SOUTH YORKSHIRE PENSIONS AUTHORITY

11 JUNE 2015

Report of the Fund Director

ACTUARIAL VALUATIONS 2013 and 2016

1) Purpose of the Report

To draw to Members' attention issues that need to be considered ahead of the actuarial valuation due at the end of March 2016.

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2) Recommendation

Members are asked to consider the points raised in this report.

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3. Information re 2013 actuarial valuation

3.1 As Members are aware, the next triennial actuarial valuation of the Fund is due as at 31 March 2016. As part of the preparation for the exercise it is necessary to identify potential areas of concern and points for further deliberation.

3.2 Of course, at this stage it is not possible to be precise about anything but it is fair to conjecture that funding levels have not improved since 2013. The historically low level of interest rates and bond yields will continue to cause the valuation of the Fund's liabilities to increase. This comes at a time of great pressure upon district council and other employers' budgets. It has always been the case that in meeting the prudential funding requirements of the Fund cognisance had to be taken of the affordability, stability and sustainability of employers' contribution rates. This was a difficult balance to strike in 2013 and it looks set to be once again in 2016.

3.3 Given the volatility in key financial markets that we have seen there is a danger that by the time any preparation work is concluded it is no longer appropriate but, at least, Members and officers will be more familiar with the issues discussed.

3.4 Following the initial data as at March 2013 the actuary carefully reviewed the change in market conditions since the valuation date and also examined a number of other possible easements with a view to try and meet the employers' understandable need for predictability and affordability. The actuary and the employers were also aware that the easements applied to previous valuations, when employers' contributions were lowered from the levels first projected, had created legacy difficulties during the 2013 process (given the agreement at the 2010 valuation to recover any subsequent monetary "underpayments" over 2014/17).

3.5 Consequently, the actuary put forward certain proposals to the main employers which he believed struck a balance in terms of the contributions payable to cover 2014/17 (and potentially beyond that date). The actuary considered, amongst other matters, the impact of allowing for material changes in market conditions post April 2013 and the consideration of "flat" and "phased" payment scenarios over 2014/17. The actuary also made assumptions regarding the take-up of the 50/50 benefit option which were introduced as part of the 2014 Scheme reforms. Equally, the actuary explored the cash easements that could be given in relation to prepayments of deficit contributions over 2014/17.

3.6 It is appropriate to review the reasonableness of the assumptions made in the 2013 valuation and, in the light of experience, gauge whether or not it is worthwhile using the findings during the preparation of the 2016 valuation. It is going to be as important as ever that investment and funding strategies are aligned in order to control the risk to the taxpayer regarding the liabilities in the Fund by targeting greater certainty of outcomes.

3.7 The management of risk should always be at the forefront of administering authorities' focus. Unfortunately, last year's Government consultations focused upon future service costs rather than managing and reducing deficits in a sensible way. As pension fund contributions become a bigger proportion of decreasing local authority budgets this becomes more important as it does not reduce as local authority payrolls fall. There are different ways of approaching these issues but the best will be very much Fund specific as they relate to maturity and the risk and affordability objectives of the Fund and its employers.

4) <u>Looking towards 2016 actuarial valuation</u>

4.1 Ultimately, for any actuarial valuation exercise, the Fund's philosophy is that the investment and risk management strategy adopted must drive the funding approach that the actuary adopts when setting contribution rates. In other words, the funding approach of the actuary should not influence directly the strategies adopted by the Fund but, instead, should complement the longer term target objectives.

4.2 Apart from revisiting the assumptions used by the actuary three years ago and checking whether or not they were or remain fit for purpose, there are many bigger issues that Members and officers ought to be preparing to consider. At this stage these might be "top down" rather than detailed ones but they should be Fund specific.

4.3 Perhaps the major theme to reconsider is whether the weighting on emphasis of major objectives for all stakeholders remains correct. Are employers likely to continue to focus on absolute levels of contribution rates or should more priority be given to stability of contribution rates? Is short term affordability still the critical issue? Given the likely pressures on local government budgets resulting from central government funding proposals that might appear to be a question with an obvious answer, but with interest rates at historic lows the employers might have a different view. It would be helpful if the major employers, especially the district councils, could share their financial plans with the Authority. For example, do they predict more outsourcing of staff (in particular using the alternative service delivery models being explored by many councils), more staff cuts or a combination of these? This will impact on the longer term objectives of the Fund.

4.4 How prudent do major employers want to be now? Are employers willing to concede that there is an offset between affordability now and potential deferment of catch-up to future contributors if experience is not borne out?

4.5 How robust will the administering authority be towards employers if they see short-term pressures adversely affecting the longer term solvency of the Fund?

4.6 In the past it could be argued that investment and risk management strategies did not receive their proper recognition in the valuation process. Is it time to begin the process by considering what sort of asset mix would be appropriate if the Fund was 100% funded? Whilst this might be fanciful now given the present funding position, thinking about it will help to determine policy priorities. Conventional theory would suggest that the Fund should then be wholly invested in index linked bonds but such a strategy would not lead to a reduction in employer contribution rates. The inclusion of an element of growth assets might be appropriate. Would the mix then between protection and growth assets be significantly different from the present starting position?

4.7 One option worth considering would be to put in place a framework which captures favourable market positions to reduce risk, whilst targeting stability (and ultimately a reduction) in employer contributions. De-risking programmes can be adjusted to meet specific employer or employer group characteristics if necessary.

5) <u>Summary – Key Questions/Initial considerations</u>

5.1 Key Questions

In summary, the Fund could view the following questions as being key to the outcome and approach adopted for the 2016 valuation:

- To what extent can the employers in the Fund tolerate volatility in their funding position (and contribution requirements), and how can the Fund control such volatility in practice with the assistance of the actuary?
- What will be the Fund's philosophy on risk hedging to provide more certainty of outcomes?
- To what extent will any margins of prudence built into the actuary's assumptions be maintained (or reduced) in light of this increased certainty?
- How will the diverse nature of the employers in the Fund (e.g. different maturity/covenant profiles) be reflected in the funding strategy adopted?

5.2 Initial considerations

As commented above, the Authority could ask that the major employers, in particular the district councils, look to provide the following information over the coming months as it becomes available in order to assist with the planning for the 2016 valuation:

- Their short (and medium) term budgets (actual or expected). This should include their views (if any) on pay growth;
- Whether or not there are likely to be further redundancy/restructuring exercises;
- Are the councils planning to further outsource services and, in particular, are they looking to change their service delivery models as part of this process.

6) <u>Implications</u>

6.1 Financial

Clearly there are financial implications arising out of the outcome of the actuarial valuation and the agreed contribution rates arising from it.

6.2 Legal

There are no legal implications.

6.3 Diversity

There are no diversity implications.

6.4 Risk

There are no risk implications unless the contribution rates cannot be agreed.

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Background papers used in the preparation of this report are available for inspection in the offices of the Authority.

Sources: Mercer Limited