Item: 14

Policy and Resources Committee: 17 April 2018.

Orkney Islands Council Pension Fund – Triennial Actuarial Valuation.

Report by Head of Finance.

1. Purpose of Report

To advise of the outcome of the actuarial valuation of the Pension Fund as at 31 March 2017 and the recommended level of employers' contributions.

2. Recommendations

The Committee is invited to note:

2.1.

The actuarial valuation of the Pension Fund as at 31 March 2017 issued by the Actuary, Hymans Robertson, attached as Appendix 1 to this report.

2.2.

That the funding level of the Pension Fund has reduced from 114.4% to 112.7% over the past three years.

2.3.

That the funding level of the Pension Fund has been maintained broadly in-line with the previous valuation after allowing for a reduction in the future expected investment returns, resulting from a fall in the real gilt yield and adoption of a lower Asset Outperformance Assumption than the previous valuation.

2.4.

That the increase in liabilities on the Pension Fund has largely been offset by positive membership experience and better than anticipated investment returns.

2.5.

That the Actuary is required to provide a Rates and Adjustment Certificate that sets the employers' contribution rates for the next valuation period.

2.6.

That the Actuary has approved a graduated reduction in the employers' contribution rate expressed as a percentage of pensionable pay, from the rate of 19.2% applicable in financial year 2017 to 2018 as follows:

- 2018 to 2019 – 18.2%.
- 2019 to 2020 – 17.6%.
- 2020 to 2021 – 17.0%.

2.7.

That the reduction in the employers' contribution rate would equate to a revenue budget saving of approximately £450,000 in financial year 2018 to 2019 and a further saving of £270,000 in 2019 to 2020.

3. Policy Aspects

This report relates to the Council complying with internal governance and reporting and therefore does not relate specifically to progressing the Council's six declared key priorities.

4. Background

4.1.

Orkney Islands Council, in its capacity as administering authority, is required by regulation 60 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2014, to carry out a triennial review of the Pension Fund.

4.2.

The main purpose of the actuarial valuation is to review the financial position of the Pension Fund and to determine the rate at which employing bodies participating in the fund should contribute to ensure that the fund assets will be sufficient to meet future liabilities in the form of benefit payments.

4.3.

The results of the previous actuarial valuation as at 31 March 2014, which were reported to the Policy and Resources Committee on 15 April 2015, indicated that the assets of the Pension Fund represented 114.4% of the accrued liabilities of the Fund.

4.4.

The main objective of the Pension Fund was therefore being met in that the Fund held sufficient assets to meet the assessed cost of members' past service benefits. The main contribution objective, to maintain a relatively stable contribution level, was also being met.

4.5.

The actuarial valuation at 31 March 2014 set the minimum contributions to be paid by each employer in the fund from 1 April 2015 to 31 March 2018 as follows:

- 2015 to 2016 – 21.4%.
- 2016 to 2017 – 19.8%.
- 2017 to 2018 – 19.2%.

5. Valuation Approach

5.1.

The valuation is a planning exercise for the Fund, to assess the monies needed to meet the benefits owed to its members as they fall due. As part of the valuation process the funding strategy is reviewed to ensure that an appropriate contribution plan and investment strategy is in place.

5.2.

The valuation is only ever an estimate as the future cannot be predicted with certainty however, the Actuaries use their understanding of the Fund and the factors that affect it to set the pace of funding, in conjunction with the administering authority. The pace of this funding can vary according to the level of prudence that is built into the valuation method and assumptions.

5.3.

The valuation approach adopted recognises the uncertainties and risk posed to funding by the factors referred to at section 5.2 above and follows the process outlined below.

5.3.1.

A funding target, which defines the target amount of assets to be held to meet the future cashflows, and a measurement is made at the valuation date to compare the assets held with the funding target.

5.3.2.

A time horizon, over which the funding target is to be reached, is set.

5.3.3.

Contribution rates, that give a sufficiently high likelihood of meeting the funding target over the set time horizon, are set.

6. Valuation Results

6.1.

The actuarial valuation of the Pension Fund as at 31 March 2017, prepared by the Council’s actuary, Hymans Robertson, is attached as Appendix 1 to this report.

6.2.

The main actuarial assumptions used to assess the funding position of the Pension Fund as at 31 March 2017 have been determined as follows:

	2014	**2017**
Price Inflation	2.7%	2.4%
Pay Increases	4.5%	2.8%
Discount Rate	5.1%	3.1%

6.3.

Pay increases includes an allowance for career progression over the working lives of employee members of the scheme.

6.4.

The discount rate is used to assess the current value of future benefit cash-flows expected to be paid from the Fund. The discount rate assumes that an average return on investments at 1.4% in excess of a “gilt based” approach can be achieved by the Pension Fund i.e. when compared to a strategy where all investments are held in Government backed bonds. The reduced Asset Outperformance Assumption of 1.4% is considered a prudent assumption for this valuation and compares to the 1.6% average return assumption used at the 2014 valuation.

6.5.

