ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	15 JUNE 2015
REPORT BY:	HEAD OF FINANCE
TITLE OF REPORT	2014 ACTUARIAL VALUATION AND FUNDING STRATEGY STATEMENT
REPORT NUMBER:	PEN/JUN15/AV

1. PURPOSE OF REPORT

This report provides elected members with details of the final outcome of the 2014 Actuarial Valuation, the 2014 Funding Strategy Statement and the outcome of the consultation exercise on the valuation carried out with all participating employers within the Fund.

2. RECOMMENDATION(S)

It is recommended that the Committee note the report.

3. FINANCIAL IMPLICATIONS

The financial implications are detailed in the report.

4. OTHER IMPLICATIONS

None

5. VALUATION OUTCOME AND FUNDING STRATEGY STATEMENT

5.1 2014 ACTURIAL VALUATION

In accordance with the regulations governing the Local Government Pension Scheme, the actuary carries out a full actuarial valuation every three years. Based on this he provides the funding ratio at that point in time and sets the employer contribution rates for the next three years.

The scheme actuary has calculated that the overall funding position for the North East Scotland Pension Fund as at 31 March 2014 was 94%. This translates to a shortfall of £191m when comparing the assets held by the Fund against the liabilities or ‘funding target’ calculated by the actuary using the assumptions set out in the Funding Strategy Statement.

The funding level and shortfall have a significant improved since the 2011 valuation which is mainly due to investment performance, the impact of employer contributions and lower than expected pay awards to active members. The changes to underlying current financial conditions have had a huge negative impact on the assessment of the liabilities however, the shortfall has still decreased from £294m in 2011 (88% funded.)

It should be noted that since March 2014 there has been a significant deterioration of the funding position due to market conditions. This has been taken into account in both determining the deficit recovery plan and assessment of the employer contribution rates.

5.2 COMMON CONTRIBUTION RATE

The scheme actuary has assessed the cost of Future Service over the ‘whole fund’ as 14.9% of Pensionable payroll; this is an increase of 0.7% from the previous valuation. The increase has been driven by the change in financial assumptions adopted as a result in the poor performance of guilt yields but has been largely offset by the reduction in costs expected by the introduction of the LGPS 2015.

The Common Contribution Rate is individually adjusted for each employer or group taking into account their membership profile and the deficit contributions payable. The majority of non-council employers saw an increase in contribution requirements for the valuation period with the remainder maintaining the same rate as was set during *t*he previous valuation.

5.3 DEFICIT RECOVERY

The maximum deficit recovery period has been set in the Funding Strategy Statement as 19 years for the 2014 valuation. This is increased from the previous valuation when the shortfall was set to be recovered over 16 years. The increase has been adopted largely due to affordability.

Due to the changes in the market position that has occurred post valuation the deficit has increased considerably. The scheme actuary therefore advised that employer contribution rates be set to a minimum of the contribution rate set following the valuation in 2011.

5.4 LGPS 2015

The changes to the Local Government Pension Scheme (Scotland) which came into effect from 01 April 2015 have been taken into consideration as part of the 2014 valuation. Although the changes effect benefits after the valuation has taken place and therefore have not impacted on the funding level or the shortfall they have been considered in the calculation of the Common Contribution Rate for the cost of providing future benefits within the Fund.

5.5 EMPLOYER CONSULTATION

As per the regulation requirements a letter was issued to all participating employers the week beginning the 12th of January 2015 consulting them the proposed employer contribution rates (Copy attached at Appendix I). In particular the Fund was seeking comments on the following:

- Do you have any comments on the funding principles and actuarial assumptions adopted within the valuation as set out in the FSS?

- Do you wish to offer any information and supporting evidence regarding affordability which you would like the Administering Authority to consider before finalising the contribution rates?

- For those employers that have seen a significant increase in their contribution rate (increase of 1% or more), do you wish your increase to be phased in over the 3 year valuation period?

- Do you agree the proposed deficit recovery period (19 years) and the intention of the Fund to move to £'s recovery of the deficit instead of a percentage of payroll with effect from 2017/18?

- Do you wish to receive further information from the Scheme Actuary with regards to pre-payment of your deficit contributions?

The outcome of the consultation exercise is detailed at 5.6 below.

