

Report To:	GMPF LOCAL PENSIONS BOARD
Date:	13 October 2016
Reporting Officer:	<p>Sandra Stewart, Executive Director - Governance, Resources and Pensions</p> <p>Euan Miller, Assistant Executive Director of Pensions - Funding and Business Development</p>
Subject :	ACTUARIAL VALUATION
Report Summary:	<p>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. The Actuary's presentation to the GMPF Management Panel on 23 September is also included as Appendix 1 to this report.</p>
Recommendation:	<p>The Board is recommended to note:</p> <ul style="list-style-type: none"> (i) The Actuary's current estimated funding position of the Fund as a whole. (ii) The projected timescales and actions required to finalise the valuation process.
Policy Implications:	None.
Financial Implications: (Authorised by the Section 151 Officer)	<p>Whilst the funding level and deficit has not changed significantly since the previous valuation, the cost of providing future service benefits has increased, largely due to falls in long-term interest rates which reduce the level of expected investment returns. The impact on contribution rates will differ across employers depending on membership experience over the period and membership profile.</p>
Legal Implications: (Authorised by the Solicitor to the Fund)	<p>The LGPS Regulations require each administering authority in England and Wales to undertake an actuarial valuation as at 31 March 2016 and every third anniversary of that date thereafter. The valuation process must be completed within a year of the effective date of the valuation.</p> <p>In undertaking the valuation the actuary must have regard, in particular, to:</p> <ul style="list-style-type: none"> • the Authority's Funding Strategy Statement; • the desirability of maintaining as constant a contribution rate as possible, and • the requirement to ensure the solvency of the pension fund and the long-term cost efficiency of the Scheme.
Risk Management:	<p>A key risk when administering the LGPS is that an employer fails whilst its sub fund is in deficit. The valuation adjusts employer contribution rates with the aim of matching asset and employer values in the future, in line with the GMPF's Funding Strategy Statement.</p>

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:

The background papers relating to this report can be inspected by contacting Euan Miller, Assistant Executive Director – Funding and Business Development



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1. INTRODUCTION

- 1.1 The Management Panel and Local Board have received periodic updates on the likely outcomes of the 2016 actuarial valuation and this has been discussed in detail at the Employer Funding and Viability Working Group.
- 1.2 At the end of July, the Fund's Actuary, Hymans Robertson, received updated membership data from GMPF which it has been using to undertake the valuation calculations. Hymans gave a further update at the Panel allowing for the impact of membership experience over the last 3 years at the whole fund level, such as pay increases and mortality.
- 1.3 The aims of this report are:-
- (i) to give an indication of the whole fund position based on the assumptions set out in section 3;
 - (ii) to flag material issues that the Actuary, the Employer Funding and Viability Working Group and Panel will need to consider as part of the valuation process; and
 - (iii) to comment on the outlook for employer contributions.

2. DEVELOPMENTS INFLUENCING EMPLOYER COSTS

- 2.1 There has been a significant change in the membership of GMPF over the inter-valuation period. Over 40,000 members transferred to GMPF as a result of the changes to the Probation Service. The number of employee members has also been supported by the implementation of auto-enrolment, which is likely to have offset much of the impact of employers reducing their workforce due to the continuing austerity in public sector spending. In 2015/16 alone GMPF processed around 18,000 new joiners and the total membership of GMPF now stands at over 350,000.
- 2.2 A summary of the GMPF membership at the current and previous valuation dates is provided in Table 1 below:

Table 1 – Comparison of GMPF membership at 2013 and 2016 valuations

	31 March 2013	31 March 2016	Increase
Employee members	88,265	109,702	24%
Deferred members	95,597	126,868	33%
Pensioner members	91,807	115,005	25%
Total membership	275,669	351,575	28%

- 2.3 Pay restraint has continued for public sector workers and inflation has been lower than anticipated at the previous valuation. GMPF's assets have also produced a higher return than assumed over the 3-year period (18.4% vs 15.1%). These factors help to reduce the deficit in the Fund.
- 2.4 However, these factors are offset by a fall in long-term interest rates which result in the expectation of future investment returns being lower than at the last valuation. This increases both the expected cost of paying the benefits that members have earned to date and the cost of members building up future benefits.

3. FINANCIAL ASSUMPTIONS AND INDICATIVE FUNDING LEVEL

- 3.1 Provisional valuation assumptions were recommended by the April meeting of the Employer Funding and Viability Working Group. The financial assumptions used in the 2013 valuation and the assumptions proposed for the 2016 valuation are summarised

below in Table 2. The reduction in assumed investment return reflects the reduction in long-term interest rates over the inter-valuation period. This assumption (and in particular the difference between this assumption and the CPI inflation assumption) generally has the most material impact on funding outcomes.

