee notes:

2.1 The outcome of the 2016 actuarial valuation exercise.

2.2 The actions taken to monitor and mitigate employer risk

3 FINANCIAL IMPLICATIONS

3.1 The actuarial valuation assesses the funding position of the Fund as a whole, for the individual employers and sets the contribution rates due from all employers for the 3 years commencing 1 April 2017. The costs for completing the valuation are provided for in the 2016/17 budget.

4 BACKGROUND AND VALUATION APPROACH

4.1 The long-term funding objective is to achieve a 100% solvency over a reasonable length of time, and then maintain that position. Alongside this overarching objective, the 2016 valuation sought to maintain stable employer contribution rates where possible, and the FSS, which was approved by the Committee in September 2016, set out the parameters as to how these aims would be met.

4.2 This valuation is taking place amid significant funding pressures within the public sector. By utilising the flexibility allowed within the FSS, deficit recovery payments have been kept relatively stable with payments being held in line with the 2013 payment plan where possible. The basis for calculating the future service rate has been adjusted to take account of current market conditions; this in isolation has led to an increase in the FSR for all employers.

4.3 However individual employer results vary significantly due to other non-financial factors such as changes in the membership profile and ill health experience Overall the Fund experienced lower than assumed ill-health retirements than in the 2013 valuation.

4.4 The actuary has applied the flexibility within the FSS to accommodate, as far as possible, the budgetary pressures facing all scheme employers while not compromising the long term solvency of the Fund. In particular, an allowance for short term pay increases of 1% p.a. for this valuation period was permitted for bodies with tax raising powers or a guarantee.

5 ACTUARIAL VALUATION 2016 OUTCOME

5.1 The current valuation has been taken as at 31 March 2016 and a summary of the valuation results is attached. The initial outcome of the valuation is as follows:

	2013	2016
Deficit	£876m	£597m
Funding Level	78%	86%
Value of assets	£3,146m	£3,737m
Value of Liabilities	£4,023m	£4,334m
Average employee contribution rate	6.3%	6.4%
Average future service rate (employer)	13.9%	15.3%
Annual past service deficit payments	£43m	£38m
Past service recovery period (years)	20	17

Note: The 2016 figures include allowance for short-term pay of 1% per annum for 4 years up to 2019/20 for all employers for ease of comparison. The final position will be based on the sum of the individual positions of each employer allowing for the actual pay increases built into their contribution plan.

5.2 The FSS provides a flexible framework such that affordability can be taken into account when setting contribution rates and deficit recovery payments. In this regard some employers have:

a. Phased in increases in deficit recovery payment increases over 3 years

b. Phased in increases in future service rates over a maximum of 3 years

c. Opted to pay their deficit contributions in advance in order to benefit from a monetary discount.

5.3 The average deficit recovery for the Fund has reduced from 20 years in 2013 to 17 years.

5.4 The main drivers of the valuation outcome are:

a. The investment return over the 3 years to 31 March 2016 was approximately 5.6% per annum compared to an expected return assumption made at the 2013 valuation of 4.8% p.a. This served to reduce the deficit by c. £86m.

b. The discount rate used to value the past service a liability is based on the expected return on the assets relative to CPI. At 31 March 2013 the equivalent annual discount rate relative to CPI was CPI +2.2% p.a. and this has been retained for the 2016 valuation.

c. The fall in long term interest rates has also affected the FSR. The Actuary uses a “smoothed” discount rate to value future accruals, in order to keep the FSR as stable as possible in line with the Regulations. This has been achieved over recent valuations and at 2013 a future service discount rate of CPI + 3% p.a. was adopted. However, the Actuary does not believe this reflects a sufficiently prudent investment return outlook for future service liabilities and thus the cost of on-going accrual. Therefore, the discount rate used to value future service at the 2016 valuation was reduced by 0.25% p.a. to CPI + 2.75% p.a. The FSR increased by 1.2% of pay per annum as a result of this update to the assumptions.

d. At each valuation the actuary uses an analysis of the life expectancy experienced by the Fund and other LGPS funds alongside improvement trend models from the Continuous Mortality Investigation (CMI) to assess the adequacy of the longevity assumptions.

   The longevity assumption is made up of two elements, the current life expectancy (or baseline assumption) and an assumption of future improvement / deterioration around the baseline assumption. The Actuary has altered the baseline assumption for the 2016 valuation reflecting the updated membership information to include the Fund’s experience since 2013. In 2016 the assumption for the long term minimum improvement rate was increased to 1.75% p.a. for males, while the same rate (1.5% p.a.) for females was retained.

e. In addition the Actuary has looked at life expectancy prior to retirement, ill health rates, withdrawal rates, commutation rates and the rate of dependants pensions coming into payment. Overall the demographic analysis decreased the past service liabilities by £27m and decreased the future service rate by 0.6% of pay per annum.

f. Overall the changes in the financial and demographic assumptions have increased the average FSR by 0.6% of pay per annum. The impact of the change in membership profile is an increase of 0.3%. The removal of the allowance for the 50:50 option for members resulted in a further increase of 0.5%, giving an overall average increase in the FSR of 1.4% of pensionable pay. (it should be noted that, in 2013 at the individual employer level, only the UAs included an allowance for the 50:50 option).

