Corporate Governance and Standards Committee Report

Report of Head of Financial Services

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Local Government Pension Scheme Triennial Valuation

Executive Summary

Guildford Borough Council is a member of the Surrey Pension Fund. The actuaries for the fund have carried out a valuation as at 31 March 2016. We have received the draft results of the valuation, which are outlined in this report. The actuarial report is attached as **Appendix 1**.

The draft valuation results show that investment performance of the fund has been good over the three-year period since the last valuation and outperformed the actuary's assumptions at the previous valuation. As a result, the deficit on the pension fund for the Council has decreased from £51.2 million in 2013 to £37.3 million in 2016, and the funding level has increased from 71% to 80%. The three main reasons for the decrease in the deficit are as follows:

- Investment performance has exceeded the expectations at the last valuation
- The rate of pension increases for scheme members has reduced due to the Consumer Price Index (CPI) being lower than anticipated at the last valuation
- Salary growth for scheme members has been lower than expected at the last valuation, this is due to continued public sector pay restraint and the impact of changes to the scheme for members

The decrease in the deficit will mean that the Council's back funding payment into the scheme can slightly reduce from £2.424 million to £2.326 million per annum between 1 April 2017 and 31 March 2020, a saving of £98,000. The draft valuation results propose an employer's contribution rate of 15.1% of payroll per year, an increase of 0.5% from the 2016-17 contribution of 14.6% of payroll. The increase in contribution rate will cost approximately £118,000. Therefore, the overall impact of the valuation is an increase in cost of £20,000 from 2016-17. The increase has been included within the 2017-18 budget.

The back funding payment is split between the General Fund (approx. 90%) and the Housing Revenue Account (approx. 10%). Therefore, the back funding payment in 2017-18 for the General Fund is £2.121 million and the HRA share is £205,000.

Recommendation to Corporate Governance and Standards Committee

That the Committee notes this report.

Reason for Recommendation:
Officers have presented the report at the Committee's request, to inform it of the background and position of the Local Government Pension Scheme.

1. Purpose of Report

1.1 Under the Council's Constitution, the Corporate Governance and Standards Committee is responsible for matters relating to the accounts of the Council. The Council is a member of the Local Government Pension Scheme (LGPS), through the Surrey Pension Fund, and carries a deficit on its balance sheet in relation to the pension fund. The amount of the deficit included within the balance sheet is calculated under International Accounting Standard (IAS) 19 each year and does not affect the employer's contribution rate that the Council pays. The triennial valuation of the fund determines the contribution rates. This report provides the Committee with the draft results of the 2016 valuation, the deficit, the funding level of the fund and the contribution rate the Council is required to pay into the fund for the next three financial years.

2. Strategic Framework

2.1 This update supports our value of being open and accountable to our residents as set out in the Corporate Plan.

3. Background

3.1 The LGPS is a national pension scheme for people working in local government and some other public sector organisations. Some employers join as an admitted body. These organisations choose to join in order to provide access to the scheme for some or all of their employees. Admitted bodies usually provide a public service. The company managing our leisure management contract, Freedom Leisure, is an admitted body and it is likely that the Academy of Contemporary Music (ACM) will apply to become an admitted body when it takes control of the lease of the Electric Theatre.

3.2 Our administration body is Surrey County Council (SCC), one of 99 local pension funds that administer the LGPS. We do not have a choice over which fund to join. The Surrey fund has 91,427 members of whom 34,072 are active members, 23,197 are pensioners and the remaining 34,158 are deferred members. As at 30 November 2016, the fund was valued at £3.6 billion.

3.3 The LGPS is a funded pension scheme, which means that employees' and employers' contributions are vested in separate trustees (either individuals or corporate bodies), and this is distinct from the employers' normal business activities. Investment of the contributions generates interest income but also means that the value of the fund can vary. The fund meets the payment of benefits accrued by pensioners.

3.4 The contribution rate paid by employees is set nationally and depends on their whole time pay. The rates from April 2017 are:

Whole time pay rate	Contribution rate %
Up to £13,700	5.5
£13,701 to £21,400	5.8
£21,401 to £34,700	6.5
£34,701 to £43,900	6.8
£43,901 to £61,300	8.5
£61,301 to £86,800	9.9
£86,801 to £102,200	10.5
£102,201 to £153,300	11.4
£153,301 or more	12.5

3.5 Since the last valuation, there have been a number of changes to the LGPS as outlined in the paragraphs below.

<u>Auto Enrolment</u>

3.6 A change in legislation aimed at increasing the number of people with an occupational pension, meant that the Council had to enrol all employees that were not already in the fund on 1 October 2013. Any employees that did not want to remain as a member could then decide to leave. This has led to an increase in membership of around 30 to 40 employees. We have to repeat this process every three years. Any increase in the number of people in the scheme increases our direct costs through the employers' contribution, but also makes the scheme more sustainable and may reduce the contribution rate in the longer term.

