Pension Fund Committee

Dorset County Council

Date of Meeting	1 March 2017
Officer	Pension Fund Administrator
Subject of Report	**Review of Fund Valuation 2016 – lessons learnt**
Executive Summary	The purpose of this report is to update the Committee on the progress on the Triennial Pension Fund Valuation 2016 and lessons learned from this year's process. It offers recommendations to provide more certainty to employers about contribution rates in future valuations, and the work that employers need to do to ensure a smooth valuation in 2019.
Impact Assessment:	Equalities Impact Assessment: N/A
	Use of Evidence: N/A
	Budget: N/A
	Risk Assessment: The rate of employers' contributions are variable unlike the employee contribution rate that is fixed. This means that any funding shortfall currently has to be made up by adjusting the employers' contribution rates. In the current financial and economic climate contributions certainty is required to ensure that employers can provide sufficiently for changes to their contribution rates in a timely and planned way, so as to minimise the impact on wider council services.

	Other Implications: None
Recommendation	i) That indicative future employer contribution rates are provided for the years 2020/21 and 2021/22 to provide early planning for medium term financial plans; ii) That employers conduct regular data cleansing reviews to ensure that the data which the valuation is based on is clean to aid a smooth process in 2019; iii) That a plan be put in place to ensure a more timely release of future valuation results; iv) That the committee note the particular difficulties encountered during the 2016 process which are not anticipated in future valuations.
Reason for Recommendation	To ensure that employers have greater certainty of future years contribution rates, enabling them to better plan over the medium term.
Appendices	Appendix 1 – Summary of Data issues and Action Plan
Background Papers	2016 valuation
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1. Background

1.1. The Dorset County Pension Fund, like all Local Government Pension Scheme funds, is required to undertake a triennial valuation of its assets and liabilities, in order to set future employer contribution rates to be paid into the Fund for the following three financial years. The latest valuation took place based on asset and liability information and data records as at 31st March 2016. Valuation rates for all employers have to be legally certified by the fund actuary by 31st March 2017 for the following three years. In reality, because of the contributing employers' requirement to set a budget, employer rates are usually announced in the December prior to the legal deadline.

1.2. The 2016 valuation was the first valuation since the new 2014 scheme had been introduced and has been the first valuation since new oversight arrangements had been introduced from both the Government Actuary's Department (GAD) and the new LGPS Scheme Advisory Board.

2. The 2016 Valuation

2.1. There were a number of new factors that had to be considered as part of the 2016 valuation which added to the complexity of the valuation. These are considered in turn:

<u>Discount Rate assumptions</u>

2.2. The new oversight rules, has resulted in a drive for consistency between the different actuarial valuation approaches in deriving the discount rate used to value the Fund's liabilities. Barnett Waddingham, the Fund's actuary, has developed over a number of years an economic model approach, which considers the mix of assets owned by the Fund and looks at likely future returns from each asset class on a smoothed basis to help stabilise employer contributions.

2.3. These returns are added together and a discount rate is derived reflecting the expected rate of investment return from the long term strategic asset mix. Other actuaries use different approaches ranging from a gilts plus return model to an inflation linked model. The impact of these different approaches affects the discount rate used. The higher the discount rate used the lower the funding gap.

2.4. Liabilities are affected by four main things:

- 2.4.1. Inflation – pensions are index linked to CPI so this needs to be factored into the calculations on future pension payments;
- 2.4.2. Pay growth – the majority of the Fund liabilities are linked to final salary, with only the past 2 years on a career average basis. The rate of wage growth therefore impacts on the amount of pension that will be paid when the employee retires;
- 2.4.3. Longevity – the length of time that pensioners live after retirement impacts on the full quantum of pensions paid;
- 2.4.4. The accrual rate – the rate at which pension benefits are accrued. The current scheme is now a mixture of 1/80th, 1/60th and 1/49th depending on when benefits were accrued.

2.5. The Fund is comfortable with the economic model approach because it invests in mainly growth assets and remains in a cashflow positive position (whereby employer and employee contributions exceed amount paid out in pensions). There has been downward pressure on the discount rate since the financial crash of 2008 due to lower yields and expected investment returns. This has had the impact of increasing deficits and therefore higher contribution rates.

2.6. Unlike the majority of private sector pension schemes, the LGPS remains open to all employees, and the majority of employers in the Fund (by value) are sovereign tax raising bodies. This provides a good degree of certainty and most employers carry the Government's high credit rating, meaning they are unlikely to go bust, unlike some private sector companies. Private sector valuations and some LGPS valuations take a very prudent approach and essentially measure liabilities based on gilt returns which have fallen to all-time lows. This has had the impact of lowering the discount rate and increasing deficits, resulting in higher contribution rates for employers, and, in a lot of cases in the private sector, closure of schemes to new employees.

2.7. However, the impact of the new GAD rules (s13 of the 2013 Public Service Pensions Act) and the Scheme Advisory Board (SAB)'s plea for more consistency in approaches to valuations and standardised results have resulted in more focus on greater convergence of assumptions. In setting assumptions therefore, actuaries have to take heed of the GAD s13 basis and the SAB standard basis. This essentially resulted in the actuaries having to increase the overall prudence level and effectively reducing the discount rate applied to the Fund increasing the "pace of funding" and ultimately increased employer contribution rates in the short term, albeit lower contributions in the longer term. The discount rate has reduced from 6% in the 2013 valuation to 5.4% in the 2016 valuation, although in real terms the discount rate only reduced by 0.3%.

2.8. Under s13 there is provision for DCLG to effectively intervene and require an administering authority to take remedial steps as recommended by GAD if in GAD's view the contribution levels set do not satisfy the requirements of s13. This could potentially mean, for example, higher contribution rates being required to be paid than have been certified.

