Appendix 'A'

2013 Actuarial Valuation of the Lancashire County Pension Fund

Introduction

This report presents the results of the 2013 actuarial valuation process at whole Fund level for consideration by the Committee in order to enable formal consultation with stakeholders on issues to be included in the revised Funding Strategy Statement (FSS).

Consultation has already begun with individual employers in order to fit in with the budgetary timetables which they adopt.

Background

Every three years the Fund's Actuary is required to carry out a formal valuation of the Fund in order to set employer contribution rates for the next three years.

The valuation currently being undertaken is based on the position of the Fund at 31 March 2013. However, it must also take into account a number of other specific forward looking factors such as the change in the benefit structure of the Local Government Pension Scheme from 1 April 2014 which will impact on the rate at which members build up new benefits.

The valuation is also taking place in the context of

- The ongoing reductions in the public sector workforce particularly in local government which results in fewer active members contributing to the scheme.

- The ongoing dislocation of the bond markets which affects the discount rate the actuary uses to value the Fund's liabilities.

As previously reported to the March meeting of the Committee all these factors combine to make this probably the most challenging valuation in the history of LGPS.

At its March meeting the Committee endorsed a number of propositions to underpin the valuation process, specifically

- The use of a tailored assumption on pay growth in the earlier years of the valuation model to reflect the impact of public sector pay restraint.

- The development of fund specific assumptions around life expectancy.

- The use, where appropriate of assumptions around the normalisation of bond yields to replace previous assumptions of Increased Inestment Return.

- The conversion of deficit recovery contributions to fixed cash amounts rather than a percentage of payroll.

- Changes in the way in which the pension strain that results from early retirements is dealt with.

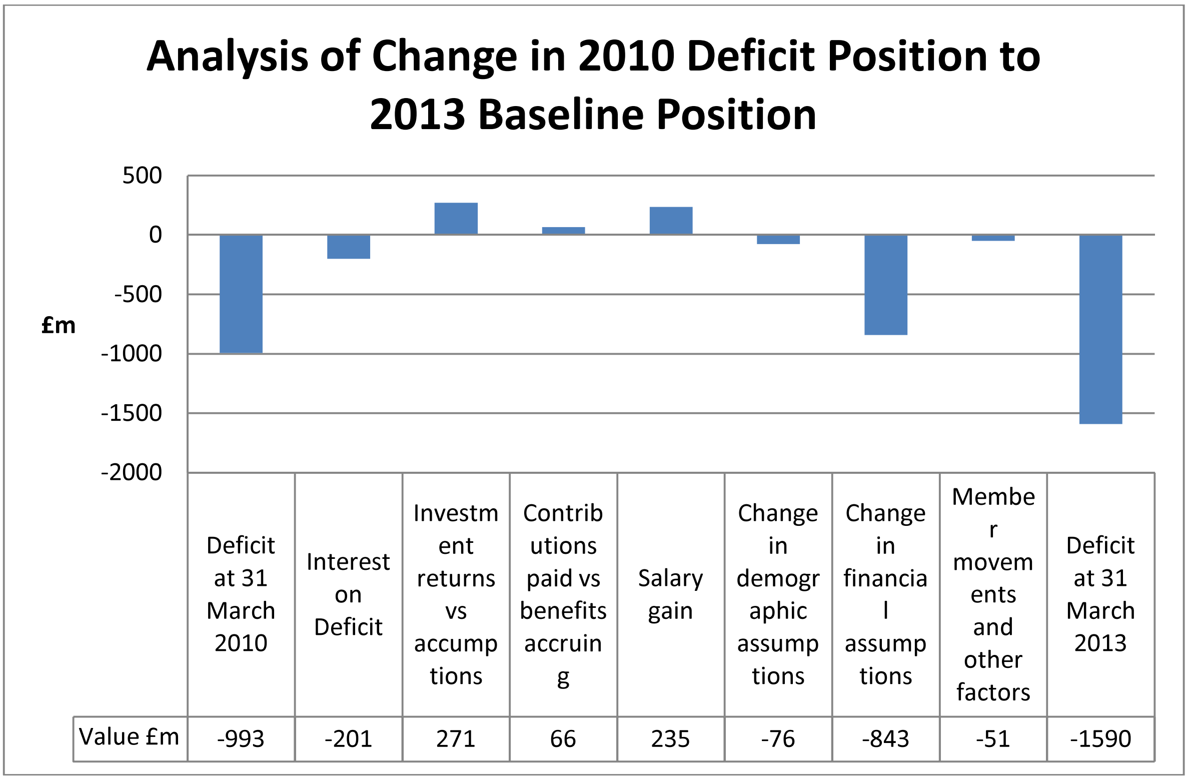
- An initial intention to bring the deficit recovery period down to 16 years (see below).

