Government Actuary's Department

Local Government Pension Scheme England and Wales

Review of the Actuarial Valuations of Funds as at 31 March 2016 Pursuant to Section 13 of the Public Service Pensions Act 2013

Executive Summary

Date: 27 September 2018

Author: Martin Clarke, John Bayliss


35%

Executive summary

1.1 The Government Actuary has been appointed by the Ministry of Housing, Communities and Local Government (MHCLG) to report under section 13 of the Public Service Pensions Act 2013 in connection with the actuarial valuations of the 91 funds in the Local Government Pension Scheme in England and Wales ('LGPS' or 'the Scheme').

1.2 Section 13 requires the Government Actuary (GAD) to report on whether the following aims are achieved:

- compliance
- consistency
- solvency
- long term cost efficiency

1.3 This is the first formal section 13 report. This report is published as three documents: the executive summary, the report and appendices. A 'Dry Run' was produced in respect of the 2013 valuations and published in 2016.[1]

1.4 This report is based on the actuarial valuations of the 91 funds, other data provided by the funds and their actuaries, and a significant engagement exercise with affected funds. We are grateful to these stakeholders for their assistance in preparing this report. We are committed to preparing a section 13 report that makes practical recommendations to advance the aims listed above. We will continue to work with stakeholders to advance these aims and expect that our approach to section 13 will continue to evolve to reflect ever-changing circumstances and feedback received.

Overall comments

1.5 In aggregate, the LGPS is in a strong financial position and funds have made significant progress since the 2013 valuation based on the criteria that:

- total assets have grown in market value from £180bn to £217bn. The aggregate funding level on prudent local bases has improved from 79% to 85% at 2016
- the improved funding level (assets divided by liabilities) is due in part to the significant financial contributions from LGPS employers (total contributions in the three years covered by the 2013 valuation report were £6.9bn per year, on average of which approximately £2bn per year were deficit recovery payments), as well as better than expected returns on assets
- on our best estimate basis, the LGPS was in surplus in aggregate at 2016 (funding level approximately 106%), and around 60 of the 91 individual funds were in surplus. This means that we expect there is, on average, a greater than 50% chance that existing assets would be sufficient to cover benefits in respect of accrued service when they fall due

1.6 Significant progress has been made by a number of funds that were highlighted in the dry run, which we welcome:

- South Yorkshire Passenger Transport Fund's assets and liabilities have been transferred to Greater Manchester Pension Fund, to remove the specific risk arising from the fund being backed by a single private sector employer

[1] http://www.lgpsboard.org/images/Reports/Section13DryRun20160711.pdf

- Berkshire and Somerset Pension Funds have taken steps to increase their employer contributions which has helped reduce our concerns regarding long term cost efficiency
- a consistent definition of Primary and Secondary Contribution Rates has been agreed between the four firms of actuarial advisors that undertake local valuations, which has gone a long way towards improving consistency of valuation reporting

1.7 We also consider it our role to highlight specific areas where risks may be present. We have looked at a range of metrics to identify potential issues in respect of solvency and long term cost efficiency. Each fund's score under each measure is colour coded (red, amber or green). In total, 70 out of 89 funds tested had green flags on all solvency and long term cost efficiency metrics. This is a significant improvement compared with the previous dry run report (52 out of 90). There are a total of 20 amber and 2 red flags, which is again a significant improvement compared with the dry run (58 amber, 5 red).

1.8 Based on the criteria above, the Scheme is in a strong financial position, and has made significant progress since the dry run. To further improve transparency and comparability, we consider it would be helpful for administering authorities and other stakeholders if they were able to make meaningful comparisons between the 91 actuarial valuations. Consequently this report makes three recommendations on consistency which affect all the funds. It also makes one specific recommendation on solvency (affecting one fund) and one recommendation on long term cost efficiency (affecting all funds).

1.9 We set out below our findings on each of the four aims and our recommendations.

Compliance

1.10 Our review indicated that fund valuations were compliant with relevant regulations on the basis described in Chapter 2 of this report.

Consistency

1.11 We interpreted 'not inconsistent' to mean that methodologies and assumptions used, in conjunction with adequate disclosure in the report, should facilitate comparison by a reader of the reports.

1.12 Readers of the actuarial valuations face two difficulties in making meaningful comparisons between the reports:

- presentational: information is presented in different ways in different reports (eg funding levels), and sometimes information is contained in some reports but not others (eg life expectancies), so readers may have some difficulties in locating the information they wish to compare. We call this presentational inconsistency
- evidential: even when the reader has located the relevant information (eg funding levels), differences in the underlying methodology and assumptions mean that it is not possible to make a like-for-like comparison. We call this evidential inconsistency. We believe that local circumstances may merit different assumptions (eg financial assumptions are affected by the current and future planned investment strategy, different financial circumstances leading to different levels of prudence adopted). However, in some areas, it appears that the choice of assumptions is more dependent on the house view of the particular firm of actuaries advising the fund, than on the local circumstances of the fund

1.13 There has been an improvement in consistency of presentation of contribution rates emerging from the 2016 valuations.