<u>Career Average Revalued Earnings (CARE) Scheme</u>

3.7 On 1 April 2014, the new LGPS came into effect, replacing the final salary scheme with a career average revalued earnings (CARE) scheme for future benefit accrual. The new scheme:

(a) has a normal pension age equal to the state pension age (minimum 65)
(b) gives a pension for each year at a rate of 1/49th of pensionable pay received in that year
(c) provides increased flexibility for members wishing to retire early
(d) allows members to pay reduced contributions as an alternative to opting out (though benefits build up at a slower rate)
(e) provides for previous years' CARE benefits to be inflation proofed in line with the Consumer Prices Index (CPI) while the member is still paying in
(f) requires members to have at least 2 years membership to qualify for pensionable benefits

3.8 The implementation of the CARE scheme means that salary growth assumptions will have a lower impact on the valuation of scheme liabilities than under the final salary scheme.

4. Surrey fund investment performance

4.1 There are only two ways to fund a pension; contributions from scheme members and employers, and investing the money to generate more money (investment return). The investment strategy and performance of the fund is important; current contribution rates require the fund to generate investment returns well above inflation, which the managers cannot achieve by investing only in safe assets. The fund has to invest in a diverse portfolio to achieve above inflation returns.

4.2 The fund had eleven fund managers during 2015-16. The fund investment performance over the past ten years is given below:

Financial Year	SCC (%)	Surrey benchmark (%)
1 year	-0.5	-0.9
3 year average	6.7	5.7
5 year average	7.2	6.3
10 year average	5.5	5.0

4.3 The investment performance of the fund in 2015-16 was above benchmark as well as the outperformance target over the 3 and 5-year period. The outperformance above the benchmark is partly a result of strong investment returns generated by actively managed portfolios.

4.4 The Surrey fund is cash flow positive; that is, the income from contributions exceeds that paid to pensioners. This means that a long-term investment stance is possible.

5. 2016 actuarial valuation

5.1 The scheme generates a fund to pay out future benefits; however, the trustees do not know the cost of those benefits. The cost of benefits is valued during an actuarial valuation every three years. This looks at the value of the fund on 31 March, make-up of the members (age, gender, length of service) and current funding level. The actuary makes assumptions about investment returns over the next three years and factors such as life expectancy. The actuaries for the Surrey pension fund are Hymans Robertson and they have carried out a valuation of the fund as at 31 March 2016.

5.2 We have received the initial results of the 2016 valuation and the final valuation is due before the end of March 2017. The key results of the initial valuation for the whole fund are:

- the overall funding level has increased from 72.3% in 2013 to 82.6% in 2016
- the value of the deficit has reduced from £980 million to £680 million,
- contribution rates will increase slightly but the back funding contribution will decrease;
- overall investment returns over the three year period since the last valuation have been 6.7% which is higher than the assumed outperformance target of 5.7%, this has had a positive impact on the funding level of the scheme;

- inflation, pension increases, salary increases and ill health retirements have been lower than expected which have also had a positive impact on the funding level.
- an increase in the retirement age has also had a positive impact on the funding level

However,

- there have been fewer pensioner deaths than expected which has had a negative impact on the funding level; and
- there has been a reduction in the discount rate used to value the future pensions cost (liabilities) of the scheme (from 4.6% to 4.2%) which has had a negative impact on the funding level.

5.3 The reduction in the discount rate from 4.6% per cent in 2013 to 4.2% per cent in 2016 is due to the Surrey Pensions Committee (i.e., the pension fund trustees) changing the way the discount rate is calculated. At the 2013 valuation, the largest element of the discount rate related to the expected return on government bonds (gilts). However, for the 2016 valuation the committee decided to base the discount rate on CPI. The change in methodology means that the surrey pension fund is now consistent with the Government Actuarial department in the valuation of pension liabilities. The move to CPI is likely to have had a positive impact on the valuation, as gilt yields for the past 3 years have been artificially low at around a return of 1.2%. There was concern that the use of gilts would have artificially depressed the liabilities.

