

BABERGH DISTRICT COUNCIL

FROM: Director of Finance

REPORT NUMBER: **K191**

TO: **OVERVIEW AND SCRUTINY
(STEWARDSHIP) COMMITTEE**

DATE OF MEETING: 25 January 2011

PENSION FUND

1. **PURPOSE OF REPORT**

- 1.1 To advise Members on the outcome of the Pension Fund valuation for the 31 March 2010 and the proposed level of contributions to the Pension Fund from the Council for the next 3 years.

2. **RECOMMENDATIONS**

- 2.1 That the outcome of the Pension Fund valuation for the 31 March 2010 and the proposed level of contributions to the Pension Fund from the Council for the next 3 years be noted.

This matter can be resolved by the Committee.

3. **FINANCIAL IMPLICATIONS**

- 3.1 The increase in contributions and an additional cost to the General Fund of £35,000 for next year is allowed for in the 2011/12 draft Budget.

4. **RISK MANAGEMENT**

- 4.1 This report is most closely linked with the Council's Significant Business Risk No. 6 – Performance & Cost Management. Key risks are set out below:

Risk Description	Likelihood	Seriousness or Impact	Mitigation Measures
Future liabilities and economic conditions result in a worsening position on the Pension Fund.	Significant	Marginal	The actuary has made appropriate assumptions - the actual position could be better or worse than this. The Hutton review is expected to include proposals to reduce future cost pressures.

5. **EQUALITY AND DIVERSITY IMPACT**

- 5.1 None.

6. **KEY INFORMATION**

6.1 The Pension Fund is formally valued every 3 years. Results for the 31 March 2010 and the impact on contributions from the Council to the Pension Fund were considered by the SFP Task Group on the 16 December 2010.

6.2 Key points include:

- Babergh's deficit increased from £6.7m to £11.2m
- As a result, future annual contributions for ongoing benefits need to increase from the current level
- Annual contributions towards the deficit can be kept the same but only by spreading the deficit over 20 years instead of 15 years
- If the period for spreading the deficit remained at 15 years, an increased cost of around £150k a year would arise.

6.3 In terms of further details, the final valuation results indicate that the further service rate for Babergh needs to increase from 16% to 18.1% over the next 3 years. It has been agreed with the County Council that this will be phased in over the next 3 years i.e. an increase of 0.7% a year. The Medium Term Financial Strategy (MTFS) allowed for an increase in the contribution rate of 1% per annum so the actual results are a little better than this.

6.4 In addition, the following minimum deficit contributions were proposed compared to the current year:

Current Year	Total £933k (General Fund £700k)
2011/12	Total £870k (General Fund £652k)
2012/13	Total £935k (General Fund £701k)
2013/14	Total £981k (General Fund £736k)

6.5 Following further clarification and discussion on this with the County Council, the following options were presented to the SFP Task Group:

Option	Basis	Financial Impact – General Fund		
		2011/12 £000	2012/13 £000	2013/14 £000
1	Immediate increase in future service rate in 2011/12 of 2.1% + minimum deficit contribution	+52	+49	+35
2	Equally phase increase in service rate (0.7% a year) + minimum deficit contribution	-15	+73	+68
3	As Option 2 but maintain deficit contribution at same level next year as in the current year	+35	+35	+68
4	As Option 1 but maintain deficit contribution at same level next year as in the current year	+100	+1	+35

- 6.6 Although Option 2 is the most attractive for 2011/12 in that this would actually result in a reduced contribution, however, Option 3 was favoured and recommended, as it spreads the increases fairly evenly over the 3 years. This was supported by the Task Group as it was affordable within the Financial Strategy and relieved pressure slightly for 2012/13, which will be another very difficult year financially.
- 6.7 Appendix A sets out a briefing note from the County Council on the overall valuation results. These are at whole Fund level not just Babergh's share. Key figures for Babergh are summarised in the table below:

	March 2007 £000	March 2010 £000
Liabilities	49.2	53.9
Assets	-42.5	-42.7
Deficit	6.7	11.2
Funding Level	86%	79%

- 6.8 Public Sector Pensions are being comprehensively reviewed by Lord Hutton. An interim report was issued in October 2010 as part of the Government's Spending Review announcement and outcomes of the final review by the Government will be known later in the year. Appendix B provides further details.

