Pensions Investment Committee			
Report Title	**2010 Revaluation of Pension Fund**		
Key Decision	**No**		**Item No. 3**
Ward			
Contributors	**Executive Director for Resources**		
Class	**Part One**	Date: **18th November 2010**	

1. SUMMARY

1.1 This report informs Members of the results of the 2010 Revaluation of the Pension Fund and the funding strategy stipulated by the Consultant Actuary Hymans Robertson.

1.2 The report comprises the following sections:

2. Recommendations
3. Background
4. Purpose of Valuation
5. Past Service Rate
6. Stabilisation of Employer Contribution Rates
7. Future service Funding Rate
8. Achieving Full Funding
9. Conclusions
10. Financial Implications
11. Risk Management Implications
12. Legal Implications

2. RECOMMENDATIONS

Committee is recommended to: -

2.1 Note the contents of this report .

2.2 Forward this report to the Council's Mayor and Cabinet for incorporation into the 2011/12 Budget Report;

3. BACKGROUND

3.1 The Local Government Pension Scheme Regulations 1997 require that a valuation of the Pension fund administered by this Council be undertaken by a qualified actuary every three years.

3.2 The revaluation, which is the subject of this report, was undertaken by the Council's consultant actuary, Hymans Robertson, with a valuation date of the 31st March 2010.

4. PURPOSE OF THE VALUATION

4.1 The Local Government Pension Scheme (LGPS) is a funded scheme. This involves employers and employees contributions being invested by the Pension Fund until they are required to pay pensions.

4.2 In theory, the value of the shares held by the Fund should be equivalent to the projected pensions payable to the Scheme members. However until the last member of the Scheme dies the adequacy of the funds investments to finance the liability to pay pensions cannot be determined.

4.3 To enable the actuary to assess the adequacy of the fund to discharge its liabilities it is necessary to make a number of assumptions on significant factors including investment returns, earnings growth and life expectancy.

4.4 A revaluation is a sophisticated statistical exercise, which compares the value of investments held by the Fund with the projected costs of providing pensions to Fund members.

4.5 The purpose of the valuation is to determine the level of the employers' contribution to the Fund for the next three years until the next revaluation.

4.6 The revaluation solely determines the employer's contribution because under the current Local Government Pension Scheme the level of employee contributions and basic benefits are prescribed by the Government and the Council has no discretion to vary either. The level of investment income is determined by the performance of the Fund's investment portfolio. Consequently a surplus or deficit must be financed by a revision to the employer's contribution. The Council effectively underwrites the solvency of the Fund.

4.7 The revaluation exercise addresses two questions: -

4.7.1 What is the surplus or deficit on the Fund at the revaluation date? This compares the assets of the fund to the liability to pay pension entitlements accrued by scheme members at that date. This is termed the "Past Service Rate".

4.7.2 What level of employers contributions are required to fund members pension entitlements accruing after the revaluation date? This is on the assumption that there is no surplus or deficit and is termed the "Future Service Rate".

4.8 It should be noted that the valuation is based on the current structure of the Local Government Pension Scheme and does not incorporate changes anticipated from the Hutton review of public sector pension provision or the cost sharing arrangements the details of which have yet to be published.

5. THE PAST SERVICE RATE

5.1 The Actuary has calculated that the Pension Fund has a funding level of 75.7%. which represents a deterioration of 11.7% on the position of the 2010 revaluation when the funding level was calculated to be 87.4%

5.2 The funding level is based on the actuary's assessment of the cost of providing pensions to all current members of the Fund of £945 million (£840million 2007) and the corresponding value of the investments from which such pensions are to be paid £715million (£735million 2007). Consequently in monetary terms, the deficit has increased by £125 million from £105 million to £230 million.

5.3 The principal factors, which have contributed to the change in the funding position, are as set out in Table 1: -

Table 1: Factors Contributing to Changes to the Funding Level

	£ Million
2007 Revaluation Funding Deficit	105.6
Investment Returns lower than Projected	177.8
Change in Pensions Increase from Retail Prices Index (RPI) to Consumer Prices Index (CPI).	-64.9
Other Assumptions	-13.3
Increased Life Expectancy	71.9
Net Additional employers contributions to the Fund	-14.2
Other Experience Items	-40.0
Miscellaneous: Interest etc.	7.0
2010 Revaluation Deficit	229.9

5.4 The principal factors are explained in detail below: -

5.4.1 Investment Returns lower than Projected (£177.8 million)

The 2007 Revaluation projected that the fund's investments would yield a return of 18.4%. The impact of the global recession has depressed investment returns and resulted in pensions funds investments significantly underperforming against the projections incorporated into the 2007 Revaluation. The revaluation projected cumulative returns of 18.4% over the three year period whilst those actually achieved were -5.9%. The underperformance against projections of 24.3% contributed £177.8 million to the deficit.

5.4.2 Change in Pensions Increase from Retail Prices Index (RPI) to Consumer Prices Index (CPI).(-£64.9 Million).

The Chancellor of the Exchequer announced in his emergency Budget on the 22nd June 2010 that the CPI would replace the RPI as the basis for future increases to pension payments under the LGPS. The CPI is generally lower than the RPI because it excludes housing costs and includes a factor which assumes that consumption patterns react to changes in prices.

