HERTFORDSHIRE COUNTY COUNCIL

PENSIONS BOARD

FRIDAY 17 JUNE 2016 AT 10AM

Agenda Item No:
3

2016 TRIENNIAL VALUATION

Report of the Director of Resources

Author of the report: Lyn Stainton (Telephone: 01992 555394)

1. Purpose of the Report

1.1 To inform the Pensions Board about arrangements for the 2016 Triennial Valuation exercise for the Hertfordshire Pension Fund ("Pension Fund").

2. Summary

2.1 Under the Local Government Pension Funds Regulations 2013 ("the Regulations") all pension funds in England and Wales are required to undertake a valuation of their funds in 2016.

2.2 The last valuation of the Pension Fund was undertaken in 2013 by Hymans Robertson the Pension Fund actuary. Hymans Robertson will again conduct the valuation in 2016 and officers have worked with the actuary to determine a recommended set of assumptions that are proposed for the 2016 exercise.

2.3 Officers have also prepared a detailed project plan in conjunction with the actuary and LPFA for the work required for the valuation exercise. A timetable of key events has been communicated to scheme employers through the Pension Fund's newsletter and a summary provided as Appendix B to this report.

3. Recommendations

3.1 That the Pensions Board reviews the Pension Fund's arrangements to meet its statutory obligations to carry out the 2016 Triennial Valuation.

4. 2016 Triennial Valuation Exercise

4.1 The Local Government Pension Scheme (Administration) Regulations 2013 (the Regulations) require administering authorities in England and Wales to obtain a valuation of their pension funds on a triennial basis, the last valuation of the Hertfordshire Pension Fund was at 31 March 2013 and the next one is on 31 March 2016. Administering authorities are required to obtain:

- an actuarial valuation of the assets and liabilities of the pension fund;
- a report by an actuary in respect of the valuation; and
- a rates and adjustments certificate prepared by the actuary setting out the individual contributions for each employer in the pension fund.

4.2 The main purpose of the valuation is to:

- assess the solvency of the Pension Fund as a whole and the level of solvency for each participating scheme employer;
- assess the effectiveness of the Funding Strategy both retrospectively and how this applies for future years;
- comment on the main risks to the Pension Fund that may result in future volatility in the funding position or to scheme employers' contributions;
- determine scheme employers' contribution rates for a three year period. The 2016 Triennial Valuation will determine scheme employers' contribution rates for the financial years 2017/18, 2018/19 and 2019/20;
- provide certificates and statements as required by the Regulations.

4.3 The actuarial valuation for the Pension Fund will be carried out by Hymans Robertson who will provide a report detailing the results of the triennial valuation, factors affecting the results and provide a rates and adjustments certificate. The last valuation of the Pension Fund was undertaken by Hymans Robertson in 2013 and the Valuation Report is accessible from http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx

5. Actuarial Assumptions

5.1 Actuarial assumptions are required for a valuation in order to set an appropriate funding target. The assumptions are informed estimates about future experience and will need to be revised in successive valuations to reflect emerging evidence and changes in the regulatory and environmental background. Generally, the assumptions fall into two categories:

- **Demographic**. These aim to forecast when benefits will come into payment and the types of benefits. For example, when members will retire, how long they may survive and whether a dependant's pension may be paid.
- **Financial**. These aim to anticipate the size of benefits. For example, how much a members' final salary may be at retirement and how the pension will increase over time. In addition, the financial assumptions aim to estimate how much all of the benefits will cost the Pension Fund in today's money.

5.2 As part of the Valuation exercise, officers have worked with the actuary who has carried out a review of the assumptions used to set the funding target for the 2013 valuation. The Pension Fund investment consultant, Mercer, has also taken part in these discussions particularly on the discount rate assumption. The results of the review is summarised in Table 1 and the detailed report is provided as Appendix A.

Table 1: Excerpt from Hymans Roberts Report (see Appendix A) Proposed Actuarial Assumptions for the 2016 Triennial Valuation

Assumption	2013 assumption	Proposed 2016	Reason for change
Discount rate [1] **- Methodology** **- AOA**	 Gilts plus 1.8%	 Gilts plus 1.8%	 No change
Pension Increase [2] **- RPI-CPI gap**	 CPI = RPI – 0.8%	 CPI = RPI – 1.0%	Increased gap due to emerging evidence
Salary increases [3] **- Inflationary**	 RPI + 0.5%	 RPI - 0.9%	Continued public sector pay restraint, closure of final salary scheme to accrual of new benefits
Longevity **- Baseline** **- Future Improvements**	 Club Vita analysis CMI model, peaked improvements, long term rate of improvements of 1.25% p.a.	 Club Vita analysis CMI model, peaked improvements, long term rate of improvements of 1.25% p.a.	No change in methodology but updates to the underlying mortality tables
Withdrawal	Minor adjustments to reflect recent experience		
Ill health retirements	Reduction in assumed incidences of ill health to reflect recent experience		
Promotional salary increases	Removed distinction between genders and extended increases up to age 50 to reflect national trends and equal pay commitments		
50:50 take up option	10%	To be decided	To be discussed with officers taking into account emerging experience
Commutation	To be discussed with officers		
Pre-retirement mortality	No proposed change from 2013 valuation assumption		
Proportions married	No proposed change from 2013 valuation assumption		

Notes

1 **Discount rate:** The discount rate is the name given to the assumed rate of investment returns that the Fund will achieve in the long-term. It determines the money or assets needed today such that future investment returns and contributions will be sufficient to pay members' benefits.

Whilst considering the discount rate, the Fund should always consider:

- How likely are the Fund's assets able to return the rate assumed in the discount rate over the long term?
- Does the choice of discount rate tie up with the Fund's objectives and level of investment risk?
- Does the discount rate reflect the changing nature of the Fund?

