ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	1 DECEMBER 2017
REPORT TITLE	2017 ACTUARIAL VALUATION AND FUNDING STRATEGY STATEMENT – INITIAL RESULTS
REPORT NUMBER	PC/DEC17/ACT
DIRECTOR	HEAD OF FINANCE
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1. PURPOSE OF REPORT:-

1.1 This report provides elected members with details of the initial results of the tri-ennial valuation for the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF) as at 31 March 2017, which has been carried out by the scheme actuary. In addition, it provides a first look at the 2017 Funding Strategy Statement (FSS) for each Fund.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Note the initial valuation results of both Funds as at 31 March 2017;
ii. Note the draft FSS for both the NESPF and ACCTF including the assumptions recommended by the scheme actuary to determine the value placed on the Fund liabilities as at 31 March 2017 and the individual employer contribution rates payable from 2018/19;
iii. Instruct the Head of Finance to carry out a full consultation on the FSS as required by the scheme regulations and provide a report on the consultation outcome to the March Pensions Committee;
iv. Note the intention to disaggregate the remaining employer groupings within the Fund; and
v. Note the remainder of the report.

3. 2017 ACTUARIAL VALUATION AND FUNDING STRATEGY STATEMENT

3.1 In accordance with the Local Government Pension Scheme (Scotland) Regulations 2014, the scheme actuary is required to carry out a valuation of the Funds every 3 years. The results of the tri-ennial valuation provide the funding level which will be published in the Annual Report and Accounts and will set the individual employer contribution rates for the following valuation period.

3.2 The scheme actuary (Mercer) has carried out the initial calculations in relation to both the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF) as at 31 March 2017.

3.3 NESPF

3.3.1 Initial results indicate that the funding level over the whole Fund is 107% as at 31 March 2017. This translates to a surplus of £239 Million when comparing the assets held by the Fund against the calculated value of the liabilities held for members.

3.3.2 The funding level has significantly improved since the 2014 valuation which is predominately due to investment returns but is also as a result of lower than expected pension increases, change in demographic assumptions and member movements within the Fund.

3.3.3 Another factor which has positively affected the valuation results is the change in methodology in setting the discount rate which is the main driver in determining the valuation of the liabilities. Where the discount rate was set using the gilt yields in the 2014 valuation the scheme actuary has advised a shift towards setting the discount rate in relation to real asset returns is now more appropriate (given the low value of gilt yields in relation to asset performance within the Fund). Although this change of methodology has resulted in an improvement in the overall funding position the Fund still wish to adopt a prudent approach with regards to setting the valuation assumptions and determining the value of the liabilities.

3.4 ACCTF

3.4.1 Initial results indicate that the funding level for the Transport Fund is 92.7% as at 31 March 2017. This translates to a deficit of £7.9 Million when comparing the assets of £100 Million against the calculated liabilities of £107.9 Million.

3.4.2 Although the published funding level will drop from 93% in 2014 to 92.7% as at 2017, the methodology used to establish this has changed over the inter-valuation period to reflect the de-risking approach that is being taken for this rapidly maturing Fund.

3.4.3 The suggested discount rate will be determined using the value of gilt yields +0% allowance for out performance in assets compared to the 2014 discount rate of gilts +0.25% p.a. If the scheme actuary were to use a like for like assumption this would translate to a funding level of 97% (an improvement of 4% from the previous valuation).

3.4.4 As the Transport Fund is a ‘closed’ Fund with only one participating employer it is essential that a prudent approach is applied to the calculation of the liabilities and that the funding level is monitored closely over the inter-valuation period to ensure that the de-risking 'flight plan' currently being delivered through Schroders can be adhered to.

3.5 Funding Strategy Statement (FSS)

3.5.1 In accordance with the Local Government Pension Scheme (Scotland) Regulations 2014 a revised Funding Strategy Statement (FSS) for each of the Funds has been drafted as part of the valuation process. The draft FSS's outline the methodology used to determine the valuation outcomes including the suggested assumptions to be applied, the deficit recovery plan and how assets are proportioned throughout the participating employers.

