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Agenda Item No: **15**

CITY OF WOLVERHAMPTON COUNCIL

Pensions Committee

16 March 2016

Report Title	2016 Actuarial Valuation Overview and Planning	
Originating service	Pension Services	
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Recommendations for noting:

The Committee is asked to note:

1. The report and the associated preparatory work and planning for the 2016 actuarial valuation of both the West Midlands Pension Fund (the Main Fund) and the West Midlands Integrated Transport Authority Fund (the WMITA Fund).

1. Purpose

1.1 To provide Committee with an overview of the 2016 actuarial valuation process, deliverables and context in preparation for the review of funding strategy and employer contribution rates.

2. Background

2.1 The actuarial valuation is carried out on the instruction of Wolverhampton City Council (the “Administering Authority”) in accordance with the requirements of Regulation 62 of the Local Government Pension Scheme Regulations 2013. The next valuation is due as at 31 March 2016.

The primary aims of the actuarial valuation are to;

- Review the financial position of the Fund (assets relative to the expected cost of providing accrued pension benefits);
- To assess the Fund’s funding position relative to its objective of being fully funded;
- Where appropriate, and following consultation, revise the Funding Strategy Statement and Statement of Investment Principles.
- Taking the above into account, to determine the appropriate level of employer contributions for the three year period commencing April 2017.

2.2 The Funding Strategy Statement (FSS) together with the Rates and Adjustments actuarial certificate and actuary’s valuation report summarise the outcome of the valuation (approach, assumptions and contribution requirement) and form the formal documentation the Administering Authority is required to put in place before 31 March 2017. Funding strategy cannot be considered in isolation – the review will incorporate an assessment of employer covenant risk and will be carried out in conjunction with the investment strategy review.

2.3 This report provides an outline of the Fund and regulatory changes since the 2013 valuation which will impact on funding discussions in 2016/17. Further training will be provided to Committee later this month. A timetable of proposed activity to deliver the valuation (including analysis and consultation) is included in Appendix A.

3. Main Fund 2013 actuarial valuation outcome

3.1 The valuation as at 31 March 2013 showed a funding shortfall of £3,275m based on the assumptions made for calculating the funding target and allowing for post valuation market changes to 31 August 2013. This represented a funding level of 75% of the Fund’s funding target.

3.2 The actuary certified a Common Contribution Rate (i.e. the average employer contribution rate) of 13.3% of Pensionable Pay which allowed for 5% of existing and future members to opt for the 50:50 scheme.

3.3 The deficit was to be recovered through additional employer contributions as specified for each employer over the deficit recovery period in each case. At Fund level, recovery of the shortfall of £3,275m required a deficit contribution of £167m per annum increasing at 4.35% per annum for 22 years.

3.4 Contributions for each individual employer were levied as a combination of a percentage of payroll to cover the expected cost of active member benefit accrual and a cash lump sum amount to meet the employer’s share of deficit contributions due under the recovery plan. These are recorded in the Rates and Adjustments actuarial certificate which covers contributions due to April 2017 and is legally binding.

3.5 Some flexibility in the timing of deficit contributions and stepping up of contribution rates from levels set in 2010/11 were agreed with employers on an individual basis.

4. WMITA Fund 2013 actuarial valuation outcome

4.1 The valuation as at 31 March 2013 (again allowing for post valuation market changes but to 31 December 2013) showed a funding shortfall of £86m based on the assumptions made for calculating the funding target. This represented a funding level of 84% of the Fund’s funding target. A slightly different approach was adopted in setting the funding target for each of the two participating employers, West Midlands Travel Limited and Preston Bus Limited, to reflect differences in their underlying investment strategies.

4.2 The actuary certified a Common Contribution Rate (i.e. the average employer contribution rate) of 21.5% of Pensionable Pay.

4.3 The deficit was to be recovered through additional employer contributions as specified for each employer over the deficit recovery period in each case. The contributions of £350,000 per annum due from Preston Bus Limited anticipate recovery of the deficit in just over nine years from the valuation date. For West Midlands Travel Limited it was agreed that the level of deficit contributions would continue at £5.5 million per annum to 31 March 2017 as agreed on implementation of the pensioner buy-in contract in April 2012, pending review as part of the 2016 actuarial valuation and on condition that a suitable guarantee is maintained to support the employer covenant.

