ACTUARIAL VALUATION 2019

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendations: **That the Committee:**

(1) Approves the planned approach to the 2019 triennial valuation of the Pension Fund.

(2) Approves the addition of a paragraph to the Funding Strategy Statement in relation to exit credits as set out in the report.

1. Introduction

1.1 The LGPS Regulations require administering authorities to complete an actuarial valuation of their Pension Fund on a three yearly cycle. The next valuation date is at 31 March 2019, and the results must be published by 31 March 2020. The 2019 valuation will set employer contribution levels for the financial years 2020/21, 2021/22 and 2022/23 (the contribution levels for 2019/20 were set at the previous valuation in 2016).

1.2 This report summarises the plan for the valuation which has been discussed with the scheme actuary, Barnett Waddingham. Further background to the valuation process was provided in the presentation by Barnett Waddingham at the Committee training session in October.

1.3 In addition, the Government Actuary's Department has just published its report, under Section 13 of the Public Service Pensions Act 2013, reviewing the 2016 Valuation.

2. Actuarial Valuation 2019

2.1 An actuarial valuation aims to set a suitable level of employer contributions to ensure that the Fund achieves its long-term solvency objective. As part of the valuation the actuary estimates the scheme's long-term liabilities, compares the liabilities with the current value of the Fund's assets and calculates the surplus or deficit. The key factors in calculating the Fund's position will be the experience of the three years from April 2016 to March 2019 compared with the assumptions made by the Actuary at the 2016 Valuation and the revised assumptions used by the Actuary in calculating future liabilities.

2.2 A timetable for the 2019 valuation has been agreed with Barnett Waddingham. The key dates are as follows:

Date	Activity
October 2018	Initial planning meetings
January 2019	Longevity Analysis undertaken
April 2019	Employer covenant review
June/July 2019	Provision of Data to Barnett Waddingham
September 2019	Officer meeting with Actuary – • Preliminary results understood • Final Valuation assumptions agreed
Mid/Late October 2019	Presentation of preliminary results to employer meeting
November 2019	Presentation of results to Investment and Pension Fund Committee
February 2020	Review of Funding Strategy Statement
March 2020	• Confirmation of employer contribution rates. • Actuary issues Rates and Adjustments certificate.

2.3 At the 2016 valuation the Devon Fund was assessed to have a funding level of 84%. The latest update from the Actuary, using the approach of rolling forward the data from the 2016 valuation, and updating it for subsequent investment returns, pension and salary increases, has given an indicative updated funding level of 94%. However, the Government has recently reduced the discount rate (the SCAPE rate) that it uses to assess the unfunded public sector schemes from 2.8% above the consumer Prices Index (CPI) down to 2.4% above CPI. While this is not directly applicable to the LGPS, the Fund Actuary has indicated that this is likely to have an impact on the discount rate assumptions used at the 2019 Valuation, which could therefore bring the funding level down.

2.4 The Triennial Valuation will provide a much more comprehensive review of the funding level, which will include a review of the full range of assumptions looking forward. This will include a detailed assessment of life expectancy to inform any changes in the assumptions on how improvements in mortality will impact on future liabilities. The actuary will also review assumptions on inflation over the shorter and medium to long terms, and the discount rate used to calculate the present value of the liabilities. The discount rate is based on the Fund's investment strategy and the likely returns that can be achieved by each asset class over the longer term, but is likely to be influenced by the SCAPE rate as outlined above.

2.5 The key output of the valuation is the schedule of employer contributions for the next 3 financial years. Each employer's individual contribution rate is composed of an element for past service, which will recover any existing deficit, and an amount to cover the future accrual of pension rights in each year. The deficit recovery part of the contribution rate will depend in part on the length of the deficit recovery period, the time allowed for the deficit to be paid off. At the last valuation the Fund deficit recovery period was 22 years, with variations for different employers from 20 years up to 27 years. Ideally the recovery period should reduce at each valuation to indicate progress towards achieving a funding level of 100%. At this valuation it is proposed that an assessment of risk should be used to inform the recovery period set for each employer, i.e. if there is a higher risk that an employer will not be able to meet contribution payments for the longer term, they will be expected to pay off their deficit over a shorter period.

2.6 There will be an ongoing dialogue with employers over the valuation period to ensure that any concerns they have about the process and the future level of contribution rates are addressed. The timetable for the valuation assumes that preliminary results will be available for a proposed employer meeting in October 2019. The plan is for the actuary to be available to meet individual employers at that meeting, although queries can also be addressed separately.

3. Section 13 Report on 2016 Valuation

3.1 Under the Public Service Pensions Act 2013, the Ministry of Housing, Communities and Local Government (MHCLG) is required to commission a "Section 13" valuation following each Triennial Actuarial Valuation. The aim is to look at the valuation results for each LGPS fund and check whether, in their opinion, the various Funds have carried out their valuations in a way that:

- Is compliant with the LGPS Regulations
- Is not inconsistent with other Funds
- Will ensure solvency
- Will ensure long-term cost efficiency.

