worcestershire county council

AGENDA ITEM 6

PENSIONS COMMITTEE
13 DECEMBER 2019

ACTUARIAL VALUATION AND FINAL PENSION FUND STRATEGY STATEMENT

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **the results of the Actuarial Valuation (Appendix 1) are noted by the Committee;**

   b) **the Funding Strategy Statement (Appendix 2) is approved by the Committee and any further operational changes are delegated to Fund officers with an update provided to the March Pensions Committee; and**

   c) **The points raised (Appendix 3) regarding the specific questions asked on the Funding Strategy Statement be considered and noted**

Background

2. Every three years, in line with legislation, the Fund Actuary, Mercer, carries out a full Actuarial Valuation of the Fund to calculate how much the employers in the Scheme need to contribute going forward to ensure that its liabilities, the pensions due to current and future pensioners, will be paid as they fall due.

3. The purpose of the Funding Strategy Statement ("FSS") is to set out a clear and transparent funding strategy that will identify how each Fund employer's pension liabilities are to be met going forward.

4. The draft Funding Strategy Statement was agreed at Committee on the 16 October 2019 and sent to Employers for consultation on the 29 October 2019 with an initial deadline of the 22 November 2019. However, this was extended to the 4 December 2019 as some Employers did not receive their initial valuation results until the 19 November 2019. Details of the outcome of this consultation is detailed further on in this report.

Provisional Actuarial Valuation

5. The results at a total Fund level are shown in Appendix 1 to this report. The Fund's funding level has increased from 75% funded at 31 March 2016 to 91.3% at 31 March 2019. Total employer contributions are expected to decrease for 2020/21 below those planned following the 2016 Actuarial Valuation by £15.0m (£82m compared to £97m) based on the initial base option.

6. Committee are asked to note that the actual whole fund contributions to be received will ultimately depend on the employer contributions agreed with each individual employer.

7. This will depend upon the key funding strategy parameters, such as open / closed to new entrants, deficit recovery period, short term pay allowance, investment pot as well as choices made around the timing of contributions (e.g. selected prepayments or phasing of contribution increases). If the major employers opt for 3-year prepayments this would have a notable impact on the timing of the cashflows.

8. Members may recall the McCloud case and the judgement in the summer regarding retirement ages. Mercers have provided an estimate of the potential impact for all Employers separately and Employers were asked via the consultation as to whether they wanted to include this as part of their annual contributions or set a provision aside to meet this once the actual impact is known.

Funding Strategy Statement for employer consultation

9. The Funding Strategy Statement is attached as Appendix 2 to this report. The key points of the statement are shown below:

- The target recovery period for the Fund as a whole is 15 years at this valuation which is 3 years shorter than the corresponding recovery period from the previous valuation. Subject to affordability and other considerations, individual employer recovery periods would also be expected to reduce by 3 years at this valuation. **(Page 2 of the FSS)**

- A Key change to the method of valuing the Fund's liabilities is the valuation of the real return over CPI inflation for determining the past service liabilities is 1.65% (2.15% in 2016) per annum and for determining the future service (“Primary”) contribution rates is 2.25% (2.75% in 2016) per annum. CPI inflation has been assumed at 2.4% over the review period making the nominal total discount rate / investment return target of 4.05% p.a. for past service and 4.65% p.a. for future service as at 31 March 2019 (**Page 4 of FSS)**

- As the Committee are aware, the remedy for McCloud is not yet known. However, guidance from the Scheme Advisory Board is for Funds to consider their policy in relation to the costs that could emerge in conjunction with their Actuary. As you will see from the attached, the FSS has been drafted to confirm the relevant estimated costs have been quantified and notified to employers. Employers will then have the choice to include these estimated costs over 2020/23 as part of their certified contributions or to make allowance within their budgets and potentially make backdated contributions if the remedy is known before the next valuation. **(Page 3 of FSS)**

- Investment ‘pots’ – the narrative assumes that the Fund has implemented alternative investment strategies with differential levels of investment risk with effect from 1 April 2020. The aim is to provide greater control over employer’s exposure to investment risk **(Page 20 of FSS)**

10. The Committee is asked to note that the FSS is not expected to change fundamentally in between now and when the actuarial valuation is signed off by the actuary in March. There are a few areas where enabling wording has been included for anticipated changes to the LGPS Regulations following consultation with the key stakeholders. These may need to removed, if the amendment Regulations are not laid ahead of the valuation sign off date and reinstated at a future FSS review. The Committee is requested to delegate any further amendments to officers for finalisation. Any changes to the FSS will be reported back to Committee in March 2020 for completeness.