4.4 Contributions for West Midlands Travel Limited were levied as a combination of a percentage of payroll to cover the expected cost of active member benefit accrual and a cash lump sum amount to meet the deficit contributions due under the recovery plan. For Preston Bus Limited, for whom there are no remaining active members, contributions were expressed solely as a cash lump sum amount in accordance with the recovery plan. The contributions due are recorded in the Rates and Adjustments actuarial certificate which covers contributions due to April 2017 and is legally binding.

5. Developments since 2013

5.1 Changes to the employer base, membership profile and experience over the three years to 31 March 2016 will impact on the outcome of the 2016 valuation, as will changes to the regulatory environment.

Employer base

5.2 The number and profile of employers within the Main Fund has changed significantly since the 31 March 2013 valuation and this is summarised in the following table:

Employer type	Number of employers at 2013 valuation	New employers since 2013 valuation	Cessations since 2013 valuation	Number of employers at 31 January 2016
Scheduled - District	7	0	0	7
Scheduled - University/College	21	0	1	20
Scheduled - Resolution	8	2	0	10
Scheduled - Academy	143	189	2	330
Scheduled - Other	8	3	3	8
Community of Interest admission body	66	4	12	58
Transferee admission body	79	41	22	98
Total	332	239	40	531

It is notable that there has been a significant increase in the number of Academy conversions, many of whom are currently being processed by the Main Fund. There is an expectation that a further 20 known schools will convert to Academy status before the valuation date. In addition, there are a further 36 prospective admission bodies seeking participation in the Main Fund, a number of which may be active before or during the valuation period.

5.3 As the make-up of the employer-base has changed, so has the overall employer covenant and risk. Although the drivers and issues vary by sector and employer, common themes include a reduction in financial support available for pensions as

- income streams are either reducing or under greater pressure;
- many could be forced to exit (and incur an exit debt) as membership falls and insolvency risk increases; and
- the backing of perceived guarantors are tested. For example, LGA received advice in 2015 that the liabilities of HE/FE institutions would not be backed by central government in the event of employer failure.

In view of the cost pressures many employers are facing, we expect a much greater focus on employer affordability in setting contribution rates effective from 2017.

However, regulatory change (see below) will also bring greater scrutiny of comparison of LGPS employer contributions, with pressure to address funding deficit more quickly and this is expected to limit the flexibility which can be offered to employers.

Membership profile and experience

5.4 The membership profile of the Main Fund has developed since the 2013 valuation with an overall increase in active members and slight fall in deferred and pensioner members. The effects of automatic enrolment legislation may account for some of the increase in active members along with the processing of lagged joiners from the major employers. A summary of the change in membership profile is detailed below:

Membership Category	31 March 2013	31 January 2016	Percentage change
Active	97,330	108,037	11.00%
Deferred	86,509	93,540	8.12%
Pensioner	77,485	85,143	9.88%
Total	261,324	286,720	9.72%

Although the overall membership profile has continued to grow, we are seeing an increase in early leavers and retirements. Longer term the membership profile is expected to mature as local government headcount reduces and more members reach retirement age.

5.5 The membership profile of the WMITA Fund has changed significantly since the 2013 valuation with a large reduction in active members and deferred members and an increase in pensioner members. A summary of the change in membership profile is detailed below:

Membership Category	31 March 2013	31 January 2016	Percentage change
Active	744	480	-35.48%
Deferred	903	822	-8.97%
Pensioner	3,612	3,832	6.09%
Total	5,259	5,134	-2.38%

As the Fund is closed to new members and has been for some time, the membership profile is much more mature than the Main Fund and it will continue to mature at a faster rate. Differences in the maturity of the funds and the employers backing these liabilities (private companies) are key drivers for the difference in the funding and investment strategies for this Fund.

5.6 As part of the actuarial valuation, member movements and experience (salary growth, leavers, retirements, deaths and take-up of options such as cash and 50:50) will be reviewed and the impact on the Fund liabilities assessed to inform the 2016 approach.

