Lincolnshire COUNTY COUNCIL Working for a better future

Regulatory and Other Committee

Open Report on behalf of Executive Director of Finance and Public Protection

Report to:	**Pensions Committee**
Date:	**21 March 2019**
Subject:	**Valuation Process**

Summary:

This report details the process that the Fund's Actuary, Hymans Robertson, in conjunction with officers, is proposing to use for the 2019 Triennial Valuation.

Recommendation(s):

That the committee:
1) note the report; and
2) approve the 2019 Valuation process.

Background

1. The LGPS Regulations require that a valuation of the Fund's assets and liabilities is undertaken every three years by the Fund's appointed Actuary. This is known as the Triennial Valuation and the output provides a funding level percentage (value of assets compared to value of liabilities) and sets the contribution rates (both primary and secondary) that each Fund employer is required to pay for the next three years.

2. The Committee received presentations and training on the Valuation process from the Fund's Actuary on 13 December 2018 and 26 February 2019. This detailed:

   - An overview of how Lincolnshire Pension Fund is funded;
   - Why a valuation is carried out;
   - What assumptions are included;
   - The role of the Committee in the valuation process;
   - How employer contributions are set;
   - The Funding Strategy Statement (FSS);
   - How key assumptions are set; and
   - The timeline and tasks required to complete the Valuation.

3. This paper is provided to enable the Committee to consider and approve the <u>process</u> of the Valuation, with the two areas being how the key assumptions

are set and the contribution strategy for employers which feeds into the development of the FSS.

4. A further paper will be brought to the July meeting of the Committee detailing the actual assumptions proposed by the Actuary to be used in the Valuation, following further discussion with officers and advisors, for the Committee to approve. The FSS, detailing how contributions are set and the overall funding strategy will be brought in draft to the January 2020 meeting of the Committee, ahead of being circulated to all Fund employers for consultation and then to the March 2020 meeting for final approval.

5. Each of the two areas of the process is explained in the paragraphs below for the Committee to consider.

Setting the assumptions

6. The key assumptions are shown in the table below, alongside the proposed process for setting them:

Assumption	Process for setting
Discount Rate (long-term investment return)	The projected investment returns over the first 20 years are created using a risk-based approach encompassing stochastic modelling over 5000 different scenarios. From year 20 onwards the expected investment return is expressed as a "risk-free" rate of return plus a margin of expected asset out-performance. This margin in based on the additional return that could be expected from the Fund's investment strategy allowing a prudent assumption of the likelihood of achieving this (say 66%).
Salary growth assumption	This applies to the final salary element of an individual's pension, so will have a reducing impact over time as the CARE scheme benefits become a greater part of the overall pension. The Actuary has discussions with officers and employers to identify a reasonable assumption.
Pensions increase assumption (RPI-CPI gap)	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. This was 1% in the 2016 valuation and it is expected to remain at the same level.
Longevity assumption	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.

Employer contribution setting and FSS

7. All employers are required to pay cash into the Fund to reflect the future liabilities their scheme members build up each day (the primary rate) and any mismatch between the current value of their assets and their historical liabilities (the secondary rate). The employer contribution setting process has a three step approach:

- What is the employer's funding target?
- How long do we want to give the employer to get to that target?
- How sure do we want to be that the employer hits the target?

8. Different approaches are required for different employers, and work is undertaken by officers to understand the risks of each employer and the strength of their covenants. Examples of the considerations and implications are shown in the table below:

Feature	Implications
Guarantor or security	Allows greater flexibility around contributions (treated as lower risk)
Maturity	More mature = higher % payroll required (better to pay secondary rate as £)
Term	Contractors aim to be fully funded at end of contract (depending upon contract terms)
Planning to exit?	Non-contractor heading for cessation – plan contributions accordingly
Open or closed?	If closed then heading to cessation – plan contributions accordingly
Changes at employer	If significant may trigger review of contributions outside of valuation period
Funding position	Is there a deficit? What is the cashflow position – is the employer's asset share shrinking?

9. Once this risk profiling has been undertaken employers are allocated a rating. This provides the Fund with an objective and transparent approach to risk based contribution setting.

10. Once employer contribution rates have been drafted by the Actuary and proposed rates for the three years to March 2023 have been sent to employers, Employer Surgeries are organised to enable one-to-one discussions with the Actuary and Officers where requested.

11. The final step in agreeing the rates is that all employers are required to sign a declaration form committing them to paying the required contributions over the next three years.

12. This approach is formalised in the Funding Strategy Statement, which will be brought in draft version to the Committee in January 2020 before being circulated to all employers for consultation. Any comments are then fed back to the Committee in March 2020 for formal approval of the final document.

Conclusion

13. The Triennial Valuation process is a statutory requirement to provide a funding level for the Pension Fund and contribution rates for the employers to pay over the following three years. Officers work very closely with the Fund Actuary throughout the process of completing the valuation, calculating the employer rates and preparing the FSS.

Consultation

a) Have Risks and Impact Analysis been carried out?

Yes

b) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the author of this report.

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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