7. **APPENDICES**

A – County Council Briefing Note on the Valuation Results

B – Spending Review – Public Sector Pensions

8. **BACKGROUND PAPERS REFERRED TO:**

None

CONTACT: Barry Hunter

EMAIL: barry.hunter@babergh.gov.uk

**SUFFOLK PENSION FUND
ACTUARIAL VALUATION AND FUNDING STRATEGY 2010**

ACTUARIAL VALUATION MARCH 2010

The actuarial valuation is an assessment of the financial health of the pension fund which the administering authority (Suffolk County Council) is required to undertake every three years.

The outcome of the valuation is a report on the funding level of the pension fund, which represents a comparison between the fund's assets (the value of its investments) and the fund's liabilities. The fund's liabilities are the present value of all the future pension payments that will fall to be paid, based on the service that has been accrued by scheme members up to the valuation date. The long-term objective of the pension fund is to maintain a 100% fully-funded position. The results of the actuarial valuation are used to determine the contributions to the pension fund which are required by the fund employers for the following three years.

The results of the actuarial valuation for the Suffolk Pension Fund at March 2010 show a deterioration in the funding level, from 89% funded at March 2007 to 82% funded at March 2010. The deficit on the pension fund has increased from £158 million at March 2007 to £306 million at March 2010.

	March 2007 £million	March 2010 £million
Liabilities	1,461	1,721
Market value of assets	1,302	1,415
Deficit (£m)	158	306
Pension Fund Funding level	89%	82%

Events since 2007

The deterioration in the funding level over the past three years is the result of a number of separate factors.

Investment performance. The investment returns over the three years to March 2010 have been significantly worse than the actuary's long-term expectations for the fund. The sharp falls in stock markets in 2007 and 2008 were followed by a partial recovery in 2009. However over the three years, the investment return for the fund was negative, -0.2% per year. This was the largest single factor in the deterioration of the funding level for the fund.

Change in market conditions. The valuation of the fund's liabilities is based on the real return on fixed interest gilts. A decrease in the real yield on fixed interest gilts means an increase in the actuarial valuation of the fund's liabilities. Over the period since March 2007, there has been a decrease in the real yield on index-linked gilts. The actuary estimates that this factor has added around 10% to the fund's liabilities over the period.

Mortality. The impact of mortality experience among pensioners over the valuation period has had an adverse effect on the fund, since fewer pensions in payment have ceased than expected by the actuary at the previous valuation. The actuary has also made allowance at the 2010 valuation for the expected future improvements in longevity, which increases the cost to the fund of ongoing scheme membership.

Change from RPI to CPI indexation. The announcement in the June 2010 Budget that the pensions in future will be subject to indexation in line with the consumer price index (CPI) rather than the retail price index (RPI) has reduced the actuary's assumption of long-term inflation for pension purposes by around 0.5% per year. The impact of this change is to improve the funding level, which in part offsets the adverse impact of the poor investment returns and the change in market conditions over the past three years.

Salary growth. The level of pay growth between March 2007 and March 2010 was less than assumed by the actuary at the March 2007 valuation, which has had a positive effect on the actuarial valuation. The actuary has also allowed for the potential impact of a short-term reduction in pay increases in 2011 and 2012, in line with the Government's expectation of a pay freeze for public service workers earning more than £21,000 per year.

Additional deficit contributions. The actuary determined employer contributions at the 2007 based on an expectation that the scheme deficit would be recovered over a period of around 15 years for the major public sector employers. The additional deficit contributions that have been made by employers over the period to 2010 have mitigated to some extent the adverse effect of the other changes over the inter-valuation period.

