Croydon Council

REPORT TO:	**PENSION COMMITTEE** **7 June 2016**
AGENDA ITEM:	**6**
SUBJECT:	**Actuarial Assumptions**
LEAD OFFICER:	**Richard Simpson, Assistant Chief Executive (Corporate Resources and Section 151 Officer)**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Treasury**
WARDS:	**All**
CORPORATE PRIORITY/POLICY CONTEXT: Sound Financial Management: Decisions about the actuarial assumptions underpinning the 2016 valuation are critical in ensuring the sustainability of the local government pension scheme.	
FINANCIAL SUMMARY: This report deals with key assumptions relating to the 2016 actuarial valuation. These are fundamental to the affordability of the Scheme.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	

1. RECOMMENDATIONS

1.1 The Committee is asked to note the contents of this report.

1.2 The Committee is asked to set an Asset Outperformance Assumption of 2.2%.

1.3 The Committee is also asked to confirm that pay growth assumption will be 1% p.a. until 2020, and then RPI p.a. thereafter.

2. EXECUTIVE SUMMARY

2.1 This report seeks to present Members with sufficient information to make a recommendation as to the assumptions that should be employed in calculating the 2016 actuarial valuation.

3. DETAIL

3.1 The next actuarial valuation of the Fund takes place as at 31 March 2016. This paper provides comments on analysis that can be used to agree two key valuation assumptions - the discount rate and the pay growth assumption. This report examines two components of the valuation, requiring the Committee to make a decision about the appropriateness of options described. In order to assist in this process the Scheme Actuary will facilitate a discussion, introducing and describing the key issues.

3.2 Since the 2013 valuation, new Governance regulations have greatly increased the scrutiny that LGPS funds are under. LGPS funds will now be expected to be able to justify their actions, including choice of assumptions, to both internal and external parties. Additionally, as the Fund's funding plans are increasingly set via a risk based approach, the Fund also needs to understand the risk inherent in any choice of assumption. This paper will form part of the audit trail for the 2016 valuation.

3.3 The full reports on which the comments in this paper are based are attached as an appendix to this report.

Discount Rate

3.4 This assumption reflects the rate of investment return that the Fund expects to earn in future. The choice of discount rate is one of the key decisions made at the actuarial valuation. The discount rate is used to place a single 'present' value on a series of projected future benefit payments. The single value is known as the liabilities.

3.5 The discount rate assumption is set in two parts:

1. Current long dated UK Government Fixed Interest bond yields; plus
2. the Asset Outperformance Assumption ("the AOA").

3.6 The current yield available on long dated UK Government bonds (1) is an estimate of the future 'risk-free' return that can be achieved by the Fund. However it is expected that the Fund's assets will achieve higher returns due to the combination of riskier assets held by the Fund (e.g. equities, property and corporate bonds). The AOA (2) is a prudent estimate of the additional return expected to be achieved by the Fund's assets in the long term over and above the "risk-free" return available on long dated Government bonds. At the 2013 valuation, the AOA was set equal to 2.0% p.a.

3.7 For the purpose of the 2016 valuation, it is important to set an AOA that reflects likely future experience, with allowance for prudence. The Fund should adopt an assumption that is appropriate based on the current investment strategy and is likely to remain appropriate under expected possible future changes to strategy. It may be considered prudent to opt for the upper end of the range of outcomes as the long-run return achieved to date has been 7.6%.

2016 valuation AOA recommendation

3.8 The decision on the appropriate AOA level depends on how prudent the Fund wants to be, and on how it expects its investment strategy to change over the longer term (the next 20 or so years). There is no formal definition of "prudence" – typically an actuary might view an assumption as being prudent if there is at least a 2 in 3 chance of a positive outcome.

Pay Growth

3.9 One of the key actuarial assumptions used to determine the value of the past service liabilities is that relating to future pay growth. This assumption comes in two parts:

1. Annual 'inflationary' pay awards, historically set in order for employees' pay to keep up with the cost of living, and
2. Promotional pay awards or those awarded as part of a defined pay scale.

This analysis considers the first element of the pay growth assumption only.

3.11 The assumption for annual 'inflationary' pay awards increases at the 2013 valuation was set equal to the rate of expected future RPI to reflect future pay growth expectations at that time. There are, however, two prevailing factors that necessitate a review of how the pay growth assumption is set:

1. LGPS benefits accrued from 1 April 2014 are no longer linked to members' final pay due to the introduction of CARE benefit accrual. A Final Salary benefits underpin applies for members within 10 years of retirement at 1 April 2012, however it is unlikely that this will 'bite' in many cases due to the low salary growth environment we are currently experiencing. Future pay growth therefore only affects benefits built up before 31 March 2014. Although pre-2014 liabilities currently make up the vast majority of the Fund's total active liabilities, this will diminish over time. The future period for which the pay growth assumption applies can therefore no longer simply be referred to as 'long-term'.

2. Since 2010, pay growth in the public sector has been restricted and Government policy suggests that this is likely to persist in the near future. In particular, the Government announced during the Summer Budget on 8 July 2015 that funding would be provided to meet public sector pay increases of only 1% p.a. for 4 years from 2016/17 (i.e. to 2019/20).

   The analysis explores the suitability of different long term flat rate assumptions for pay growth from 2016 onwards, allowing for the proposed Government salary freeze until 2020 followed by a higher long term assumption thereafter.

3.12 It is no longer appropriate to set the pay growth assumption, used to value the past service liabilities at the 2016 valuation, equal to the historic average. This report suggests that an appropriate 2016 valuation pay growth assumption would be 1% p.a. until 2020 reverting to a long term rate of RPI p.a. thereafter.

4 FINANCIAL CONSIDERATIONS

4.1 There are significant financial considerations associated with calculating the 2016 Actuarial Valuation as this contributes to the process of setting the employers' contribution rate.

5. OTHER CONSIDERATIONS

5.1 Other than the considerations referred to above, there are no customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report

6. COMMENTS OF THE SOLICITOR TO THE COUNCIL

6.1 The Council Solicitor comments that there are no direct legal implications arising from this report.

(Approved by: Gabriel MacGregor, Acting Council Solicitor & Acting Monitoring Officer)

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BACKGROUND DOCUMENTS: None

APPENDIX A: 2016 Actuarial Valuation: Setting discount rate and pay growth assumptions, Hymans Robertson.