ITEM NO: 6

Report To:	**Pension Fund Management Panel**
Date:	13 September 2013
Reporting Officer:	Peter Morris, Executive Director of Pensions
Subject :	**ACTUARIAL VALUATION**
Report Summary:	The Actuary has been giving periodic updates to the Fund regarding the 2013 actuarial valuation and the issues that will arise therefrom. The purpose of this report is to provide a further update that will serve as background to the Actuary's presentations to the Panel and the AGM.
Recommendation:	(i) To note the Actuary's current estimated funding position of the Fund as a whole. (ii) That officers have discussions with individual employers re their potential outcome as the Actuary assesses their positions with priority being given to employers without a local authority guarantor.
Financial Implications: **(Authorised by the Borough Treasurer)**	The 2013 actuarial valuation will result in higher employer contributions for most employers. Additional costs of advice, e.g. legal and actuarial are likely to be incurred in discussions with employers.
Legal Implications: **(Authorised by the Solicitor to the Fund)**	In obtaining additional security from employers, the Panel will need to satisfy itself on the value of such security. It is important as highlighted in the report that the necessary legal, financial and actuarial advice is taken before each individual decision made.
Risk Management:	The Actuary and the Panel will have complex issues to consider in setting contribution rates for the next 3 years balancing prudence, stability, affordability and stewardship.
ACCESS TO INFORMATION:	**NON-CONFIDENTIAL** **This report does not contain information which warrants its consideration in the absence of the Press or members of the public.**
Background Papers:	For further information please contact Peter Morris, Executive Director of Pensions, Greater Manchester Pension Fund, Wellington Road, Ashton-Under-Lyne, Tel 0161 342 3438, email peter.morris@tameside.gov.uk

1. INTRODUCTION

1.1 The Panel and employers have received periodic updates on the likely outcomes of the 2013 actuarial valuation. The Actuary will give a further update at the Panel that will take account of membership experience over the last 3 years at the whole fund level, such as pay increases and mortality.

1.2 The aims of this report and the Actuary's presentation are:-

(i) to give an indication of the whole fund position based on the assumptions set out in section 4;
(ii) to flag material issues that the Actuary and Panel will need to consider as part of the valuation process;
(iii) to comment on the outlook for employer contributions.

2. DEVELOPMENTS INFLUENCING EMPLOYER COSTS

2.1 The Government has announced further pay restraint for public sector workers.

2.2 The Government has changed the basis of Pensions tax relief, reducing the annual allowance and lifetime allowance which will result in some members opting out.

2.3 The implementation of auto-enrolment will have a positive impact on employee membership that will offset some of the effect of employers reducing their workforce in response to shrinking funding..

3. IMPLICATIONS OF LEGISLATIVE OR PROSPECTIVE LEGISLATIVE CHANGES

3.1 It is proposed that the Actuary reflect the ongoing "pay restraint" in the valuation assumptions. There is a risk based on long term evidence that pay restraint in the short term is offset by higher compensating increases in the longer term. An issue to consider is the duration for which a short term pay freeze can be assumed in the context of the Government's announcement. Given the change to career average, this only has an impact on benefits earned up to 31 March 2014 for all active members and those active members where protections apply.

3.2 In April 2014, future accrual of pension benefits in the LGPS will be based on the new career average scheme.

3.3 Pensions and deferred benefits are linked to the consumer price index. The Actuary has reassessed the difference between RPI and CPI for future inflation projection and he is intending to increase his estimate of the differences from 0.5% to 0.8% (i.e. CPI is assumed to be 0.8% less than RPI). This will have a beneficial impact on funding levels and the cost of future benefits earned.

4. FINANCIAL ASSUMPTIONS AND INDICATIVE FUNDING LEVEL

4.1 The valuation assumptions used in the 2010 valuation and the indicative assumptions that could apply at the 2013 valuation are summarised below in Table 1. The 2013 assumptions are derived on the same basis as those used in the 2010 valuation adjusted to reflect current market conditions. The assumptions have yet to be finalised by the Actuary. Any changes to the financial assumptions (and major demographic assumptions) can have a material impact on funding outcomes.