3.5.2 Particular emphasis has been put into the 2017 FSS in relation to the overall Fund solvency and long term cost efficiency. This is a reflection of the change in regulations that require all LGPS (Scotland) Funds to prioritise these values over the desirability to provide contribution rate stability for participating employers.

3.5.3 The FSS has been developed alongside the Funds Statement of Investment Principles (SIPP) and should reflect investment strategy, particularly in relation to allowance made for asset out performance when determining the discount rate assumption.

3.5.4 It is a regulatory requirement that the FSS undergoes a full consultation with all participating employers prior to the valuation being signed off by the scheme actuary in March 2018.

3.6 Individual employer results and rates

3.6.1 The positive valuation results mean that the Local Authorities that make up the vast majority of the active membership within the Fund will be able to maintain the current employer contribution rate that has been applied for the last 3 years (19.3% of pensionable payroll).

3.6.2 However all employers will have their individual funding levels and employer contribution rates determined upon their own membership profiles and experiences throughout the inter-valuation period from 2014 to 2017. This will mean that some employers will have increased contribution requirements from 2018 onwards. This reflects the increased future service costs of providing benefits through the LGPS (Scotland) and the maturing of a lot of the membership profiles of smaller employers.

3.7 Groups

3.7.1 Employer groups were established as part of the 2011 valuation in order to reduce the amount of 'cross subsidy' within the Fund. Prior to this point the Fund was valued as a whole and one employer rate with applied throughout 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)

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

3.7.3 As part of the 2014 valuation, decisions taken by the employers within the group and changes to the admission agreements between the employers and the Fund meant that both the colleges group and the closed employer group were disaggregated from 1 April 2015.

3.7.4 Due to the positive outcome of the 2017 valuation and the increased emphasis by the Pensions Regulator (tPR) on solvency and long term cost efficiency the Fund proposes to disaggregate the remaining groups with effect from the valuation date. This would mean that from1 April 2018 all participating employers would stand alone and would have their own employer contribution rate based on their individual membership profile, fund experience and funding level. In addition, this will allow the Fund to set rates which take into account the covenant and future plans of each employer and also where appropriate, on an individual basis, to consider affordability.

3.7.5 The final decision will be taken regarding the disaggregation of the remaining groups following consultation with employers. Pension Committee approval for this decision will be required in March 2018.

3.8 <u>Covenant Review</u>

3.8.1 Monitoring of the covenant of each employer in line with the NESPF policy on risk management continues to be a priority of the Employer Relationship Team. Effective monitoring ensures 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.

3.8.2 Covenant assessment for all admission bodies will be carried out in line with the valuation and will be an important consideration in the setting of the individual employer rates from 2018 onwards.

3.9 <u>Employer Consultation</u>

3.9.1 The regulatory requirement to consult with all employers on the draft Funding Strategy Statement will be carried out in conjunction with the issue and discussion on individual employer contribution rates.

3.9.2 As part of the discussion process an opportunity will be afforded to all employers to discuss the contribution requirements and the suggested assumptions with the scheme actuary at a ‘results event’ to be held in mid-December.

3.9.3 The consultation will be carried out over December and January to ensure that Committee approval can be obtained prior to the valuation being signed off by the scheme actuary in March 2018.

4. FINANCIAL IMPLICATIONS

4.1 The actuarial valuation sets the employer contribution rates for all participating employers within the Funds. It is essential that the underlying assumptions used to determine the contribution requirements are set in such a way that ensures that the Funds remain solvent whilst also taking into consideration the desirability to create stability for employers.

4.2 Whilst the Funds recognise that affordability is a concern with all employers that actively participate within the scheme the regulations require that the emphasis is put on overall solvency of the scheme and minimising risk for the Funds as a whole.

4.3 Failure to set accurate assumptions or set high expectations on the future investment performance will mean that employer rates are not set accurately and will have a detrimental effect on the funding levels for future valuations.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 There are no direct risk implications arising from the recommendation of this report.

7. IMPACT SECTION

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

8. BACKGROUND PAPERS

8.1 None

9. APPENDICES

9.1 **Appendix I**, North East Scotland Pension Fund Funding Strategy Statement 2017 (draft)

Appendix II, Aberdeen City Council Transport Fund Funding Strategy Statement 2017 (draft)

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