CT/16/87
Devon Pension Board
20th October 2016

ACTUARIAL VALUATION 2016 AND SECTION 13 REPORT

Report of the County Treasurer

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

Recommendation: **That the Board notes the Section 13 "dry run" report produced by the Government Actuary's Department, and the planned approach to the 2016 triennial valuation of the Pension Fund.**

1. Introduction

1.1 The LGPS Regulations require administering authorities to complete an actuarial valuation of their Pension Fund on a three yearly cycle. Work is currently underway on the valuation as at 31st March 2016, with the results due for publication by 31st March 2017. The 2016 valuation will set employer contribution levels for the financial years 2017/18, 2018/19 and 2019/20.

1.2 In addition to the normal actuarial valuation carried out the by the Fund Actuary, the Public Service Pensions Act 2013 means that the Department of Communities and Local Government (DCLG) are required to commission a "Section 13" valuation which will look at the 2016 valuation results for LGPS Funds and check whether, in their opinion, that valuations have been conducted 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.

The Section 13 valuation will be carried out by the Government Actuary's Department (GAD). GAD will review whether funding valuations and employer contribution rates have been set to meet these objectives and DCLG can require remedial steps to be taken where the Secretary of State considers appropriate. In the extreme, DCLG can essentially impose the level of contributions that employers are required to pay, over riding what has been certified by the Fund actuary.

1.3 GAD have carried out a dry run of the process using the 2013 valuation results in order to allow Funds to be aware of any areas that would have been highlighted. The results of the dry run report can be taken into account by Funds and fed into the process for the 2016 valuation.

2. Section 13 Dry Run Report

2.1 The GAD assessment applies six tests around solvency, and seven tests on long-term cost efficiency. Funds can be assessed as green, amber or red on each of them. Although there are seven tests on long-term efficiency, they are more or less measuring the same thing which is simply whether GAD believes that the level of employer contributions is sufficient. The dry run tests, based on the 2013 valuations, are broadly looking at whether their assessment of 2014/15 deficit contributions, if increased in line with assumed salary increases, are sufficient to make each Fund fully funded in 20 years' time.

2.2 The 2013 dry run assessment has identified a number of Funds which received red and amber flags. If this was an official Section 13 valuation, GAD would have engaged with administering authorities that have received red flags to investigate in more detail whether the aims of Section 13 were met. They may also have engaged with some other administering authorities who had a significant combination of amber flags.

2.3 The good news is that the Devon Fund received no red or amber flags in the dry run report. However, there are a number of areas where the position of the Devon Fund is not as good as the majority of LGPS Funds and potentially faces the risk of gaining a red or amber flag in the 2016 report.

2.4 Part of this is a result of the different assumptions and methodologies being used by different firms of actuaries. At the 2013 actuarial valuation, Barnett Waddingham calculated a funding level of 84% for the Devon Fund. This gave Devon the 21st best published funding level of the 90 different LGPS Funds across England and Wales. However, this was in part due to Barnett Waddingham adopting less prudent assumptions than other actuarial firms. The Section 13 dry run report has produced revised funding levels for the 90 Funds on a standardised set of assumptions. On this basis Devon's funding level is 82%, which remains close to the Barnett Waddingham valuation, but falls in rank to 73rd place out of the 90 Funds. Other Funds, where arguably their own actuaries have been over-prudent, have seen their funding level increase under the standardised basis. The Cumbria Fund, for example, had a 78% funding level on the basis of their own actuary's assessment, but on the standardised basis their funding level has increased to 96%. The different funding levels are shown in Appendix 1.

2.5 The impact of the above inconsistency is that the GAD analysis shows that the Devon Fund is paying off its deficit at a much slower rate than all but three other LGPS Funds. This is shown at Appendix 2. The reason for this is that the deficit recovery contributions payable by employers are based on the assessed funding level. Those with a lower funding are likely to be paying higher contribution rates. Therefore, when their funding levels are reassessed to be higher, they are then paying off their deficit at a much faster rate.

2.6 As a result, while GAD assesses that Devon is paying off 7.5% of its deficit each year (with an average actual contribution rate of 19.26% in 2014/15), Cumbria, for example, (with an average actual total contribution rate of 30.51% in 2014/15) is paying off over 50% of its deficit each year. At that rate, it will take Devon 15 years to pay off the deficit (still less than Barnett Waddingham's assumed recovery period of 25 years), while Cumbria will pay off its deficit in less than two years. A comparison between the contribution rates being paid by each of the LGPS Funds is shown at Appendix 3. Two of the only three Funds who are paying off their deficit at a slower rate than Devon have been given amber flags on these criteria.

