# ACTUARIAL VALUATION 2016

## Report of the County Treasurer

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

**Recommendation: that the Committee note the content of this report.**

## 1. Introduction

1.1. Every three years Devon County Council (as the administering authority) is required to have an actuarial valuation of the Devon Pension Fund conducted by a qualified independent actuary. The Council has appointed Barnett Waddingham to act as the Fund Actuary.

1.2. The purpose of the valuation is to establish the Fund's liabilities in relation to its assets and determine the current funding level, and to set contribution rates for the Fund's employers for the next three years. The approach to the Valuation has to take into account Section 13 of the Public Sector Pensions Act 2013.

1.3. The timetable and process for the current valuation was outlined in a report to the previous meeting of this Committee. The Actuary met with officers in September to confirm the assumptions to be used for the valuation.

## 2. Factors taken into consideration

2.1. The triennial actuarial valuation examines how the assumptions built into the previous valuation have fared and then considers future prospects for the Fund. The Actuary has to certify levels of contribution to secure the solvency of the Devon Fund, but also have regard to the desirability of maintaining as stable a contribution rate as possible.

2.2. The Actuary also has to take into account Section 13 of the Public Sector Pensions Act 2013. This provides for an independent review (by the Government Actuary's Department (GAD)) of the valuation and employer contribution rates to check that they are appropriate and requires remedial action to be taken where that review identifies a problem. The Actuary will therefore aim to ensure that the assumptions applied will lead to contribution rates that ensure the long term cost efficiency of the fund and achieve solvency over an appropriate period, and thereby avoid any red flags when GAD carry out their review. Long term cost efficiency is now seen as a requirement while stability of contribution rates is only "desirable".

2.3. The following factors, outlined in paragraphs 2.4 to 2.6, have been considered by the Actuary and have been taken into account in the current valuation, and calculation of the level of deficit and future contribution levels.

2.4. ***Inter-valuation experience*** – The valuation will be impacted by what has happened over the three years since the last valuation, compared to the assumptions made by the actuary at the time. These are summarised in the following table:

| | Expected | Actual | Effect on Funding Level |
|---|---|---|---|
| Investment Returns | 6.10% | 4.80% | Negative |
| Pay Increases | 3.30% | 2.20% | Positive |
| Pension Increases | 2.70% | 1.30% | Positive |
| Deaths - Pensions Ceasing | £8,185k | £11,196k | Positive |

Investment returns have been below the expected level, which has had a negative impact on the funding level. However, the level of pay and pension increases have both been below the level assumed in 2013, and the value of pension cessations has been higher than anticipated, which will have reduced the Fund's liabilities.

2.5. ***Revised Assumptions*** – These include:

(a) Price Inflation – based on the Bank of England's 20 year inflation curve, average CPI estimated at 2.4% in projecting future liabilities. This compares with an estimate for CPI of 2.7% at the 2013 Valuation.

(b) Salary Increases – Assumed to be equivalent to CPI until 31 March 2020, and CPI + 1.5% thereafter. The level of pay increases takes into account the effect of increments and promotions for individual members of the Fund, not just the national pay awards. This is a lower assumption than that made in 2013.

(c) Statistical Assumptions – The key factor influencing pension liabilities is pensioner mortality, i.e. how long pensioners will be receiving their pension. For this valuation Barnett Waddingham have produced an analysis specific to Devon, looking at the mortality experience of the Fund and a socio-economic analysis, based on postcodes and other fields in our member data. This has resulted in an adjustment to 90% of the statistical values in the tables published by the Actuarial Profession's Continuous Mortality Investigation for both males and females. An assumption of a 1.5% long term improvement in life expectancy has been made. This equates to a life expectancy beyond the age of 65 of a further 25.4 years for females and 23.3 years for males retiring now.

(d) Discount Rates – In determining the value of accrued liabilities and future contribution requirements it is necessary to discount future payments to and from the Fund. There are a number of different approaches which can be adopted to derive the discount rate. Barnett Waddingham's approach is to reflect the investment return expected to be achieved from the underlying investment strategy. The investment return going forward has been assumed to be 5.5%, which compares with an assumption of 6.1% at the last valuation. This is summarised in the following table:

**Actuarial Valuation 2016 - Breakdown of Discount Rate**

| Asset Class | Percentage of Fund | Assumed Return | Real (relative to CPI) |
|---|---|---|---|
| Gilts | 6% | 2.4% | 0.0% |
| Other Bonds | 8% | 3.3% | 0.9% |
| Cash/temporary investments | 2% | 1.8% | -0.6% |
| Equities | 55% | 7.4% | 5.0% |
| Property | 14% | 5.9% | 3.5% |
| Diversified Growth Funds | 15% | 5.8% | 3.4% |
| Expenses (deduction) | | -0.2% | |
| **Neutral estimate of discount rate based on long-term investment strategy** | | **6.1%** | **3.7%** |
| Prudence allowance | | -0.6% | |
| **Discount rate assumption** | | **5.5%** | **3.1%** |