Employer Consultation

11. The provisional individual employer funding results and proposed employer contribution rates for 2020/2021 to 2022/2023 were discussed at the Employer Administration Forum on the 14 October 2019. A presentation from Mercers covered the assumptions used in and the results of the actuarial valuation as at 31 March 2019. Initial meetings were also held with the County Council and District Councils early September 2019.

12. All employers were offered the opportunity to meet up with Mercers, the Funds actuarial advisors to discuss further their results.

13. Employers were also consulted on the specific risk management / contribution rate stabilisation proposals for introducing different investment approaches for employers with similar characteristics instead of continuing with one investment approach for all our employers. The idea being to place employers into potentially one of three to four 'pots' dependent on the perceived Fund risk and resultant investment strategy required.

14. The consultation on the draft FSS was sent to Employers on 21 October and were asked to respond by Friday, 22 November 2019. However, this was extended as per paragraph 4 above. There were 13 formal responses received which is just under 7% of our employers. Appendix 3 provides a summary of the specific questions and responses that were received. A summary is provided below: -

a) What prepayment options should be available e.g. 100% (deficit repayment) / 90% (future service contributions) annually in advance; all 3 years 100% / 90% in advance; first two years 100% / 90% in advance; etc?

   Employers who could afford to prepay were in favour of the differing options being proposed

b) When you think the investment pots should be made available; which investment pot you think might be appropriate for you; whether we should introduce other investment pots and what any other pots should look like? (Even if you do not believe this flexibility will be appropriate for you at the 2019 valuation, we would appreciate your comments in relation to this framework being available for use at a future valuation);

   Most Employers were in favour of exploring and potentially implementing the different risk investment pots

c) Whether we should offer employers with proven short term LGPS affordability problems the option to phase in the increases to their future service % contributions or a longer deficit recovery period? NB if an employer goes bust, other employers must pick up the bill for making good on that employer's pension promises;

Most Employers agreed that such employers should be offered this option subject to their longer-term covenant strength and / or there is a guarantor in place. It was also highlighted that this should be done on exception and subject to review.

d) Whether you plan to make a provision in your contributions for the potential impact of McCloud to give yourself budgeting certainty for the next 3 years? NB the current remedy for the McCloud judgment and the timing of this remedy is unknown. However, employers making a provision at the 2019 valuation by paying the higher suggested McCloud contributions will not have their contributions adjusted before 2023 / 2024, but those choosing to wait for the McCloud remedy to be identified exactly will be asked to pay whatever that turns out to be going forward and to make good on that on a 'backdated to 1 April 2020' basis;

There was a mixed response, but most Employers agreed with either contributing for McCloud as part of their proposed contribution rates or make a specific provision in their accounts. A couple of Employers highlighted that they may not be making a provision and follow up discussions with these Employers will be made by the Fund as they will have a legal duty to comply with the financial outcome of the case.

e) Whether you feel the real pay assumption of CPI + 1.5% p.a. is appropriate? NB this assumption is an average long-term assumption over the total future working lifetime of the active membership of the Fund and should not be considered against any short term budgeted pay restraint; and

There was a mixed response. Some Employers felt that this was realistic, some possibly too high and others had no comment

f) Whether you might be interested in ill health liability insurance: under this (the exact terms would be provided once an analysis of our members has been completed by the insurer) you would pay lower % future service contributions to the pension fund but also pay an additional say 3% contributions which would not be invested in the Fund, but be used to pay the insurance premium. In return for which a contribution would be paid by the insurance company to the pension fund on the occurrence of an ill health retirement. NB For smaller employers, the cost of a single ill-health could have a large impact on your funding position, as an employee aged 30 earning £49,000 who retires on tier 1 ill health is being 'promised' an immediate extra annual pension paid for the rest of their life of (49,000 ÷ 49 * (years between State Pension age of 68 less 30)) = £38,000 p.a. that could be expected to be paid for 50 years (until the employee dies at 80) making a total extra pension paid out of £1,900,000.

4 Employers were interested in this

15. These have been considered and it is considered that although there is a need to clarify some areas with Employers, there are no changes required to the draft FSS that was provided to Employers in October and November 2019. Therefore, the final proposed actuarial valuation and FSS is attached as Appendix 2.

Contact Points

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Supporting Information

- Actuarial Valuation Results (Appendix 1)
- Funding Strategy Statement (Appendix 2)
- Key points raised (Appendix 3) regarding the specific questions asked on the Funding Strategy Statement

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.