3. Conclusion

3.1 The actuary has to make a number of assumptions in undertaking the Fund valuation. These include assumptions around inflation and life expectancy. The key assumptions in calculating the Fund's liabilities, funding level and the resulting employer contribution rates are the discount rate applied to liabilities, based on estimated future investment returns, and the recovery period allowed to pay off the deficit.

3.2 In the light of the dry run report on the 2013 Valuation, there is some risk that the Devon Fund may be given an amber or red flag when the Section 13 report is done for the 2016 Valuation. It would therefore be sensible to take a more prudent approach to the actuarial valuation to ensure that this does not happen. This would mean adopting a lower discount rate, i.e. a more prudent forecast of future investment returns, and/or a shorter recovery period, to allow the deficit to be paid off more quickly. Discussions will be held with the actuary to determine what assumptions would be prudent, whilst still aiming to keep contribution levels stable as far as possible. However, the likelihood is that adopting more prudent assumptions will result in an increase in employer contribution rates.

3.3 Provisional results will be presented at a meeting for Fund employers on 19th October. This will also provide employers to discuss with the actuary their specific circumstances and the impact of the valuation on their individual contribution rates. The provisional outcome of the valuation will then be reported to the Investment and Pension Fund Committee in November. A revised Funding Strategy Statement will then be produced in 2017 to reflect any significant changes to funding assumptions. The results will also feed into future reviews of the Fund's investment strategy.

Mary Davis

Electoral Divisions: All
<u>Local Government Act 1972</u>
<u>List of Background Papers – Nil</u>
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Chart 4.6: Standardising local valuation results