2.6. ***Deficit recovery period*** – At the last valuation the length of the recovery period was reduced from 30 to 25 years. At this valuation the Actuary has reduced the average recovery period back to 22 years. There is some logic to this, in that the ultimate aim is to reach 100% funding, and as we are three years further on since the last valuation, a reduction of three years in the recovery period demonstrates that the Fund is progressing towards that goal. Reducing the recovery period will decrease the level of risk to the Fund, and reduce the cost of meeting the deficit.

## 3. Overall results

3.1. The Actuary has determined that the Devon Fund has a funding level of 84%. The Fund's assets were valued at £3,311m against future pension liabilities assessed at £3,939m, giving a deficit for this valuation of £628m. This, along with the comparative figures for the previous valuation in 2013, is shown in the table below:

| | ***2013 Results*** | ***2016 Results*** |
|---|---|---|
| ***Assets*** | £2,970m | £3,311m |
| ***Liabilities*** | £3,589m | £3,939m |
| ***Deficit*** | (£619m) | (£628m) |
| ***Funding Level (whole Fund)*** | 83% | 84% |

3.2. The Actuary has determined that an overall employer rate of 20.9% (of pensionable payroll) is required to meet future service accruals and to clear the current deficit:

| | ***2013 Results*** | ***2016 Results*** |
|---|---|---|
| ***Future Service Rate*** | 13.6% | 14.9% |
| ***Deficit Contribution*** | 5.2% | 6.0% |
| ***Total Employer Contribution Rate*** | 18.8% | 20.9% |

## 4. Effects on Individual Employers

4.1. The 20.9% contribution figure and the 22 year recovery period are the average required across the fund. Individual employers within the fund will have their own individual rates and recovery periods reflecting their own unique circumstances. The recovery period for individual employers will be set in a range between 17 and 24 years.

4.2. At the 2010 and 2013 Valuations it was recognised that payrolls were likely to fall as a result of a reduction in funding levels for local services. This would have had an impact on the level of cash coming in to meet the deficit. Therefore, the deficit amounts for each employer have been certified as a cash figure, rather than a percentage of pay, in order to address this issue. The same approach will be adopted at this Valuation.

4.3. Given the increase in the overall rate from 18.8% to 20.9%, all employers are likely to see an increase in their contribution rates. This will vary between employers, according to the profile of their individual liabilities and past experience. For example, where employers have made additional deficit contributions, this will have had the effect of reducing their deficit and the level of their ongoing deficit contributions. An initial analysis of the results for the major employers suggests increases to their overall contributions ranging from 1% to 3.8% of pensionable pay.

4.4. It is recognised that contribution increases will place extra pressure on employers at a time of reduced funding from Government, but as outlined in paragraph 2.2 above the Fund needs to ensure that sufficient contributions are being paid to ensure long term cost efficiency and achieve full funding over an appropriate period. The requirement of Section 13 of the Public Sector Pensions Act 2013 for GAD to review the Fund's 2016 Valuation makes this an even more important requirement. It should be noted that the recent "dry-run" analysis of the 2013 Actuarial Valuation conducted by GAD showed that Devon was in the bottom quartile for contribution rates, i.e. 75% of LGPS funds charge higher rates than Devon. This is still likely to be the case even with the increases proposed.

4.5. In order to achieve as stable a rate as possible, groups of smaller employers have been put together in pools to even out their contribution rates. This reduces the level of volatility in their contributions. This will include a pool for academies in line with the response submitted to the DCLG consultation, subject to the result of that consultation process.

## 5. Conclusion

5.1. The 2016 Valuation demonstrates that the Fund is making progress towards the long term objective of 100% solvency, with the funding level increasing from 83% to 84%, and the deficit recovery period reducing from 25 to 22 years. The reduction in the average recovery period will help to reduce the cost of pensions in the longer term. The approach adopted to the Valuation should ensure that the Devon Fund receives a clean bill of health when the Section 13 review is conducted by GAD.

5.2. It is anticipated that employers will be provisionally notified of their individual rates by the end of December. The formal certification of the rates will not be until the end of March, in order to take into account any issues that are identified in the intervening period. However, it is unlikely that the results will change significantly from the provisional results.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
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