5.7 As has been widely reported in the press, death rates in 2015 were higher than expected and this could bring some easement to the upward pressure on funding costs (although it is not expected to materially impact the results and contribution requirement).

Investment returns and changes in financial conditions and outlook

5.8 Investment returns and financial conditions at and around the valuation date are likely to have the most material impact on the valuation outcomes and in particular, the required employer contribution rates over the three years to 31 March 2020.

5.9 At the 2013 actuarial valuation, the invested assets of the Main Fund were valued at £9.8bn and at the 31st December 2015 stood at £11.3bn. Annualised returns for the period to the 31st December 2015 have been around 6%, compared to 5% per annum assumed at the 2013 valuation. However, 2016 year to date the Fund has seen negative returns and overall, based on conditions at the time of writing; the Fund is not expected to see a funding gain from excess investment return over the inter-valuation period. The outlook for future investment returns has also reduced leading to an expected increase in the Fund liability measure, funding deficit and associated contribution requirement when assessed using the same approach as adopted for the 2013 actuarial valuation.

5.10 At the 2013 actuarial valuation, the invested assets of the WMITA Fund were valued at £178.9m and at the 31st December 2015 stood at £203.5m (both excluding the value of the pensioner buy-in contract held by the Fund). Returns for the period to the 31st December 2015 are broadly comparable with those of the Main Fund. Similarly, the funding deficit in this Fund is expected to be adversely impacted by the market falls since 1 January 2016.

Regulatory change

5.11 Significant change to the regulations, associated guidance and oversight of LGPS funding valuations will impact on the funding strategy review and the approach adopted for the 2016 valuation.

- 2016 will incorporate the first valuation with benefits accrued in the CARE Scheme, set up from April 2014.

- LGPS regulations (2013) now require the actuary to consider the solvency of the Fund in certifying contributions. For the first time, all LGPS funds will be required to report results on a standardised basis.

- The Government Actuary Department (GAD) has been appointed by DCLG to review and report on LGPS valuations and the appropriateness of employer contributions (as required by section 13 of the Public Sector Pensions Act 2013). Four main areas under review are compliance, consistency, solvency and long term cost efficiency. The outcome (which will name funds who, in GAD's view, do not meet the standard or require further investigation) is expected to be reported by GAD mid-late 2018.

- Scheme Advisory Board KPIs (as currently drafted) will measure funding developments and contribution strategies on a consistent and transparent basis. There is an expectation for deficit recovery periods to reduce and move to be less than 15 years.

- In addition, the consultation on changes to the LGPS investment regulations lists the GAD section 13 review as one of the triggers for the Secretary of State to intervene and direct action in relation to the Fund investment strategy.

5.12 We await further information from GAD in relation to how they will conduct their section 13 review and understand they are working closely with the Scheme Advisory Board to align with funding related KPIs. New guidance for funds on preparing the Funding Strategy Statement is expected to follow from CIPFA in April 2016.

Cost cap mechanisms

5.13 In addition to the above, and following the valuation, LGPS benefits will be assessed relative to the HMT and SAB cost cap mechanisms. As outlined in a previous report to Committee, in the LGPS in England & Wales, there will be two mechanisms used to assess the costs of the reformed scheme:

a) the employer cost cap (ECC) process as operated by HM Treasury, and
b) the future service cost (FSC) process as operated by the LGPS Scheme Advisory Board.

5.14 The Scheme will be assessed every three years against the cost control mechanisms using the data provided to individual actuaries for funding valuations. Importantly, both processes could lead to changes to the scheme design or to the level of members' contributions if the mechanisms demonstrate that the cost of the LGPS has moved sufficiently from the target.