Valuation Results

The Fund's Actuary will present the results for the whole fund to the Committee. It should be emphasised that at this valuation there are significant differences between the results for different employers and these differences are much greater than has been seen previously.

At headline whole fund level the overall funding level based on the various updated assumptions is around 78% as at the 31 March 2013, compared to 80% at March 2010. This differs from the figures in the regular performance reports because of the revised assumptions. Given the significant negative movements in key elements such as the discount rate this should be seen as a positive result for the Fund.

The overall deficit on the Fund has increased from £0.993bn to £1.590bn.
As illustrated on the graph below the movement in the cash value of the deficit has been due to those factors which cannot be influenced by either the Fund or employers. Those factors which can be influenced have moved favourably.



These results clearly present a challenging position in terms of achieving the Fund's objectives of stable and affordable levels of employer contributions.

Achieving a Sustainable Contribution Plan

The key objective for the Fund is dealing with the valuation results must be to achieve a sustainable contribution plan which, all other things being equal, will make inroads in to the current deficit and create a situation where future service contributions are broadly matching liabilities as they build up. Given the considerable level of uncertainty both in terms of future movements in the financial markets and the real impact of changes in the LGPS scheme design this presents a very significant challenge.

To deal with this challenge it is proposed to reflect the following within the valuation as applied to individual employer contributions.

- A deficit recovery period of 19 years (unchanged from the 2010 valuation). This reflects the relative stability of the funding level and while a case might be made for extending the period further, for some employers, it is felt by fund officers and the actuary that to do so could be seen as imprudent particularly given the likely impact on funding levels of further reductions in employers' staffing levels.

- An assumption of 10% take up of the 50/50 option within the new scheme design in line with the assumptions made by the Government Actuary. If reality is that fewer than 10% of members take up this option employers will be underpaying future service contributions. Equally if more than 10% take up the option they will effect be making additional deficit contributions.

- Allowing for some of the impact of movements in bond yields between April 2013 and August 2013, in setting contributions.

- Where relevant adjusting the period over which it is assumed bond yields will revert to the mean (i.e. back to "normal") from 10 years to 5 years.

- Ensuring the new Future Service Contribution rates are paid in full from 1 April 2014. All other things being equal this means that contributions and new liabilities should build up in line with each other avoiding the deficit increasing.

- Allowing phasing of the increase in deficit contributions over the three years of the valuation period, but within this requiring that the inflationary increase is paid each year and the phasing results in the full payment by year 3. Because deficit contributions are now to be expressed as cash this means employers and the Fund will have transparency over the degree to which phasing results in underpayment towards the deficit (in effect an increase in the deficit recovery period). This gives employers a much clearer option around making additional payments against their deficit.

- Not allowing any employer to reduce the cash level of contributions between valuations. This allows the small number of employers in this position to make greater progress in reducing their deficit which is in the interests of both the Fund overall and the individual employers.

Taken together with the steps agreed in March these measures provide the best balance possible between the interests of employers in terms of affordability and those of the Fund in terms of being able to meet its overall liabilities as they fall due.

Schools and Academies

The increasing number of academies and free schools presents specific issues at this valuation as does the move to a cash value for deficit contributions in relation to maintained schools.

In relation to Academies, the Department for Communities and Local Government and the Department for Education have:

- Provided a form of guarantee intended to offset the risk to Pension Funds from the fact that academies only have a seven year funding agreement. While in many ways this guarantee is deficient the Government's intention is clearly that academies should be treated in terms of covenant in the same way as maintained schools.

- Consulted on "pooling" arrangements for academies. In practice this would mean that each Academy while retaining its own share of the deficit will have the same Future Service Contribution rate.

In relation to these issues it is proposed:

1. To treat academies as "ongoing" institutions in the same way as maintained schools.

2. To create three Academy pools, one for each Education Authority from which academies have transferred. This is likely to result in less movement in future service rates for the individual institutions.

For maintained schools the issue is that within the framework that exists for funding schools it is not possible to charge individual schools a fixed cash contribution to the deficit, nor is it practical as it would mean treating a further 700+ institutions as though they were separate employers. It is therefore proposed that for maintained schools deficit contributions are set as a percentage of pay taking into account the need to ensure both a minimum fixed amount and the relevant inflationary increase are collected. The relevant arrangements will need to be agreed on a case by case basis between the Fund's officers and the three education authorities.

Next Steps

A process of engagement with employers around the valuation results has already begun and will continue into the new calendar year. This process will now be extended to include consultation on a draft Funding Strategy Statement which formalises the various measures set out above and sets them alongside the Fund's high level investment approach.

The results of this process will be reported back to the Committee during the first quarter of the New Year alongside the issuing by the Actuary of the final rates and adjustments certificate.