5.6 CONSULTATION OUTCOME

As a result of the increased contribution requirements for the 'other employers' group and for the majority of employers with individual employer rates the response to the consultation was very high. Many employers took the opportunity to engage with the Employer Relationship Team and the Pensions Manger regarding affordability and possible pre-payment of deficit contributions.

On the whole the responses were constructive and allowed the Fund to discuss individual issues or concerns that employers had. The main responses were:

- To individually request that increased contribution be phased in over the three year valuation period
- To request further clarification on both the Termination Policy and Covenant Assessment Policy which are imbedded within the 2014 Funding Strategy Statement
- To request confirmation of the group members and obtain further information on the cross subsidy within those groups
- To request further information on stand-alone rates (grouped employers)

In addition, the vast majority of the responding employers advised that they were not in favour of the intention to move from the collection of deficit contributions from a percentage of payroll to a £'s amount.

In accordance with the Funding Strategy Statement all requests for phasing of increased were granted. Discussions with the Fund also led to allowances for short term pay restraint, the opening up of admission agreements and the adjustment of deficit recovery periods for some employers on the grounds of affordability.

Following the completion of the consultation period all employers were advised that the Fund no longer intended to collect deficit contributions as a £'s amount due to the responses received.

5.7 GROUPS

Employer groups were established as part of the 2011 valuation in order to reduce the amount of 'cross subsidy' within the Fund. The groups were created based on both their characteristics and their date of admission to the fund. The groups were made up as follows:

- Closed employer group

- Council group
- Colleges group
- Other employers group (admission bodies admitted prior to 2008)

All employers admitted to the fund after 2008 were given an individual rate.

Since the 2011 valuation there have been many factors affecting employers which has resulted in changes to the groups which has affected the employer contribution rates applied.

Closed Group

This group consisted of three employers, two of which opened their admission agreement during the inter-valuation period. This has resulted in the disaggregation of the group and individual rates have been applied to each employer from March 2015 onwards.

Councils Group

This group consists of the three Councils and Grampian Valuation Joint Board. There has been no change to this group.

Colleges Group

One member of the Colleges Group elected to withdraw from the group and have a stand-alone rate applied for future contributions. This left only two employers remaining in the group. In order to prevent one employer subsidising the other the group was disaggregated and individual rates have now been applied for all Colleges within the Fund.

Other Employers Group

There have been several changes to the make-up of this group. Three employers have 'closed' their admissions therefore necessitating their removal them from the group, two employers terminated within the Fund and two were removed from the group following a review of their employer covenant.

Over the inter valuation period before March 2017 the Fund will continue to monitor and assess the appropriateness of the groupings for the next valuation.

5.8 CONSULTATION ON THE FUNDING STRATEGY STATEMENT

In accordance with the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 a revised Funding Strategy Statement was drafted during the 2014 valuation process. The draft Funding Strategy Statement was issued as part of the employer consultation in the week beginning 12 January 2015.

The Funding Strategy Statement sets out the NESPF Funding Principals and in particular details the actuarial assumptions used when calculating the liabilities held within the Fund.

The North East Scotland Pension Fund continues to take a prudent long term approach to funding the liabilities. When assessing the liabilities the scheme actuary has made allowances for asset out performance of 1.4% based on the investment strategy as set out in the Statement of Investment Principals:

Equities 65%
Property 10%
Bonds 10%
Alternative assets (including private equity) 15%

5.9 OUTCOME OF THE CONSULTATION

Feedback in respect of the Funding Strategy Statement was positive from all groups, accepting the funding principals outlined in the FSS and the assumptions adopted for the purpose of the valuation.

6. PENSION FUND IMPLICATIONS

Officers will use the scheme valuation and the discussions held during the employer consultation as a starting point in order to fully implement the Funds policy on Employer Engagement – Risk and Assessments of Employer Covenant. This will ensure that the risk to the fund and its participating employers, in relation to the ability of employers to meet the scheme liabilities, is managed and minimised.

The Fund, with the help of the scheme actuary will continue to monitor the impact of the LGPS 2015 on the assessment of the scheme liabilities.

Investment strategy will continue to be a key consideration to ensure that the investment returns meet the requirements of the Fund to achieve the funding target.