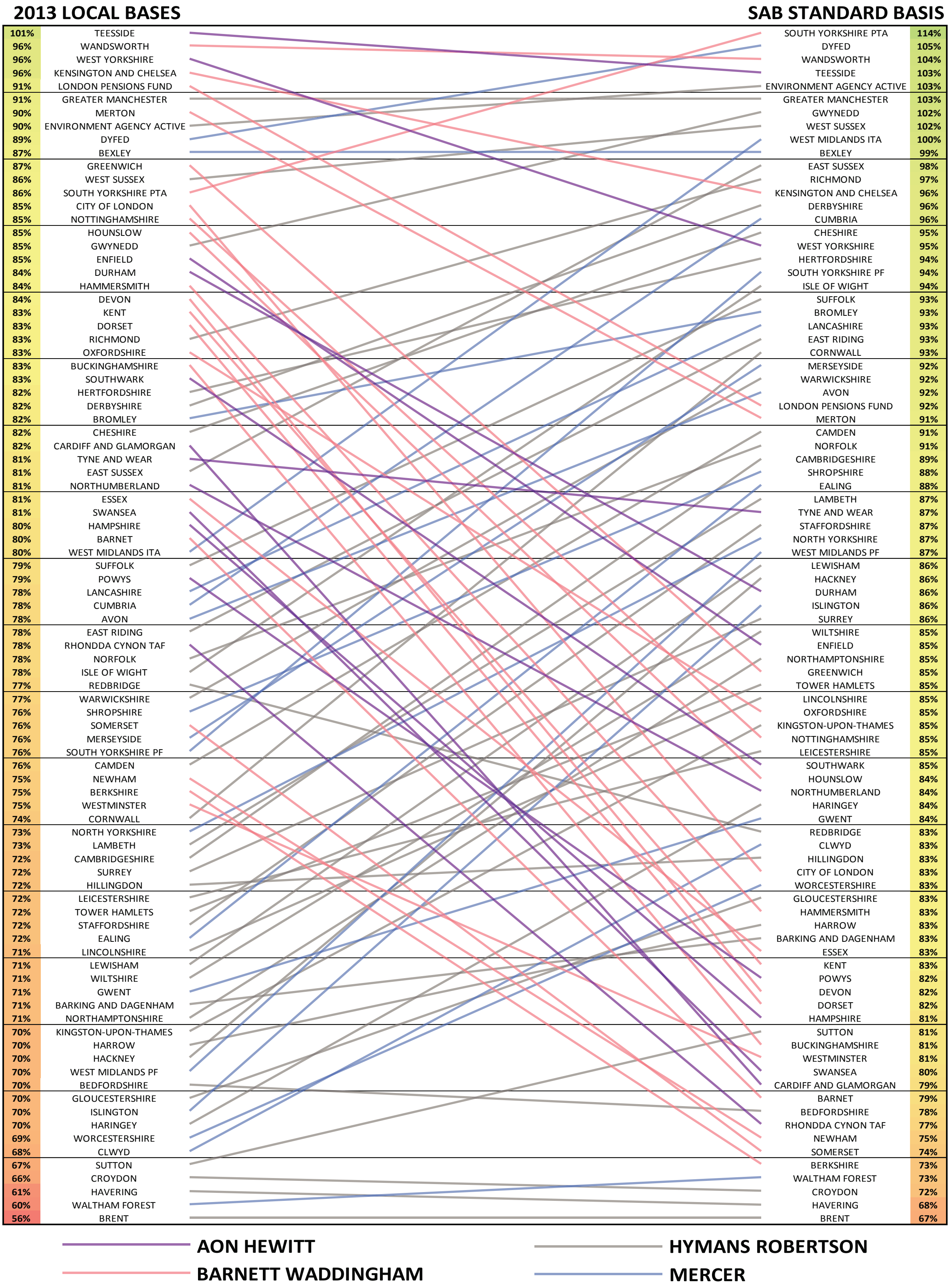
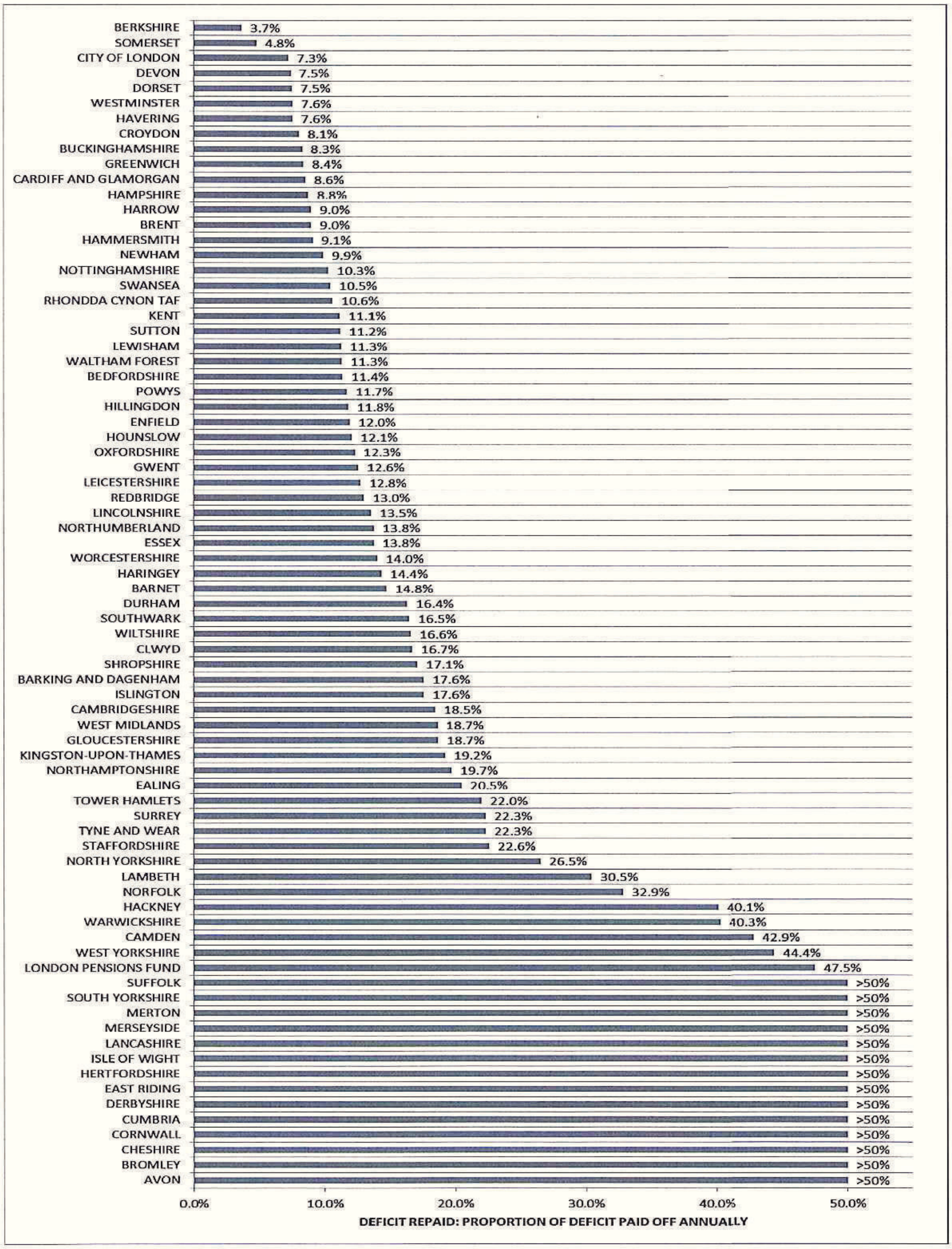


Chart H1: ***Deficit Repaid*** *by fund: The proportion of deficit paid off annually.*



Note: Funds in surplus have been excluded.

Chart 4.1: Average actual contributions vs. common contribution rates