5.4.3 Revised assumptions –financial and demographic (-13 3 million)

The Actuary has revised a number of his assumptions to reflect experience since the 2007 Revaluation and subsequent developments. In the financial assumptions (£18 million) these include reflecting falling yields in the market, allowing for lower short term salary growth attributable to the salary freeze imposed by Central Government, and increasing the level of assumed investment out-performance. The Actuary has also made allowance for an anticipated change in normal retirement patterns (-£31 million).

5.4.4 <u>Increased Life Expectancy (£71.9 Million)</u>

The actuarial profession consider that life expectancy will continue to improve.. Males were expected to live to 88 in the 2007 Revaluation and this has increased by 2 years to 90 in the current revaluation The increased term for which pensions are payable will adversely impact on the cost of providing pensions.

5.4.5 <u>Additional employer's contributions to the Fund (-£14.2 million)</u>

The payments in the inter valuation period associated with the deficit recovery strategy adopted by the Council has resulted in an improvement in the funding position of £14.2 million.

5.4.6 <u>Experience over the 3 years on payroll and investments (£-40 Million).</u>

The Actuary has analysed various aspects of the Fund's development over the 3 years. Certain areas have been favourable (actual salary experience, ill health experience) whereas others haven't (withdrawal experience). The net effect is some £40 million reduction in the deficit.

6. <u>STABILISATION OF EMPLOYER CONTRIBUTION RATES</u>

6.1 The actuary when specifying the employers contribution for the three year term of the valuation is required to consider to the "desirability of maintaining as nearly constant a rate as possible."

6.2 The revaluation exercise is based on a number of assumptions variation of which can materially influence the outcome and the associated employers contributions. The actuary had previously applied smoothing techniques to stabilise the rates over the effective 20 year life of the fund but in the current revaluation has employed sophisticated financial modelling techniques to determine the impact of alternative funding strategies on the viability of the fund.

6.3 Details of the modelling and the implications of the funding strategy for the investment asset allocation is set out in a further report on this agenda.

6.4 The modeling however indicates that a stabilization policy which restricts increases and decreases in employers contributions rates to 0.5% per annum based upon employees pay. is acceptable. It should be noted that this stabilization purely relates to the Lewisham element of the fund and other employers participating in the fund will be considered on a individual case basis.

7. FUTURE SERVICE FUNDING RATE

7.1 The future service funding rate (FFSR) is the level of employer's contributions necessary to fund the cost of benefits accruing in the future.

7.2 The Actuary has calculated that the rate should be 17.7% of employee's pay with effect from the 1st April 2011. This compares to a rate of 16.4% of employee's pay in the 2007 revaluation.

7.3 The increase of 1.3% is principally attributable to the increase in life expectancy and the reduction in the projected investment returns. The actuary has specified that the following rates be applied to provide for the Future Service Liabilities.

Year	Employers Contribution Rate
2011/12	17.7%
2012/13	17.7%
2013/14	17.7%

8. ACHIEVING FULL FUNDING

8.1 The Actuary when determining the strategy to achieve full funding considers a number of issues including: -

8.1.1 Stability of contribution rates over time

8.1.2 The need to achieve full funding

8.2 Actuaries in previous valuations have adopted a relatively long deficit recovery period. This recognises the statutory backing of the Local Government Pension Scheme and the financial position of the Councils, which guarantee the solvency of the Fund.

8.3 The actuary has recommended maintaining the period over which the deficit is estimated to be recovered at 20 years. On this basis the actuary has stipulated that the basic employer's contribution for the deficit be 2.8% for 2011/12 with an increase of 0.5% for each of the two subsequent years.

Year	Deficit Contribution
2011/12	2.8%
2012/13	3.3%
2013/14	3.8%

9. CONCLUSIONS

9.1 This Council's pension fund in common with those in the public and private sectors is subject to the pressures of increasing life expectancy and falling investment returns. The change in the funds financial position and the additional demands on the revenue budget to support the pension fund correspond to the experience of comparable authorities.

9.2 The revaluation should be considered in the context of considerable uncertainty associated with pension provision within the public sector. The Hutton Report commissioned by the Government is reviewing the structure and affordability of public sector pensions schemes with preliminary indications suggesting that the employee contributions will increase. In addition the cost sharing provisions of the LGPS have yet to be finalised. These factors whilst not factored into the revaluation will have implications for the later years of the revaluation term.

10. FINANCIAL IMPLICATIONS

10.1 The comments of the Executive Director for Resources have been incorporated into the report.

11. RISK MANAGEMENT IMPLICATIONS

11.1 Administration of Pension Funds inevitably involves a high level of uncertainty because they involve vast sums of money and operate over large time spans.

11.2 The inherent risk is exacerbated by the need to invest there funds in volatile investment markets to provide additional income to fund future pension payments.

11.3 The Actuarial valuation attempts to ensure that there are sufficient assets to fund future liabilities and regulate the employer's contribution on the basis of these reviews.

11.4 This exercise attempts to minimise the disruption to revenue budgets by equalising the cost to revenue accounts over as long a period as possible subject to such stabilisation maintaining the financial viability of the fund.

12. LEGAL IMPLICATIONS

12.1 Under the Local Government Pension Scheme Regulations 1997 each administering authority must obtain an actuarial valuation of the assets and liabilities of its pension fund every third year after 31 March 1998.

12.2 The Regulations require that the administering authority set the contribution rate as determined by the actuary.

12.3 Once a rates and adjustment certificate is issued by the actuary the authority must send copies of any valuation, report and certificate to the Secretary of State and to each body with employees who contribute to the fund (admitted bodies).