SURREY COUNTY COUNCIL

PENSION FUND COMMITTEE

DATE: **23 SEPTEMBER 2016**

LEAD OFFICER: **SHEILA LITTLE, DIRECTOR OF FINANCE**

SUBJECT: **ACTUARIAL ASSUMPTIONS: 2016 VALUATION**

SUMMARY OF ISSUE:

Members are required to have knowledge of the actuarial assumptions to be used in the next actuarial valuation of the Pension Fund as at 31 March 2016.

RECOMMENDATIONS:

It is recommended that:

The Pension Fund Committee note this report and approve the actuarial assumptions as set out in the report.

REASON FOR RECOMMENDATIONS:

To comply with best actuarial valuation practice.

INTRODUCTION:

1 In line with the Regulations, the Local Government Pension Scheme (LGPS) funds undergo an actuarial valuation every three years. The last triennial valuation of the LGPS assets and liabilities was as at 31 March 2013 and the current actuarial process aligns with data as at 31 March 2016.

2 The Regulations require that an actuarial valuation should assess the liabilities of the benefits accrued and set the contribution rates required to fund any shortfall in assets and the ongoing cost of future service.

3 There is a variety of differing actuarial methodologies which underpin the valuation assumptions. This paper explores and recommends the primary assumptions to be applied to the 2016 triennial valuation.

4 The following assumptions are key for the 2016 valuation:
- Salary increases;
- Pension increases;
- Longevity;
- Discount rate and Asset Outperformance Assumption (AOA).

DETAILS:

Salary Increases

5 The change to the accumulation of member pension benefits from a final salary to a career average revaluated earnings (CARE) basis will gradually reduce the importance of the salary increase assumption as member benefits will be tied to the annual consumer prices index (CPI) level of inflation rather than to final salary.

6 The majority of liabilities accrued to date, however, are still final salary linked benefits and, given significant accrued final salary service and built in protections as part of LGPS 2014, the final salary assumption remains of long term significance.

7 In the past two actuarial valuations, the Fund has used the market derived inflation retail prices index (RPI) value plus an additional percentage to establish a long term estimate of salary increases. RPI is calculated as the difference between the yield on long dated fixed interest gilts and long dated index-linked gilts.

8 The salary increase assumption for 2016 is expressed as a single rate of RPI less 0.7% and is equivalent to 1.5% p.a. for the next five years followed by RPI going forward. This approach represents ongoing budgetary pressures in UK local authorities.

Valuation	Methodology	Salary Increase Assumption
31 March 2013	RPI + 0.5%	3.8%
31 March 2016	RPI – 0.7%	2.4%

Pension Increases

9 Annual pension increases and CARE increases are determined by consumer price index (CPI) inflation. To establish a long term CPI assumption, the actuary uses a market expectation for RPI and applies a discount based upon the historical deviation between RPI and CPI. The variance between the two measures of inflation has widened recently with the actuary predicting a difference of -1.0%.

10 The recommended pension increase assumption of 2.1% p.a. is calculated as a geometric deduction of 1% p.a. from the above RPI.

Valuation	Methodology	Pensions Increase Assumption
31 March 2013	RPI – 0.8%	2.5%
31 March 2016	RPI – 1.0%	2.1%

Longevity

11 The assumption regarding improvements in longevity is based upon latest industry standards and information derived from the Fund's membership of Club Vita (provided by the Fund actuary), such as observed mortality rates.

12 The longevity assumption is predicated upon the idea that the very strong improvements in life expectancy observed amongst those born in the 1930s will start to tail off, resulting in less rapid increases in longevity for subsequent generations.

13 The expectation is that for the longer term, longevity improvements will stabilise at one additional year for every decade.

Assumed Life Expectancy at 65 (years)	**Actives**		**Pensioners**	
	Male	**Female**	**Male**	**Female**
31 March 2013	24.5	26.9	22.5	24.6
31 March 2016	24.3	26.7	22.6	24.7

Discount Rate and Asset Outperformance Assumption (AOA)

14 The Committee has chosen to adopt a CPI plus approach to setting the discount rate for the valuation of the Fund as at 31 March 2016 and all actuarial calculations going forward.

15 The level of CPI will be dynamic and therefore updated on a quarterly basis. It is proposed that the level of CPI should be updated based on the value at the end of each calendar quarter (i.e. 31 March, 30 June, 30 September, 31 December).

16 The level of CPI will be calculated as the level of RPI, with a geometric deduction of 1% p.a., with the level of RPI being the difference between the long term yield on fixed interest and index-linked government bonds.

17 The discount rate at 31 March 2016 will be set as CPI plus 2.1%. Going forward, the level of CPI will be updated on a quarterly basis, with the discount rate derived by adding the same excess return of 2.1% above CPI during the inter-valuation period to 31 March 2019. This excess return will be reviewed as part of the next formal valuation.

Valuation	**Methodology**	**Discount Rate**
31 March 2013	Gilt Rate + 1.6%	4.6%
31 March 2016	CPI + 2.1%	4.2%

18 This method for deriving the discount rate and CPI will be used for ongoing employer work, including setting contributions for new employers and assigning assets to them. The Navigator Funding Update report for the whole Fund as provided on a quarterly basis will also use this method for setting the discount rate.

19 The move to this method will achieve the Pension Fund Committee's aim of a more stable liability value and should therefore result in a more stable funding level. However, it should be noted that this depends on the movement in the value of the Fund's assets relative to the liabilities.

20 The approach for setting the discount rate for cessation valuations for any employer exiting the Fund will be reviewed as part of the Funding Strategy Statement (FSS) review later in the year and will incorporate the new CPI plus approach where appropriate. The FSS will be presented to the Committee at the February 2017 meeting.

CONSULTATION:

21 The Chairman of the Pension Fund has been consulted on the report.

RISK MANAGEMENT AND IMPLICATIONS:

22 There are no risk related issues contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

23 There are no financial and value for money implications contained within the report.

DIRECTOR OF FINANCE COMMENTARY

24 The Section 151 Officer (Director of Finance) is satisfied that the recommended actuarial methodology and assumptions employed represent an appropriate and prudent mechanism for valuing the liabilities of the Fund.

LEGAL IMPLICATIONS – MONITORING OFFICER

25 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

26 The review of the Fund's private equity programme will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

27 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

28 The following next steps are planned:

- Officers will continue to work with the actuary to prepare for the 2016 actuarial valuation.
- Following the completion of the valuation process, the Committee will receive a final outcome report and FSS for approval at the February 2017 committee meeting.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Hymans Robertson Actuary
Pension Fund Committee Chairman

Annexes:
None

Sources/background papers:
None

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