5.15 The first ECC and FSC figures will be calculated by the Government Actuary Department (GAD) based on the same data produced and submitted to the Fund actuary as at 31 March 2016 for the Main Fund and WMITA valuations

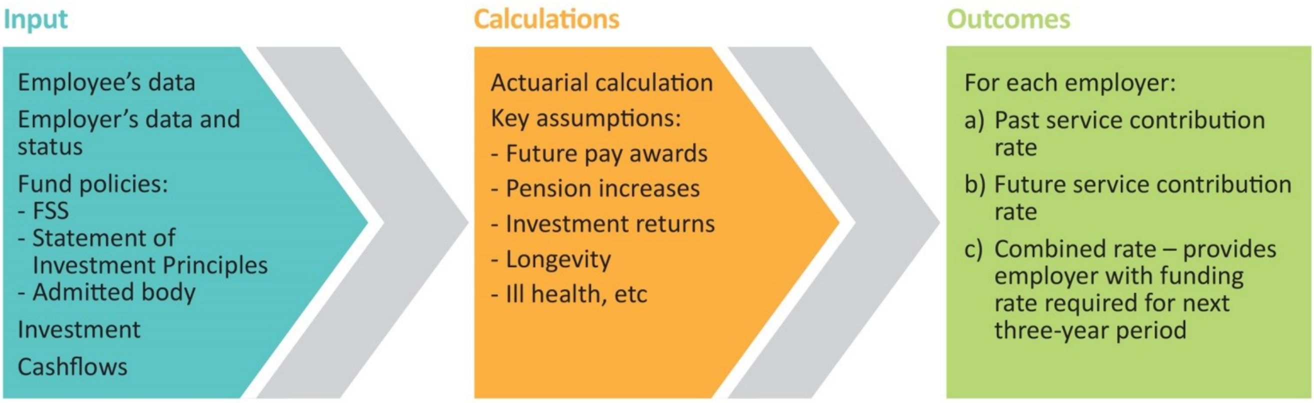
5.16 Any changes to the Scheme benefits structure or to employee contribution rates made via either of the cost control processes will first be effective in the year commencing 1st April 2019.

6. Preparatory work and planning

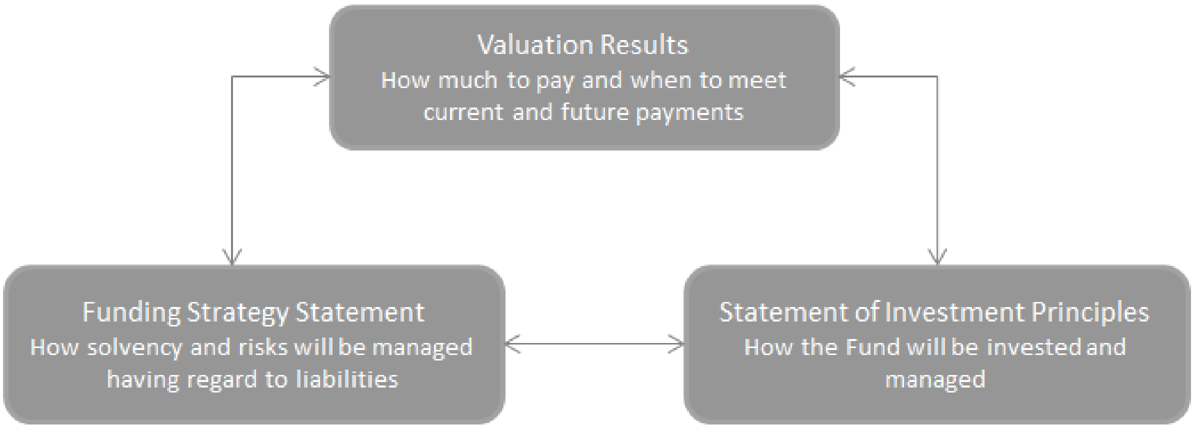
6.1 Fund officers are actively engaging with our service providers and advisers to prepare and plan for the valuation. Two critical elements to enable the valuation to progress are delivery of new valuation extract functionality by our administration software provider and on-going dialogue with employers on delivery of 2016 annual return membership data. The Universal Valuation Data extract has been agreed by all the actuarial firms and software providers but delivery is currently behind schedule. We are continuing to engage with employers on the annual return process and implement changes to address learnings from the 2015 process.