5.5 The changes are summarised in the following tables:

Changes to past service position since 2013 valuation

	£m
Deficit at 31 March 2013	**-876**
Interest on deficit	-132
Investment returns versus assumptions	+86
Contribution paid versus benefits accruing	+42
Salary gain/loss (i.e. salary increases less/more than assumption)	-45
Change in demographic assumptions	+27
CPI pension increases versus assumptions	+114
Allowance for extended public sector pay restraint to 2020	+111
Member movement and other factors	+76
Deficit at 31 March 2016	**-597**

Changes to future service rate

Average Employer Rate at 31 March 2013	**13.9% of pay**
Change in membership profile	+0.3% of pay
Change in financial and demographic assumptions	+0.6% of pay
Removal of 50/50 scheme and expenses allowance	+0.5% of pay
Average Employer Rate at 31 March 2016	**15.3% of pay**

5.6 A summary of the outcome by employer type is shown below:

Group	Number of Employers	Average Recovery Period	Average Future Service Rate	% of Fund Deficit
Unitary Authorities & Fire	5	16 years	15.5% of pay	76.1%
Universities	3	16 years	14.3% of pay	9.5%
Colleges	5	15 years	14.4% of pay	3.4%
Academies	120	16 years	15.3% of pay	10.2%
Parish/Town Councils and designating bodies	36	11 years	18.5% of pay	0.2%
Community Admission Bodies	17	13 years	22.3% of pay	0.1%
Transferees Admitted Bodies	43	9 years	20.0% of pay	0.5%
Total Fund at the Valuation Date	**235**	**16 years**	**15.5% of pay**	**100%**

6 COMMUNICATION WITH EMPLOYING BODIES

6.1 The 2016 actuarial report will be published by 31 March 2017. In the meantime, the employing bodies have been notified of their revised rates and officers are responding to queries from employers.

6.2 An Investments Forum was held on 21 November where the Actuary explained the results in greater detail to employing bodies.

7 COVENANT ASSESSMENT

7.1 As part of the valuation the financial covenants of the employers was undertaken. Priority for 2016 valuation was the further and higher education bodies due to the size of their liabilities in aggregate and the Community Admission Bodies without a guarantee.

7.2 The assessment will be ongoing annually which will provide input to future valuations.

7.3 The assessment framework has been developed with Mercer. Criterion is set for each group of employers to reflect the main financial statistics relevant to their operations. The framework will continue to be refined as the database is developed.

7.4 An example of a summary assessment for an individual employer is included in Appendix 1.

7.5 A full covenant update will be provided annually starting from 2017/18.

8 ACADEMIES UPDATE

8.1 At the valuation there were 120 academies in the fund. In addition a significant number have outsourced catering and cleaning functions, resulting in a rise in Transferee Admission Bodies.

8.2 Schools continue to convert to academies; they now join multi academy trusts (MATs) and a number of single academies have also joined a MAT. A further 26 academies have joined the fund since 1 April 2016 and a number are in the process of converting.

9 ADMISSION BODIES UPDATE

9.1 There are presently 17 Community Admission Bodies (CAB) plus 2 controlled/connected entities in the Fund. These bodies can take various forms but one common feature is that their funding generally comes from the public sector. The security of the funding sources varies which means that, in terms of being able to meet their pension liabilities, some bodies pose a greater risk to the Fund than others.

9.2 As the 2013 regulations now state that all new CABs must be guaranteed, or provide a bond to protect the Fund, new admissions are no longer brought to Committee for approval. Since December 2005, the Fund's policy has been to require all bodies seeking admission to the Fund as a CAB to be guaranteed by a Scheme Employer or have a bond in place.

9.3 The covenants of the CABs without guarantees were assessed for the 2016 valuation. The reduction in funding from public sector bodies has exacerbated the financial situation for many of these bodies, making it more difficult for them to manage increases in contributions. The regular monitoring of employer's financial information allows the Fund to effectively engage with employers to minimise the risk of defaulting on their contributions. Exempt Appendix 2 summarises the risk management for CABs and an update on CABs without a guarantee.

9.4 At the valuation there were 43 Transferee Admission Bodies (TAB) in the scheme whose pension liabilities are guaranteed by the outsourcing scheme employer. TABs are usually private sector companies where there is a commercial contract in place between them and the outsourcing employer. Some TABs have a bond in place to protect the outsourcing employer in the event of insolvency of the TAB.

9.5 A further 30 TABs have joined the fund since 1 April 2016.

10 RISK MANAGEMENT

10.1 A key risk to the Fund is the inability of an individual employer to meet its liabilities, especially when it ceases to be an employing body within the Fund. The Funding Strategy is designed to manage this risk to ensure the Fund achieves full solvency over an appropriate period. Assessing the strength of an employing body’s covenant is also a crucial component in managing the potential risk of default to the Fund. Accordingly, a formal covenant assessment process has been prepared as part of the Funding Strategy. The results are communicated in a dashboard assessing the risk as red, amber, green according to covenant strength.

11 EQUALITIES

11.1 An equalities impact assessment is not necessary.

12 CONSULTATION

12.1 Employers were consulted on The Funding Strategy Statement as part of the 2016 valuation.

13 ISSUES TO CONSIDER

13.1 Are included in the report.

14 ADVICE SOUGHT

14.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director - Business Support) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Liz Woodyard, Investments Manager 01225 395306
Background papers	Actuary reports and presentations
Please contact the report author if you need to access this report in an alternative format	