Deficit Recovery Periods

2.9. In addition, because the LGPS is an open, funded scheme, and taxpayer backed, it has meant that deficit recovery plans have typically extended for up to 25 years. The previous valuation for Dorset assumed a 25 year recovery period. These recovery periods are unusual in private sector schemes, mainly because of the going concern issues within the private sector. As a result the pensions industry is seeing recovery periods reduce which is feeding through to public sector funded schemes. GAD and the SAB are pushing for recovery periods of less than 20 years and that continue to reduce overtime. This again is placing pressure on contributions levels as more has to be paid in to shorten the recovery period.

2.10. The new approach from GAD has placed scrutiny on these assumptions and there is industry pressure to reduce deficit recovery periods significantly.

2014 Scheme

2.11. A new scheme came into place from April 2014, whereby future pensions moved from a final salary basis to a career average or CARE (Career Average Revalued Earnings) scheme. As a result the accrual rate improved from 60ths to 49ths. A major assumption was that there would be a new 50:50 element to the scheme, whereby employees could pay in 50% of their contributions in return for 50% of the benefits. Employers would continue to pay the full rate. It was assumed there would be a 10% take up. The actual take up has been much lower, presenting additional pressure on the scheme.

2.12. The 2016 valuation has been the first one since the 2014 scheme was introduced and now means that there are multiple benefit scenarios for scheme members, with some long service members in up to 4 different schemes. This has added complexity

for funds and difficulties with aggregation of member benefits which has made the valuation of liabilities more complicated.

Data Quality from Employers

2.13. There were a number of data issues encountered as a result of the transition to the CARE scheme, and changing employers due to new academies and Local Authority Trading Companies. Appendix 1 illustrates the review of the data issues, sets out the timeline of data related events and provides an action plan to ensure these issues do not arise in future valuations.

Asset Returns

2.14. Whilst asset returns have been favourable at 6.4% per annum, the Dorset Fund has not performed as well as other funds. Outperformance over the last three years would have eased the pressure on the employer contributions rates as the Fund would have operated from a higher asset base.

Number and type of Employers in the Scheme

2.15. A further complexity has been the growth in number of employers in the scheme, specifically with the increase of schools becoming academies and the growing trend of Councils setting up Local Authority Trading Companies. Changes by government to the treatment of FE colleges (effectively treating them as private companies and stating that they will not be underwritten by government guarantee) has changed the risk profile of employers and impacted on contribution rates.

3. Employer Results

3.1. As outlined in section 2, there are many factors involved in producing a robust valuation. It was hoped that results would be with employers by November 2016, but the delays caused by the various changes to the scheme and data issues meant that this timetable slipped towards the end of December 2016.

3.2. In the run up to the valuation date some indicative high level results at total Fund level were provided and it appeared that there was a possibility that contribution rates could remain at 2016 levels. However, as the results of the s13 “dry run” valuation emerged in spring 2016 (GAD went back to the 2013 valuations and carried out a dry run s13 valuation) it became evident that this might be more of a challenge as details of how they would carry out a s13 valuation emerged. Graeme Muir, Barnett Waddingham, the Fund’s actuary, presented some indicative results to the September Committee meeting before any actual numbers were run and indicated that contribution increases should be expected. The actual results being issued later than expected, coupled with previous expectations of some contribution stability has caused a number of employers serious difficulties in balancing their budgets for 2017/18.

3.3. A few employers, mainly those with very complex inter-valuation multiple transfers of staff between employers, were waiting well into January 2017 for their results which has made budget preparation extremely challenging. During the inter-valuation period there were over 100 “employer events” – new employers, transfers of staff, employers ceasing, bulk transfers etc.

3.4. Most practical issues have now been resolved and the actuary has been working hard with employers to mitigate the 2017/18 increases by agreeing stepped increases across the valuation period.

3.5. There has therefore been a lot of dissatisfaction from employers about this valuation process and it is important to learn from these issues and take mitigating action for future valuations. Employers are accepting that rates have to increase and have not

challenged the assumptions used, they have been mainly affected by the timing and the unexpected nature of the increases.

3.6. It should be noted that in the majority of private schemes actuarial valuations taken place over a 15 month period, rather than the 8 months that the LGPS requires in order to set budgets. Also, most private sector schemes are single employer schemes only requiring one contribution rate to be calculated. In the Dorset Fund the number of employers means the actuaries have to set almost 200 contribution rates. The complexities mentioned in this report have therefore added pressure to an already tight timescale.

4. Summary and next steps

4.1. A combination of the new Scheme and its additional data requirements, issues with the new valuation data extract programs, the large increase in the number of employers in the LGPS and changes to their risk profile, coupled with the new legislative and oversight requirements made the 2016 valuation one of the most complex and challenging ever for all concerned. This impacted on all Funds not just the Dorset Fund.

4.2. The majority of the issues faced during this valuation have been one off due to the changing assumptions and regulatory pressures. Employers have indicated that they mainly require contribution certainty and value this over contribution stability.

4.3. The actuary has therefore agreed to provide employers with certified rates for the three years to 2019/20 as required by law, but also to provide indicative rates, most of which will show an increase, for 2020/21 and 2021/22. This is required to allow employers to budget with greater certainty.

4.4. There is however also a responsibility on the employers to ensure that their employee records are up to date and of high quality, which will smooth the future valuation process.

4.5. Barnett Waddingham have an online inter-valuation monitoring model that will allow employers access to provide inter-valuation valuation results to assist with valuation outcome projections and so aid future budget planning. They will also produce in conjunction with the Fund a detailed plan outlining the expectations on employers for the 2019 valuation process.

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