North East Scotland Pension Fund

nespf

2023 Actuarial Valuation Initial Results and Funding Strategy Statement

December 2023

1. Background

Under the Local Government Pension Scheme (Scotland) Regulations 2018 the North East Scotland Pension Fund (NESPF) is required to instruct the scheme actuary to carry out a valuation of the liabilities based on the membership data held once every three years. Mercer is the scheme actuary for the NESPF. The valuation date for all Scottish Funds is 31 March 2023.

The outcome of the valuation will determine the Funding level of the NESPF as at 31 March 2023 and the employer contribution requirements for each participating employer for the three years from 2024/25 to 2026/27.

Having carried out their calculations on the data provided and using the assumptions outlined in the Funding Strategy Statement Mercer have provided indicative results on a whole Fund basis as at 31 March 2023.

In addition to the whole Fund results, indicative funding results and suggested contribution rates have been provided for the individual participating employers within the NESPF.

2. Funding Strategy Statement (FSS)

The Draft Funding Strategy Statement (FSS) outlines the approach used by the Scheme actuary to calculate the liabilities held. The assumptions used in these calculations are introduced in the draft document, with further detail provided in Appendix A – Actuarial Method and Assumptions.

The financial and demographic assumptions determine the outcome of the valuation and are subject to the discretion and approval of the Fund under the guidance and agreement of the Scheme actuary.

The results are particularly sensitive to the assumptions on the discount rate. The discount rate reflects the assumed level of investment return on the assets held by the Fund. This assumption has been determined using real returns since the 2017 valuation which reflects the link between expected returns (based on investment strategy) and liability changes (which are directly linked to CPI inflation).

For the purpose of the 2023 valuation the proposed discount rate is the Consumer Price Index (CPI) plus 2.0% p.a. for determining past service liabilities and CPI plus 1.5% p.a. for future service liabilities. This is an increase in the past service discount rate from the 2020 valuation which was CPI plus 1.25% p.a. This is reflective of the increased interest rate environment and expected future return on assets above inflation. The future service discount rate remains the same to provide the ongoing stability in the future service rate.

Other notable assumptions within the Funding Strategy Statement have been made around long term inflation, future salary increases for members, mortality rates and expected member movements.

The overall funding target for the NESPF remains as 100%. However a 15% 'buffer' has been provisionally applied for the purpose of determining any surplus to be returned to the employers over the surplus spread period. This reserve is being held as a method of providing extra resilience against adverse future events that could affect financial markets or the value of assets held (including reductions in interest rates globally) or continual persistence of UK inflation. In essence this means that only where an employer's ongoing funding level is above 115% would any surplus be returned (over the agreed spread period). This will be consulted upon with employers.

The main aim of the valuation approach is one of contribution sustainability and intergenerational fairness to tax payers (as required by legislation). Maintaining a fully funded position over the long term will ensure that the Fund can meet the liabilities as they become due whilst trying to ensure that employers rates remain as stable as possible. The approach taken for the 2023 valuation aims to reduce the risk to the Fund whilst also acknowledging the surplus position by reducing the total contribution requirements for participating employer, wherever possible.

As ever there are some individual cases where parameters will need to be varied to address specific characteristics – typically based on covenant and affordability of contributions.

For those employers who do not have a guarantor in the Fund, who would stand behind any surplus/deficit upon exit, the illustrative termination position for employers is calculated on a more prudent set of assumptions compared to those assumptions used to set contribution levels. The approach for this calculation is detailed in the FSS. The provisional approach has changed and been made more prudent to reflect current markets and outlook as well as to protect taxpayers. The Actuary will keep the approach under review on a regular basis to ensure it remains fit for purpose. Given the higher interest rate market environment the termination positions are more favourable at the valuation than historically for these employers.

3. Employer Consultation

The LGPS (Scotland) regulations require the Fund to consult with all participating employers around the draft FSS. The consultation has now been issued to all employers along with their proposed employer contribution rate requirements for the three year inter-valuation period. The consultation period will run from 20th November 2023 with all responses to be received by the Employer Relationship Team by 8th January 2024.

Employers have been asked to comment on the actuarial approach, the suggested assumptions and provide any comments that they may have on the policies imbedded within the draft document e.g. the buffer mentioned above.

Consultation responses will be discussed with the Scheme actuary to determine any adjustments or action to be taken.

4. Preliminary Whole Fund Results

Based on the assumptions laid out in the FSS, the NESPF has a funding level of 125% as at 31 March 2023. This has been determined using a value placed on the liabilities held of £4.45bn and a calculated surplus of £1.13bn when compared against the assets held as at the valuation date.

Individual employer results can differ significantly from the whole Fund as these are based on their own membership profile, the experience of their membership since the previous valuation and the asset returns based on actual cashflows and benefits paid out.

However, across the range, individual funding levels have improved significantly from the 2020 valuation. This has resulted in an expected reduction to the contribution rates requirement for the vast majority (possibly all) employers that participate within the NESPF. The level of any change varies from employer to employer which is dictated by the requirement to meet future liabilities having regard to other aspects including an employer's covenant.

Employers have received their suggested contribution rate requirements and discussions are ongoing around any requested adjustments that can be made on affordability, risk and future budgets and plans e.g. if they are seeking to terminate participation. Any adjustments to rates will be carried out in conjunction with the Scheme actuary and any decisions taken by the Fund will based on evidence provided by the participating employer.

5. Completion of the Valuation

Following finalisation of the assumptions and discussions with all participating employers around their contribution rates requirements the valuation can be completed and signed off by the Scheme actuary in time to meet the deadline of 31 March 2024.

Following completion of the process, the signed valuation report and contribution certificate will be provided by Mercer and made available to all employers. In addition the report will be brought to the Pensions Committee in March 2024 before a copy is issued to the Scottish Government as per the regulatory requirements including a number of factors such as budget projections and outlook. The required data will also be sent to the Government Actuary's Department for the purpose of the Section 13 valuation required by the Public Service Pensions Act 2013.