Table 1 – Comparison of assumptions used in 2010 v indicative 2013 assumptions

	31 March 2010		31 March 2013	
	Nominal %	**Real %**	**Nominal %**	**Real %**
Investment Return	6.3	3.0	4.8	2.3
Pay - short term - long term	1.0 4.3	 1.0	3.8	1.3
Inflation - RPI - CPI	3.8 3.3		3.3 2.5	

4.2 Applying the indicative assumptions outlined above is likely to result in a funding level of approximately 90%. The main reason for the fall in funding levels compared to the 2010 valuation is the change in market conditions and in particular exceptionally low long interest rates

4.3 The Actuary will give a more detailed update at the meeting and comment on:

- the basis of the assumptions; and
- the membership experience over the last 3 years.

5. FUNDING STRATEGY STATEMENT

5.1 The Funding Strategy Statement (FSS) provides guidance to the Actuary in undertaking the actuarial valuation. A revised FSS will be published for consultation in September. The Employer Funding and Viability Working Group will review the responses to the FSS consultation.

5.2 The FSS will be considered by the Panel at its next meeting and needs to be considered in tandem with the results of the actuarial valuation.

6. OUTLOOK FOR EMPLOYER CONTRIBUTIONS

6.1 The employer contribution rate comprises two components, the cost of buying future service and the sum required to recover the deficit. The revised assumptions are likely to result in a future service cost of approximately 15%. If the life expectancy assumption is strengthened, this will increase the future service cost and deficit recovery payments. The fall in funding level/increase in deficit means that deficit recovery payments will be greater than those applying in 2010. Current indications are a whole fund average of 3%. Again, the Actuary will give an update at the meeting.

6.2 The outcome at the individual employer level can result in very different contribution rates and rate of change. The factors influencing the outcome include:

- Different membership profiles (average age, sex, employee/pensioner mix etc)
- Different experience (pay increases, mortality, retirement experience, transfers)
- Previous contributions paid to recover the deficit
- Security/guarantees

- Deficit recovery period.

At the 2010 valuation, the funding level for most employers was in the range of 80% to 110%. A similar range is expected arising from the 2013 valuation with most employers expected to be between 75% and 105% depending on individual employer experience.

6.3 Over the last 18 months, the funding position and outlook for employer contribution rates has improved. The stabilisation mechanism for local authority employers (and employers that are pooled with them) will restrict employer contribution changes to 1% per annum. The current projections suggest that an increase of 1% per annum is broadly in line with the average expected increase for local authorities, but, any revisions to the mortality assumption will have an effect.

6.4 For other employers, such as education institutions, registered social landlords, transport companies, care organisations and small employers, the Panel needs to consider the risks and protect the Fund but it will also need to balance this with the affordability challenge for employers. A means of managing the scale of increase is extending the deficit recovery period and the period over which contribution increases are phased in. To facilitate longer periods, the Panel needs to be confident on the creditworthiness of the employer and / or put in place arrangements to improve the "security" from the Fund's perspective, e.g. by the provision of a guarantee or a bond or the taking of security such as a charge on property. Early dialogue with employers is essential to manage the process. This will be time consuming and difficult because of the complex issues that will arise. Some external support and advice is likely to be required in dealing with employers, (e.g. legal, accountancy and actuarial).

6.5 For an increasing number of employers the Fund will need to recover deficits through specified monetary payments rather than simply adjusting the contribution rate, in particular for those employers that are closed to new members, have shrinking workforces and where the current payroll at the employer is small relative to the value of pension liabilities.

6.6 The measures that employers can take to help improve the funding position include pay restraint, controlling early retirements, understanding the impact of transfers and making additional employer contributions.

7. SUMMARY AND CONCLUSIONS

7.1 Over the last 18 months the funding level and outlook for employer contributions has improved. The Actuary will give his latest update on the current position at the meeting.

7.2 Whilst very few valuations have reached a conclusion, the expectation is that GMPF will maintain its position amongst the best funded of local authority schemes and its employers' average employer contribution rate will be amongst the lowest.

7.3 The current expectations for further material reductions in public expenditure will affect most of the Fund's employers. Significant reductions in the public sector workforce are expected over the next 3 to 5 years, although scheme membership will benefit from auto-enrolment. Some employers will cease to be viable and some employers will be abolished. This is a very challenging environment for employers and as previously commented, raises complex matters for the Fund where issues of prudence, stewardship, affordability and stability will need to be considered.

7.4 The Actuary is aiming to have individual employer results available for the December Panel meeting.

8. RECOMMENDATIONS

8.1 To note the Actuary’s current estimated funding position of the Fund as a whole.

8.2 That officers have discussions with individual employers re their potential outcome as the Actuary assesses their positions with priority being given to employers without a local authority guarantor