6.2 The plan in Appendix A summarises key valuation tasks and timing, highlighting the responsibilities of the Fund, participating employers and advisers. The valuation process requires the collection of data and review of the relevant Fund policies. The Fund actuary uses this data and, based on a number of key assumptions, calculates the future benefit cashflows once the future contribution rate for the Fund as a whole and then each employing body. This can be summarised as follows:

Actuarial valuation – summary of key components



6.3 The process also links the valuation to the Fund's Funding Strategy Statement (FSS), employer covenant (solvency and risk) review and Statement of Investment Principles (SIP) with the balance of risk and mitigation of funding risks reflected in the review of these policy documents. The overview of the relationships is as follows:



6.4 Following the change in the Fund actuary to Barnett Waddingham in 2015, the funding approach and assumptions will be fully reviewed and the FSS updated based on the advice of our Actuary, Graeme Muir,

6.5 The consultation on changes to the Investment Regulations envisages preparation of a new Investment Strategy Statement (ISS) which would, in effect, replace the current SIPs. As the regulations are currently drafted, the Fund may need to put ISSs in place by October 2016.

7. Employer covenant review

7.1 As outlined in a separate paper for Committee, the Fund has appointed Deloitte LLP and PricewaterhouseCoopers LLP (PwC) as independent covenant advisers to supplement the framework and activity conducted in-house and to support a review of employer risk and affordability.

7.2 The covenant review will be aligned to the 2016 actuarial valuation and this will form a key part of the engagement with employers prior to provisional results being released.

7.3 In conjunction with the Fund, PwC will undertake a review of covenant strength aligned to funding strategy and associated affordability for Fund participating employers as part of the 2016 actuarial valuation. This will include a range of advice from the information collated from employers to options for enhancing security where cash is limited. It is also likely to include general sector-specific advice and individual affordability assessments for a range of employers (charity to district council).

7.4 In addition, PwC will assist the Fund with consultation/negotiation with employers with regards to covenant strength and the associated outcomes as part of the 2016 valuation process.

7.5 A detailed covenant analysis for WMITA employers (National Express and Preston Bus Limited) will be undertaken by PwC as part of the 2016 actuarial valuation process. This is expected to include a review of existing security and guarantees in place to support funding plans.

8. Consultation process

8.1 The Fund is required to consult with “such persons as it considers appropriate” on revision to the funding strategy. The Fund has already begun consultation with the West Midlands Finance Directors group who represent the district councils and a further meeting is scheduled for the end of April 2016.

8.2 Between April and June 2016, the Fund, supported by its covenant and actuarial advisers, will engage with certain employers over carrying out a covenant review and affordability assessment to inform the valuation process.

8.3 The April/May edition of the Employer Briefing note will provide employers with further background on the actuarial valuation to include confirmation of the underlying financial conditions and any experience analysis observed to date.

8.4 Participating employers will receive an invitation to group consultation meetings (to be grouped based on type of employer) around June/July 2016, which will serve as an overview of what to expect with the 2016 valuation.

8.5 The Fund is holding its annual Mid-Year Review at the Grand Station, Wolverhampton on 14 July 2016. At this meeting the actuarial valuation and proposed changes to the Funding Strategy Statement will be covered in more detail.

8.6 On 14 September the initial Fund-level valuation results will be reported to the Pensions Committee. From October 2016 to December 2016, individual provisional results will be disseminated to employers and the Fund will embark on a series of group consultation meetings to discuss these results. During this period the Fund will also formally consult on the revised Funding Strategy Statement (FSS).

8.7 The Fund will provide a summary of the individual results and key assumptions to Pensions Committee on 7 December 2016.

9. Financial implications

9.1 The results of the 31 March 2016 actuarial valuation may have financial implications for participating employers in setting employer contribution rates for the three years commencing April 2017

10. Legal implications

10.1 The report contains no direct legal implications.

11. Equalities implications

11.1 The report contains no direct equalities implications.

12. Environmental implications

12.1 The report contains no direct environmental implications.

13. Human resources implications

13.1 This report has implications for the Council's human resources policies since it deals with the pension rights of employees.

14. Corporate landlord implications

14.1 The report contains no direct corporate landlord implications.

15. Schedule of background papers

15.1 None.

16. Schedule of appendices

16.1 Appendix A: High level 2016 valuation timetable