- 3.2 The assumption for future pay growth is becoming less material following the introduction of the 2014 Scheme. Benefits earned under the 2014 scheme are calculated with reference to pay over a member's working lifetime rather than a member's final pay. This assumption is becoming increasingly challenging to set as the number of employers in GMPF increases and they become increasingly diverse.
- 3.3 Increases to pensions and deferred benefits are linked to the Consumer Prices Index (CPI). Expectations of future CPI inflation are obtained by using market statistics to estimate Retail Price Inflation (RPI) and adjusting this to reflect the expected differences between RPI and CPI in future. The Actuary has reassessed this and he is intending to increase his estimate of the difference from 0.8% to 1.0% (i.e. CPI is assumed to be 1.0% less than RPI). This will have a beneficial impact on funding levels and the cost of future benefits earned.
- 3.4 There are also minor changes being made to the demographic assumptions such as future life-expectancy and the likelihood of ill-health retirement. However, these are unlikely to have a material impact on the valuation result. The one potential exception to this is that the assumption for take-up of the 50:50 Scheme will be lowered to reflect actual experience (there have been very few members taking up this option) and this will increase the expected cost of future-service benefits.

Table 2 – Comparison of assumptions used in 2013 vs proposed 2016 assumptions

	31 March 2013		31 March 2016	
	Nominal %	Real %	Nominal %	Real %
Investment Return	4.8	2.3	4.2	2.1
Pay increases*	3.55	1.05	2.9**	0.8**
Inflation - RPI	3.3		3.1	
- CPI	2.5		2.1	

* Plus an allowance for promotional pay increases

** For local authorities, assumed pay increases will be adjusted in the short-term to allow for the pay growth restrictions that are in force

- 3.5 Applying the indicative assumptions outlined above is likely to result in a funding level of approximately 92%.

4. FUNDING STRATEGY STATEMENT

- 4.1 The Funding Strategy Statement (FSS) provides guidance to the Actuary in undertaking the actuarial valuation. CIPFA have updated their guidance on preparing the FSS and this was released in early September. GMPF Officers will be reviewing what updates need to be made to the FSS and a revised FSS will be tabled for review at the Employer Funding and Viability Working Group meeting in October. It is also a requirement for the FSS to be issued to employers for consultation.

- 4.2 The Employer Funding and Viability Working Group will review the responses to the FSS consultation and bring a final version to the GMPF Management Panel for approval in early 2017. The FSS needs to be considered in tandem with the results of the actuarial valuation.

5. OUTLOOK FOR EMPLOYER CONTRIBUTIONS

- 5.1 The employer contribution rate comprises two components, the estimated cost of providing future service benefits and an allowance towards repaying the deficit over a period of time. The fall in the assumed future investment return will mean that the estimated cost of providing future service benefits has increased from 2013. This may be offset to an extent by a small reduction in deficit contributions for the average employer. The Actuary will give an update at the meeting.
- 5.2 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; and
 - Deficit recovery period.
- 5.3 In setting contribution rates the Actuary and the Panel need to consider the risks and protect the Fund but will also need to balance this with the affordability challenge for employers. Contribution rates should reflect the creditworthiness of the employer and the “security” provided to the Fund, e.g. the provision of a guarantee or a bond or the taking of security such as a charge on property. Early dialogue with employers in this area is essential and some external support and advice is likely to be required in dealing with employers, (e.g. legal, accountancy and actuarial).
- 5.4 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.
- 5.5 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.

6. SUMMARY AND CONCLUSIONS

- 6.1 Whilst very few valuations have reached a conclusion, the expectation is that GMPF will maintain its position as one of the better funded local authority schemes and its employers’ average employer contribution rate will again be at the lower end of the range.
- 6.2 The expectation of further material reductions in public expenditure will affect many of the Fund’s employers. Further reductions in the public sector workforce are expected over the next 3 to 5 years, and the impact of auto-enrolment on increasing employee members will decline as most employers pass their Auto-enrolment staging dates. 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.

- 6.3 The Actuary is aiming to have more clarity on individual employer results ready for detailed discussion at the Employer Funding and Viability Working Group in October and a summary of the results will be brought to the November Panel meeting and the next meeting of the Local Pensions Board.

7. RECOMMENDATIONS

- 7.1 The Board is recommended to note:

- (i) The Actuary's current estimate of the funding position of the Fund as a whole; and
- (ii) The projected timescales and actions required to finalise the valuation process.