The valuation results for the Pension Fund are summarised in the table below:

	2014	**2017**
Past Service Liabilities		
Active Members	£105,000,000	£156,000,000
Deferred Members	£29,000,000	£46,000,000
Pensioners	£65,000,000	£96,000,000
Total	£198,000,000	£298,000,000
Assets	£227,000,000	£335,000,000
Surplus/(Deficit)	£29,000,000	£38,000,000
Funding Level	**114.4%**	**112.7%**

6.6.

The valuation exercise estimates that the funding level of the Pension Fund has reduced by 1.7% over the past 3 years to 112.7%. The funding level at previous valuation dates was as follows:

- 31 March 2014 – 114.4%.
- 31 March 2011 – 106.3%.
- 31 March 2008 – 86.0%.

6.7.

The main objectives of the Fund, as set out in the Funding Strategy Statement, are currently being met in that the Fund holds sufficient assets to meet the assessed costs of members' accrued benefits on the target funding basis and to set employer contributions which ensure both the long-term solvency and the long-term cost efficiency of the Fund.

6.8.

A funding level of 100% would correspond with the funding objective being met at the valuation date. The funding objective was met and there was a surplus of assets relative to the assessed costs of members' benefits on the target funding basis of £38,000,000.

6.9.

The main factors that have contributed to the change in the funding position between 31 March 2014 and 31 March 2017 are summarised as follows:

6.9.1.

Better than expected investment returns over the three-year period at approximately 41% which, compared to an expected return of 16%, equates to a gain of £59,000,000.

6.9.2.

A change in financial conditions since the previous valuation leading to an increase in liabilities of £68,000,000, attributed in the main to a decrease in the real discount rate and adoption of a lower Asset Outperformance Assumption.

6.9.3.

Better membership experience over the three-year period due to lower than expected salary and pension increases leading to a gain of £13,000,000.

6.10.

The Actuary has stated that progression of the funding position will depend on various factors including future asset performance, economic conditions and membership movements. If the financial assumptions made by the Actuary at this valuation are borne out in practice, and there are no changes to the valuation assumptions, the Actuary projects that the funding level at the 2020 valuation date will be 106%. This allows for contributions to be gradually reduced from the current rate of 19.2% to 17%. The contribution rates over the next three years as set out by the Actuary in the Rates and Adjustments Certificate will therefore be as follows:

- Year ended 31 March 2019 – 18.2%.
- Year ended 31 March 2020 – 17.6%.
- Year ended 31 March 2021 – 17.0%.

6.11.

Market conditions have continued to be volatile since the valuation date and yields on long term Government bonds have fallen since the valuation date. This reduction in the discount factor will have increased the liabilities of the Pension Fund in making future benefit payments. If future service rates were calculated on current market conditions they may be materially higher. It is therefore considered prudent that the financial position of the Pension Fund continues to be monitored by means of interim funding reviews as at 31 March 2018 and 31 March 2019.

7. Financial Implications

7.1.

The Council, through the budget strategy for financial year 2018 to 2019, has approved budget uprating assumptions that anticipate a 3% increase in staff costs offset by a 1% reduction in Local Government Pension Scheme employers' pension contributions.

7.2.

The actuarial valuation report explains that, although the funding position has declined from 114.4% in 2014 to 112.7% at 31 March 2017, the Actuary is recommending a graduated reduction in the employers' contribution rate from 19.2% to 17%.

7.3.

The reduction in the employers' contribution rate would equate to a revenue budget saving of approximately £450,000 in financial year 2018 to 2019 and a further saving of £270,000 in 2019 to 2020. These savings would be across both General Fund and non-General Fund services.

7.4.

Markets have however been volatile since the 2017 valuation and gilts yields have fallen in value which will increase the liabilities of the Pension Fund and adversely affect the funding level percentage.

7.5.

The Orkney Islands Council Pension Fund is a maturing scheme meaning that the burden (as a percentage of current contributing members' payroll) on contributing members of meeting the cost of the Fund's liabilities is becoming increasingly greater. The employer contributions paid into the Fund over the three-year valuation period were £22,602,000, while employee contributions amounted to £6,695,000. Transfer values received amounted to £2,334,000, making a combined income to the Fund of £31,631,000 over the valuation period. The combined total of pensions paid, death grants, transfers out and fees incurred over the valuation period was £20,145,000, resulting in a net cash inflow to the Fund of £11,486,000. The cost of administering the scheme included in the above cash outflow amounted to £848,000.

8. Legal Aspects

8.1.

In accordance with Regulation 60(4) of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2014 an actuary appointed by the Council was required to make an assessment on a triennial basis as at 31 March 2017 of the contributions which should be paid to the Pension Fund by the employing authorities in order to maintain the solvency of the Fund.

8.2.

In accordance with Regulation 60(8) of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2014 an employing authority must contribute to the appropriate fund in each year covered by a rates and adjustments certificate, the amount appropriate for that authority, as calculated in accordance with the certificate.

9. Contact Officers

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10. Appendix

Appendix 1: Orkney Islands Council Pension Fund 2017 Actuarial Valuation Report.