Based on analysis we have carried out for the Fund, it is recommended that the Fund does not change the approach to determining the discount rate. In other words, the discount rate will be set equal to the long-dated UK government bond yield (fixed interest) at 31 March 2016 plus an asset out performance assumption of 1.8%.

2 **Inflation / pensions increases:** LGPS benefits increase each year in line with the Consumer Prices Index ("CPI") measure of inflation, which is therefore a key financial assumption for the valuation. The best way to measure future financial values is to use information from the financial markets. As no market in CPI linked bonds exists, it is calculated using the market-implied value of future RPI ("Retail Price Inflation") increases and adjusted downwards to get an assumption for CPI.

The two main differences between RPI and CPI are:

- The 'basket' of goods that each measure is based on (e.g. CPI doesn't include mortgage payments and RPI doesn't include the cost of new cars); and
- The 'formula effect' which is related to the way the index is calculated from the price changes of the goods in the basket.

At the 2013 valuation, CPI was assumed to be 0.8% less than RPI. At the 2016 formal valuation it is proposed to increase this long-term gap between RPI and CPI to 1.0% p.a. The main reason for the increase in this assumption is the steady increase in the formula effect over the last few years, as monitored and published by the Office for National Statistics on a regular basis.

3 **Salary increases:** All benefits accrued prior to 1 April 2014 are linked to the member's final salary before they leave active service. In calculating the cost of these benefits, it is therefore important to estimate the increase in salaries for active members until they leave active service.

Salary growth modelling has been carried out for the Fund which considers the Fund's own membership, the public sector pay restraint until 2020 and 5 potential scenarios for salary increases after 2020. Following discussions with the officers, the proposed salary growth assumption for the 2016 formal valuation is RPI – 0.9% (which can be expressed as CPI + 0.1%). As this is a significant change in salary growth assumption from the 2013 formal valuation, the Fund may wish to consider the following risk mitigation actions.

Risk mitigation: The proposed pay growth assumption makes full allowance for the public sector pay restraint. However, some employers that participate in the Fund are not bound by this pay restraint e.g. Academy Schools, Colleges and private sector employers such as Housing Associations. These employers may award salary increases greater than the long term assumption of RPI – 0.9%. If salary increases were higher than anticipated then this will lead to higher than expected pension costs. This increase in costs is referred to as 'salary growth strain' and may result in employers not being able to meet the additional pension costs in the future. Therefore the Fund should consider implementing a mechanism that helps control this risk.

One such mechanism could be monitoring salary increases annually and any salary growth strain arising will be immediately billed to the responsible employer.

6. Valuation Timetable

6.1 Officers have worked in conjunction with the actuary and the LPFA to agree timescales for the valuation process and key deadlines. This information has been communicated to scheme employers as part of the year end exercise and published in the monthly Newsletter. The timetable is provided as Appendix B.

6.2 As part of the 2016 Valuation exercise a mandatory consultation with employers on the revision of the Funding Strategy Statement must be undertaken. A draft Funding Strategy Statement will be provided to the Pensions Committee and Board in November 2016 prior to the consultation with scheme employers which will be carried out during December 2016 and January 2017. The results of the consultation will be reported to the Pensions Committee and Board at their February 2017 meetings when the proposed Funding Strategy Statement will be presented for approval by the Pensions Committee. An update on the Valuation exercise will also be provided to the Pensions Committee and Board at the November meetings.

6.3 The Pension Fund actuary will issue a final report on the 2016 Valuation exercise by the statutory deadline of 31 March 2017 and provide the Pensions Committee and Board with a summary report on the outcomes of the exercise at the February 2017 meetings.

APPENDIX B: 2016 Triennial Valuation Timetable

This timetable sets out key milestones in the Valuation process for the 2016 exercise.

December 2015	Annual Employer Covenant Survey issued to Scheme Employers
December 2015	Annual Employers Forum
December 2015	Consultation with Schools and Academies on Pooling Arrangement
January 2016	Deadlines for Scheme Employers to respond to Annual Employer Covenant Survey
February 2016	Scheme Employers notified of responsibilities for submitting accurate data and Pensions Regulator sanctions
February/March 2016	Year End training provided to Scheme Employers on production and submission of data
February 2016	Schools Forum advised of outcomes of the September 2015 consultation with Schools and Academies on Pooling Arrangements; and results of actuary valuation for proposed pooled employer contribution
March 2016	Assumptions and Valuation methodology discussed and drafted with the Pension Fund actuary for approval by the Pensions Committee at their June 2016 meeting
March 2016	Town and Parish Councils consultation with on Pooling Arrangement
March 2016	2016/17 Year End guidance issued to Scheme Employers by the LPFA and templates available on “yourfund” for download
29 April 2016	Deadline for Scheme Employers to submit year end membership and contribution data via “yourfund”
31 May 2016	Deadline for employers to resolve data queries generated from initial data upload to “yourfund”
June 2016	Town and Parish Councils advised of outcomes of consultation and proposed pooled employer contribution rate for 2016/17
31 July 2016	Deadline for membership data to be submitted to the Pension Fund actuary
November / December 2016	Valuation reports issued providing details of funding levels and contribution rates
December 2016 / January 2017	Consultation with all Scheme Employers on the Funding Strategy Statement
January 2017	Finalise Scheme Employer contribution rates
February 2017	Pensions Committee and Board advised of outcomes 2016 Valuation and the outcomes of the consultation on the Funding Strategy Statement and final version presented for approval
31 March 2017	Statutory deadline for publication of final Valuation Report and Rates and Adjustment Certificate with all Scheme Employer contribution rates
1 April 2017	Implementation of new Scheme Employer contribution rates
July 2017	Renewal of financial bonds for specific Scheme Employers