Other factors. The actuary has allowed for the impact of the changes in the benefit and contribution structure of the scheme, following the introduction of the 'new-look' local government pension scheme at April 2008. The 'new-look' scheme was assessed as being broadly similar in overall cost to the pre-2008 scheme, although the impact on individual employers is likely to vary according to their actuarial position. There are a number of other smaller changes which have been broadly positive for the actuarial valuation.

The main changes that account for the movement in the funding deficit between March 2007 and March 2010 are summarised below.

	£million	£million
Deficit at March 2007		-158
Adverse effects		
Investment returns	-259	
Change in market conditions	-146	
Mortality changes	-15	-420
Positive effects		
Change from RPI to CPI	89	
Salary growth less than expected	85	
Additional employer contributions	41	
Other factors	57	272
Deficit at March 2010		-306

FUNDING STRATEGY 2010

The Funding Strategy sets out the Suffolk Pension Fund Committee's strategy to ensure that the pension fund will be fully funded over the long term. The Funding Strategy Statement has been developed on the basis of three broad principles:

- a) Prudence. The objective is to ensure the right balance between risk and reward in setting the funding and investment strategy of the fund, and in setting the individual employers' contributions to the fund.
- b) Stability. The objective is to ensure, as far as possible, that employer contributions should not vary significantly from one valuation to the next.
- c) Affordability. The objective is to recognise the potential impact of changes in employers' contributions on their overall budgets and resources, and to mitigate the adverse impact that any required changes might have, for example by the phasing of additional contributions, where this is feasible and prudent.

Deficit Recovery Periods

The Committee has agreed to adopt the following approach in setting employer contributions for individual scheme employers at the 2010 valuation.

Type of Employer	Maximum Length of Deficit Recovery Period
Statutory bodies with tax raising powers	a period to be agreed with each employer not exceeding 20 years
Transferee Admission Bodies	a period reflecting the remaining period of the contract
Community Admission Bodies that are closed to new entrants	a period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers
All other types of employer	a period to be agreed with each employer, not exceeding 15 years

Phasing in of Contribution Rises

The Committee has agreed that any contribution increases that are required, based on the deficit recovery periods set out above, should be phased for statutory bodies with tax-raising powers over a period of up to six years, with a maximum increase each year equivalent to 1% of pay.

Implementation

The Pension Fund Committee has agreed to consult with scheme employers on the proposed Funding Strategy. The Pension Fund Committee on 19 January 2011 will make a final decision on the Funding Strategy and the actuary will then certify the employer contributions for the three years from April 2011.

Public Sector Spending Review – Public Sector Pensions

The Spending Review accepts the findings of the Independent Public Service Pensions Commission (IPSPC) led by John Hutton which published an interim report on 7 October. The report highlights the importance of providing good quality pensions to public servants, rejects a race to the bottom in pension provision, but concludes that there is a clear rationale for public servants to make a greater contribution if their pensions are to remain fair to taxpayers and employees, and affordable for the country. The Government accepts these conclusions. In response to the Commission’s interim recommendations, the Government will:

- commit to continue with a form of defined benefit pension;
- await Lord Hutton’s final recommendation before determining the nature of that benefit and the precise level of progressive contribution required;
- carry out a public consultation on the discount rate used to set contribution rates in the public service pension schemes;
- implement progressive changes to the level of employee contributions that lead to an additional saving of £1.8 billion a year by 2014-15, equivalent to three percentage points on average, to be phased in from April 2012 (see note below);
- exempt the armed forces from this increase in employee contributions;
- launch a consultation on the Fair Deal policy, which Lord Hutton noted can create a barrier to the plurality of public service provision and make it more difficult to achieve innovation, to report by Summer 2011, informed by Lord Hutton’s final recommendations on structural reform; and
- seek engagement with all stakeholders including trade unions.

Note:

The figure of £1.8 billion is broken down as follows:

£million			
2011-12	2012-13	2013-14	2014-15
0	160	1,270	1,760