5.4 The three largest factors affecting the decrease in the deficit across the whole fund, are as follows:

(a) Investment performance has exceeded the expectations at the last valuation by £140million
(b) The rate of pension increases for scheme members has reduced due to the Consumer Price Index (CPI) being lower than anticipated at the last valuation
(c) Salary growth for scheme members has been lower than expected at the last valuation, this is due to continued public sector pay restraint and changing the scheme from final salary to a CARE scheme with effect from a April 2014

The combined impact of (b) and (c) is £125million.

5.5 The funding level and contribution rates set out in the valuation of the whole fund will vary between employers within the scheme due to the membership profile of the particular employer. The assets of the scheme and a number of the financial assumptions are the same across all employers.

5.6 The initial results for Guildford Borough Council show a positive impact on funding level due to the reasons outlined for the whole fund. The deficit for the Council as at 31 March 2016 was £37.3 million, a decrease of £13.9 million from the deficit at 31 March 2013 of £51.2 million. The results mean that the funding level for the Council has increased from 71% to 80%. Section 3 of Appendix 1 shows the detailed actuarial results for the Council.

6. Employer's contribution and back funding

6.1 Following the valuation, the actuary recommends the level of employers' contributions required for the next three years. This rate varies between employers.

6.2 The Council's current rate is 14.6%, until 31 March 2017. This equates to around £3.4 million per year.

6.3 Back funding is the term used to describe additional contributions paid into the fund to return the fund to 100% solvency. Our amount is £2.424 million per year until March 2017.

6.4 The actuarial results, based on the assumptions made, indicate that our ongoing service rate should increase from 14.6% to 15.1%. The actuaries use a stabilisation process, which the regulations allow, in order to set a stable rate from one valuation to the next. This means that we do not experience big increases in rate in difficult conditions, but neither will we get big reductions in rate should the valuation situation improve.

6.5 In the initial valuation results, the actuaries have proposed making, as a minimum, deficit repayments of £2.326million per annum for the next three financial years, a reduction of £98,000 from 2016-17.

6.6 These payments are split between the General Fund (approximately 90%) and the Housing Revenue Account (approximately 10%). Therefore, the back funding payment in 2017-18 for the General Fund is £2.121 million and the HRA share is approximately £220,000. These amounts have been included within the budget for 2017-18. The increase in contribution rate will cost approximately £118,000. Therefore, the overall impact of the valuation is an increase in cost of £20,000 from 2016-17 approved by Council on 8 February 2017.

7. Financial Implications

7.1 There are no additional financial implications to the ones considered throughout the report.

8. Legal Implications

8.1 The LGPS is a statutory funded pension scheme and is a secure pension arrangement with rules set out in legislation made under the Superannuation Act 1972.

8.2 It is a registered public service scheme under Chapter 2 of Part 4 of the Finance Act 2004. It has automatic registration by virtue of Part 1 of Schedule 36 of that Act. It is contracted out of the State Second Pension (S2P) because it provides benefits that are as good as most members would receive if they were in the S2P.

8.3 Schedule 4 of the LGPS Administration Regulations 2008 specifies that the appropriate fund for an employer is the fund maintained by the administering body within whose area all or most of the employer's area lies. Therefore, Guildford must be a member of the Surrey fund.

8.4 The Local Government Pension Scheme Regulations 2013 introduced a new scheme on 1 April 2014.

8.5 The 2013 regulations state that Guildford must obtain a valuation. This is to ensure the fund can meet its liabilities to members and pensioners; the valuation also determines contribution rates for employers.

8.6 There are no further direct legal implications because of this report.

9. Human Resource Implications

9.1 All eligible employees can be a member of the fund. We will carry out an auto-enrolment process every three years.

10. Conclusion

10.1 This report provides information about the LGPS in general and the Surrey fund in particular. Guildford must be a member of the Surrey fund. The Council's pension fund deficit as at 31 March 2016 has decreased and as a result, the funding level has increased from 71% to 80%. The overall impact on the Council's 2017-18 budget relating to pension contributions is an increase of £20,000 arising from an increase in employer contribution rates offset by a reduction in back funding contribution.

11. Background Papers

None

12. Appendices

Appendix 1: Guildford Borough Council 31 March 2016 Formal Valuation - Draft Results

Appendix 2: Surrey Pension Fund Employer Results Report: Valuation as at 31 March 2016