1.14 However, despite this welcome improvement, inconsistencies remain, both presentational and evidential. Our recommendations are designed to:

- encourage the presentation of results in a consistent way which is easy to understand and compare across the whole LGPS
- move towards an assumption set that differs from one fund to another only where local conditions justify it, rather than being dependent on the house view of a particular actuarial advisor

Recommendation 1: We recommend that the Scheme Advisory Board should consider how best to implement a standard way of presenting relevant disclosures in all valuation reports to better facilitate comparison, with a view to making a recommendation to the MHCLG minister in advance of the next valuation. We have included a draft dashboard in this report to facilitate the Scheme Advisory Board's consultation with stakeholders.

Recommendation 2: We recommend that the Scheme Advisory Board should consider what steps should be taken to achieve greater clarity and consistency in actuarial assumptions, except where differences are justified by material local variations, with a view to making a recommendation to the MHCLG minister in advance of the next valuation.

1.15 In relation to academies, we support the work of the SAB in seeking to simplify and streamline administration processes, noting that these improvements are not just relevant to academies, but to all employer groups. We expect this to lead to more consistent data quality, which in turn assists consistency objectives.

Recommendation 3: We recommend that the Scheme Advisory Board seeks a common basis for future conversions to academy status that treat future academies more consistently, with a view to making a recommendation to the MHCLG minister in advance of the next valuation.

Solvency

1.16 As set out in CIPFA's Funding Strategy Statement Guidance,[2] the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency of the pension fund if:

- the rate of employer contributions is set to target a funding level for the whole fund (assets divided by liabilities) of 100% over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds)

and either:

- employers collectively have the financial capacity to increase employer contributions, should future circumstances require, in order to continue to target a funding level of 100%

or

- there is an appropriate plan in place should there be, or if there is expected in future to be, no or a limited number of fund employers, or a material reduction in the capacity of fund employers to increase contributions as might be needed

[2] http://www.cipfa.org/policy-and-guidance/publications/p/preparing-and-maintaining-a-funding-strategy-statement-in-the-lgps-2016-edition

1.17 For open funds, solvency is dependent on employers being able to pay contributions as required, knowing that these contributions may increase or decrease significantly in future. Considering the LGPS as a whole, our long term expectation is that contributions will fall below their current levels as remaining deficits are paid off. However there is a significant chance that contributions remain at their current levels or even increase further in the long term, and in the short term there is always the risk that contributions need to increase or decrease following actuarial valuations.

1.18 At a fund level, we have expressed our stress tests in terms of the relative effects of an adverse stress to asset values on core spending power for English local authorities, and financing data for Welsh local authorities. We find that if asset values were to fall by 15%, then there is a range of impacts on different funds and, on the basis of our assumptions,[3] funds could face increases in contribution over 3% of their core spending. Funds should be aware of this risk, and consider if any action should be taken to manage it. For the avoidance of doubt, we do not consider that this risk implies that the aims of section 13 are not achieved.

1.19 West Midlands Integrated Transport Authority Pension Fund (WMITA) retains the specific risk arising from the majority of the fund liabilities being backed by a single private sector employer and being closed to new entrants. The administering authority and the employers have made substantial efforts by paying significant contributions to mitigate this risk. However, without a plan in place to ensure that the WMITA fund continues to meet benefits due in an environment of no future employer contributions being available, we do not think that any (realistic) employer contribution rate would be sufficient to achieve the solvency aim of section 13. We recommend that the administering authority put such a plan in place.

Recommendation 4: We recommend that the administering authority put a plan in place to ensure that the benefits of members in the West Midlands Integrated Transport Authority Pension Fund can continue to be paid in the event that employers' contributions, including any exit payments made, are insufficient to meet those liabilities.

Long term cost efficiency

1.20 As set out in CIPFA's Funding Strategy Statement Guidance, we consider that the rate of employer contributions has been set at an appropriate level to ensure long term cost efficiency if it is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

1.21 A number of funds highlighted in the Dry Run have made progress, with their employers increasing contributions following the 2016 valuation.

1.22 CIPFA's Funding Strategy Statement Guidance states "Administering authorities should avoid continually extending deficit recovery periods at each and subsequent actuarial valuations. Over time and given stable market conditions, administering authorities should aim to reduce deficit recovery periods." In the dry run, we established the deficit reconciliation measure so that funds could confirm that the deficit recovery plan can be demonstrated to be a continuation of the previous plan, after allowing for actual fund experience.

[3] Core spending power is a measure of financial resource of the underlying (tax raising) employers. Details are provided in Appendix C.

1.23 We consider that reconciliation of the deficit recovery plan is an important component of section 13 for all funds.

1.24 Through this exercise, we have identified and engaged with a number of funds that have extended their deficit recovery end points. We have not concluded that this implies the aims of section 13 are not achieved, however we do recommend that all funds review their funding strategy and consider whether this is in accordance with the CIPFA guidance referred to above.

Recommendation 5: We recommend that all funds review their funding strategy to ensure that the handling of surplus or deficit is consistent with CIPFA guidance and that the deficit recovery plan can be demonstrated to be a continuation of the previous plan, after allowing for actual fund experience.

1.25 We would not normally expect to see employer contribution rates decreasing (reducing the burden on current taxpayers) at the same time as the deficit recovery end point being extended further into the future (increasing the burden on future taxpayers).