3.2 In September the Section 13 report on the 2016 valuation was published by the Government Actuary's Department (GAD). The report concluded that all valuations were carried out in a way that was compliant with the LGPS regulations. However, it made a number of recommendations to the Scheme Advisory Board (SAB) around the issue of consistency, including that it should consider what steps should be taken to achieve greater clarity and consistency in actuarial assumptions. The four actuarial firms operating within the LGPS have subsequently written a joint letter to the SAB challenging GAD's interpretation of the requirements of Section 13 in relation to consistency.

3.3 The detailed report assesses each individual LGPS fund and their approach to ensuring solvency and long term cost efficiency at the 2016 Valuation. GAD have looked at a range of metrics to identify potential issues, and each fund's score under each measure is colour coded (red, amber or green). In total, 70 out of 89 funds tested had green flags on all solvency and long term cost efficiency metrics. There were a total of 20 amber and 2 red flags.

3.4 The good news is that the Devon Fund received green flags on all the measures assessed. However, a more detailed examination of the report highlights some areas where attention may be required to avoid red and amber flags in the future. These include:

- Barnett Waddingham assessed the Devon Fund's funding level as 84% at the 2016 Valuation. When compared with the funding levels of the other 89 LGPS funds in England and Wales, as assessed by their fund actuaries, this made Devon the 42nd best funded LGPS fund. However, the assumptions used by the difference actuaries varies and GAD therefore reassessed each fund's funding level on a consistent basis. This assessed Devon's funding level as 86%, but many funds had significantly higher funding levels on GAD's consistent basis, putting Devon down to 75th of the 89 funds. The comparison between the funding levels determined by the Fund Actuary and those assessed by GAD is shown at Appendix 1. The bottom ten funds, with funding levels below 85% on the GAD basis were given amber flags.

- The report also highlighted those funds that would be most severely impacted by an "asset shock" should the value of assets reduce by 15% as a result of market conditions. According to this measure there would be a 2.5% increase in the Devon Fund's average employer contribution rates as a percentage of core spending power after a 15% fall in value of return-seeking assets. Whilst this is not sufficient to get a red or amber flag, it is nevertheless higher than the figure for the majority of funds.

3.5 The 2019 Valuation will need to take account of these issues and ensure that a prudent approach is taken to the setting of assumptions, and continued progress is made in reducing the recovery period, so that the Devon Fund receives a clean bill of health from the Section 13 review of the 2019 Valuation.

4. Other Actuarial Issues

4.1 **Exit Surpluses** – In the past, when an employer has exited the scheme, a cessation valuation has been completed by the Actuary, and where there has been a deficit the employer has been required to make a payment to the Fund to cover the deficit. However, if the employer has been in surplus, that surplus has been retained by the Fund. However, changes to regulations means that in future should the cessation valuation show a surplus, the Fund will need to refund that surplus back to the exiting employer.

4.2 Further to the change in regulations, and pending a full review of the Funding Strategy Statement alongside the 2019 Valuation, it is proposed to add a paragraph to the Funding Strategy Statement to cover the change in regulations, as follows:

The Local Government Pension Scheme (LGPS) (Amendment) Regulations 2018 were introduced in May 2018 which allow administering authorities to make an exit credit payment to exiting employers. This will be reviewed on a case by case basis before any payment is made. Considerations will be based on any previous agreements made and discussions between the Administering Authority, the Exiting Employer and the guaranteeing employer (if relevant).

4.3 **Employer Cost Cap** – Under the Public Services Pensions Act 2013, following each actuarial review an assessment of the cost of the scheme is required to determine whether it has breached the cost cap set out by Government. Where the cost of the scheme to employers increases to more than 2% above the cap, then either benefits must be reduced or employees required to pay more. If the assessment identifies that costs are 2% below the cap, then benefits must be increased. The Treasury assesses costs across public sector pensions, but in addition the LGPS Scheme Advisory Board (SAB) does a separate assessment applying a different cost cap. The assessment does not include past deficit costs.

4.4 The Treasury has carried out its assessment based on 2016 valuations and determined that benefits across public sector pensions should be increased. However, this will not apply uniformly across the public sector schemes, and the position for the LGPS will be determined by the SAB assessment, which is still under discussion. If the recommendation is for the benefit structure to change, this will be effective from April 2019 and will be reflected in the 2019 valuation.

4.5 One consequence of the cost cap approach is that the Government is looking at bringing actuarial valuation cycles of all public sector pension schemes in line with each other. Many of the other public sector schemes have valuations every four years, which means their next full valuation is due in 2020. As a result, while the 2019 LGPS Triennial Valuation is definitely going ahead, there is a possibility a further review may take place a year later. Discussion of this is ongoing.

5. Conclusion

5.1 The Committee is asked to approve the approach to the 2019 Actuarial Valuation and the addition of the paragraphs set out in paragraph 4.2 to the Funding Strategy Statement. A full review of the Funding Strategy Statement will be undertaken alongside the 2019 Actuarial Valuation.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers – Nil
Contact for Enquiries: Mark Gayler
Tel No: (01392) 383621 Room G97

Appendix 1

Chart B1: Standardising Local Valuation Results