

By: Director of Finance
To: Superannuation Fund Committee – 7 March 2008
Subject: **ACTUARIAL VALUATION**
Classification: Unrestricted

Summary: To report the outcomes of the 2007 actuarial valuation.

FOR INFORMATION

INTRODUCTION

1. Under the Local Government Pension Scheme (LGPS) Regulations all local authority pension funds have to be valued every 3 years. For funds in England and Wales a valuation had to be undertaken at 31 March 2007. The fund is independently valued by the fund actuary, Hymans Robertson LLP, the actuary sets employer contribution rates.
2. This report explains the valuation process, in outline, and the results at Fund and major employer level.

VALUATION PROCESS

3. At the last valuation in 2004 the fund was 63% funded ie. assets represented only 63% of total liabilities.
4. The cost to the employer, normally expressed as a percentage of payroll consists of 2 elements:
 - (1) Future Service Rate – future costs of pensions for existing staff.
 - (2) Past Service Rate – this is to make good the deficit. The deficit is being recovered over a 20 year period, for local authority employers.

The deficit on the Kent Fund arises primarily from a contribution holiday 1989-92, the abolition of tax relief on (Advanced Corporation Tax) ACT in 1997 and the downturn in equity markets 2000-02.

5. There are 2 main aspects of the valuation; expected investment returns on assets and the value placed on liabilities.
 - (1) Asset Returns - in the 2004 valuation the actuary assumed a return of 6.3% pa, the Kent Fund achieved an above average return of 14.1% pa. This improved the valuation level in 2007 by around 16%.

- (2) Liabilities - the actuarial profession uses a discount rate based on gilt yields to value the future value of pensions liabilities. Gilt yields are substantially lower than in 2004 and this reduced the funding level by 12%.
6. The actuary has also had to take account of the introduction of the new LGPS from 2008, which does have some small cost reduction. But, the Government reneged on the full abolition of the 85 Year Rule after contribution rates had been set in 2004, which increases costs.
7. The other key issue for the actuary is that mortality rates have been improving rapidly ie. on average people are living longer. This has 2 main impacts, actuarial assumptions about existing pensioners dying are not being met and the actuary has to assume that future pensioners will live longer. The actuary has made a limited improvement in mortality in his 2007 valuation but further allowance will have to be made in the future.

VALUATION RESULTS

8. The overall 2004 and 2007 valuation results are shown below:

Valuation Date	2004	2007
Past service liabilities	£m	£m
Employees	1,064.7	1,555.9
Deferred pensioners	391.8	547.9
Pensioners	1,086.8	1,454.3
Total liabilities	2,543.4	3,558.1
Assets	1,602.8	2,580.3
Surplus/(deficit)	(940.6)	(977.8)
Funding Level	63%	73%

Overall the 10% improvement in the funding level is to be welcomed but unfortunately the increase in the value of liabilities means that we do not get the full benefit from the much higher investment returns.

9. In- terms of contribution rates at Fund level this means:

Valuation Date	2004	2007
Future Service costs	% of pay	% of pay
Total cost	16.7%	20.8%
Employee conts	6.0%	6.5%
Expenses	0.4%	0.4%
Net employer share	11.0%	14.7%
Past service adj (20 yrs)	10.8%	8.4%

Common contribution rate	21.8%	23.1%
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So the Future Service Rate has increased substantially from 11% to 14.7% of pay as a result of the change in financial assumptions and improvements in life expectancy from 2004 to 2007. The Past Service Rate has reduced from 10.8% to 8.4% of pay as a result of the improvement in the funding level, mainly from outperformance of assets 2004-07.

10. The figures above are at Fund level. For the local authority employers there are significant variations in the size of increases in contribution rate from -0.2% to +4.7% (Appendix). This reflects differences in:
 - (1) Membership profiles
 - (2) Experience – salaries, mortality, other demographics, outsourcings.
 - (3) Level of maturity – the value of liabilities relative to the size of payroll.
 - (4) Previous contributions paid to recover the deficit.
11. There are significant variations between District Councils but some are more mature and highly geared due to a higher average age of member and the workforce contracting due to outsourcing.
12. It should also be remembered that up until 1998 the District Councils and KCC had a shared employer contribution rate. This was no longer feasible with the creation of the unitary Medway Council. Since then whilst KCC and Medway have seen small increases in contribution rates, there have been very substantial increases for District Councils.
13. Looking at the total employer results the other group of employers to have experienced significant increases in contribution rates are the town and parish councils.

SUMMARY

14. Even after a period of strong investment returns at Fund level the cost of pensions has once again had to increase. Most commentators would not expect such strong returns over the next 3 years, coupled with the mortality issue and the difficulties faced by individual District Councils there is likely to be further upward pressure on contribution rates in the future.
15. Hymans Robertson have been commissioned to undertake modelling on the effect of different financial assumptions using proprietary software, comPASS. We will also undertake more formal inter-valuation updates of the funding position.

RECOMMENDATION

16. Members are asked to note this report.

Nick Vickers
Head of Financial Services
Ext 4603