7. BACKGROUND PAPERS

- Consultation Letter (Appendix I)
- 2014 Actuarial Valuation Report
- North East Scotland Pension Fund Funding Strategy Statement
- Aberdeen City Council Transport Fund Funding Strategy Statement

8. REPORT AUTHOR DETAILS

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Date:	12 January 2015	

Dear

NORTH EAST SCOTLAND PENSION FUND (NESPF)

Employer Consultation on the 2014 Actuarial Valuation and Proposed Contribution Rates

The enclosed schedule outlines your individual or group funding level and proposed contribution requirements following the valuation carried out by the scheme actuaries as at 31 March 2014.

The Funding Strategy Statement (FSS) is a statutory document which has to be consulted upon with all of the participating employers within the NESPF and approved by the Administering Authority before the actuarial valuation can be completed. The draft FSS has been updated as a result of the valuation and is enclosed for your information.

The Pension Fund is seeking your comments by Friday the 6th of February 2015. In particular we welcome responses to the following questions:

- Do you have any comments on the funding principles and actuarial assumptions adopted within the valuation as set out in the FSS?
- Do you wish to offer any information and supporting evidence regarding affordability which you would like the Administering Authority to consider before finalising the contribution rates?
- For those employers that have seen a significant increase in their contribution rate (increase of 1% or more), do you wish your increase to be phased in over the 3 year valuation period?
- Do you agree the proposed deficit recovery period (19 years) and the intention of the Fund to move to £'s recovery of the deficit instead of a percentage of payroll with effect from 2017/18?

- Do you wish to receive further information from the Scheme Actuary with regards to pre-payment of your deficit contributions?
- Are there any other post-valuation events that may affect your membership profile that the Administering Authority should be made aware of before setting the final contribution rates?

- Do you agree with the current grouping structure for contribution setting purposes?

Affordability

The priority of the Administering Authority is to maintain the financial health of the Fund and try to ensure that rates remain as stable as possible in line with the scheme regulations. However, we are aware that the increasing cost of the scheme does put pressure on employers and their budgets. As part of the consultation process we can carry out individual discussions regarding affordability and in particular consider how the following would affect your contribution rate for the period:

Short Term Pay Restraint

The current assumption used for pay growth within the valuation is CPI inflation plus 1.5% (4.1%). For those employers that can provide evidence that pay awards are to be restricted to 1%p.a for the 3years following the valuation this assumption could be altered to reflect the reality. This would result in reduced contribution requirements. However, it should be noted that if pay growth was in fact higher over the 3 year period this could result in even higher contribution requirements in the next valuation.

Phasing

Any employer that sees an increase in contributions of 1% or above will be permitted upon request to phase that increase over a three year period in accordance with the Funding Strategy statement.

Deficit Contributions

Historically both future service costs and deficit contributions have been collected by the Fund as a percentage of payroll. The scheme actuary has suggested that in future any deficit contributions should be collected as a £'s amount. This is to ensure that the amount paid towards the deficit does not fluctuate with your membership profile. The Fund proposes that this change be implemented following the 2017 valuation to allow for employers to fully consider the effects of the change. However, if there is a significant drop in membership profile within this valuation period this may result in increased contribution requirements for the next valuation period.

There is also the option for any employer to pre–pay deficit contributions as a lump sum either on an annual basis or for the full three years. If an employer does this then the

Fund Actuary can allow for this early payment by discounting the total expected payments resulting in a saving over the period.

Termination Policy and Risk Assessment of Employer Covenant

Embedded within the Funding Strategy Statement are the NESPF policies on the termination of participating employers (Appendix 3) and the assessment of employer covenants (Appendix 4). These policies have been implemented following the 2011 valuation process and form part of the risk management of the Fund.

Groupings

The funding levels and contribution rates have been determined using the groupings as set out in the 2011 actuarial valuation. The 'closed' group has been discontinued as only one participating employer remains eligible for the group.

Stand Alone Rate

A single opportunity is provided at this valuation for an employer to be removed from their group and be treated as a stand-alone employer. Should an employer move out of a group this may impact not only on their individual rate but also on that of the group.

Individual funding positions for those employers that are members of a group can be made available upon request to the Employer Relationship Team.

Funding Position from March to December 2014

There has been significant deterioration in the funding position for all employers since 31 March 2014. The actuary therefore proposes that the final rates are set at the minimum of each employer's current contribution rate.

Response to Consultation by 6 February 2015

Please email your comments to employer@nespf.org.uk by the above date. The actual rates will be decided by the Administering Authority and will be advised before 31 March 2015.

I look forward to receiving your feedback.

Yours sincerely

Laura Colliss
Pensions Manager