HYMANS ROBERTSON

Briefing note

Public Service Pensions Act - Section 13 valuation
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The 2016 valuations in England and Wales will be the first to be carried out under the new review framework set out under Section 13 of the Public Service Pensions Act ("S13"). This piece of primary legislation requires that an appointed person, in this case, the Government Actuary's Department ("GAD"), reports on whether the LGPS formal funding valuations adhere to the following criteria.

Compliance – to confirm the valuation has been carried out in accordance with the Regulations

Consistency – to confirm the valuation is not inconsistent with other valuations

Solvency – to confirm contributions are sufficient to ensure solvency

Long term cost efficiency – to confirm contributions are sufficient to meet benefit accrual and existing deficit

Dry Run

Over the last 6 months we have been engaging with GAD as they have carried out a review of LGPS 2013 valuations against these criteria. This exercise is now complete. GAD have published their report here and are hosting a series of seminars to discuss their findings and recommendations. The 2013 valuations pre-date the effective date of the legislation. As such, the work on the 2013 valuations has no legal force but serves as a "dry run" to familiarise all parties with the process and sets expectations as to how the 2016 valuation review might be implemented.

Throughout the process of carrying out the dry run, GAD have asked for considerable input from all LGPS fund actuaries in order to improve their understanding of LGPS funding valuations and to resolve specific queries relating to some funds' contribution schedules and funding plans.

Approach

In summary, GAD will calculate a number of metrics for each of the LGPS funds using consistent actuarial assumptions. Funds will be ranked in a league table based on these metrics and assigned a RAG (Red/Amber/Green) status against each metric to identify those funds that may need to take action. The absolute value of the assumptions in the chosen actuarial basis is not important – the important fact is that all LGPS funds are measured on the same assumptions, allowing comparison across funds. (The actuarial assumptions used by GAD in the comparison are explicitly unsuitable for use as a funding basis as they contain no intentional margin for prudence).

Understanding the Four Criteria

Compliance

This criterion is largely assumed. GAD look for funds and their actuaries to include a compliance statement as part of their formal valuation report.

Consistency

GAD have interpreted the criterion to mean that there should be alignment between the funding valuations of LGPS funds on **presentation** of results in the final valuation report, and that differences in assumptions chosen by funds should be underpinned by **evidence** of local consideration and justification of fund specific assumptions.

Solvency

Funds will be considered to have met this criterion if the rate of employer contributions is set at a level which targets 100% funding on appropriate actuarial assumptions, over an appropriate time period and if fund employers collectively have the financial capacity to increase employer contributions to continue to target a funding level of 100% if increases are required in future. In other words, funds do not have to be 100% funded at all times to meet the solvency criteria but rather, funds must have a credible plan in place for reaching 100% funded and employers must be deemed able to support that plan, even in adverse circumstances.

Long term cost efficiency

Funds will be considered to have satisfied this criterion if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund. This criteria has been characterised by GAD as ensuring inter-generational fairness by not deferring payments required into the scheme where this will result in additional long term costs.

If GAD has concerns about LGPS funds under any of these measures then they can recommend **remedial actions** which may ultimately be enforced by DCLG using powers granted under this legislation.

Dry Run Results

As anticipated, no **compliance** issues were found.

GAD reported that they had found both presentational and evidential **inconsistencies** in the valuation approach adopted by LGPS funds, and in assumptions used and disclosure of results.

GAD reported concerns over securing **solvency** for two closed transport funds. A number of funds raised amber flags on one or more metrics examined under solvency. No funds were red flagged.

GAD named two funds with whom they would have wanted to have further discussion over the **long term cost efficiency** of their funding plans. For funds advised by Hymans, no red flags were raised on either solvency or long term cost efficiency reflecting the robust and transparent nature of the funding plans put in place by LGPS Administering Authorities.

GAD clarified that **meeting solvency and long term cost-efficiency requirements takes precedence** in the regulatory framework over the desirability of stable contributions.

Our View

We welcome the GAD Section 13 report. ***For a long time, Hymans Robertson have calculated on a like-for-like basis key funding metrics for all LGPS funds*** to ensure fair comparisons can be made and to reduce the number of funds showing artificially inflated funding levels based on highly optimistic rather than prudent assumptions about the future. We welcome this additional level of scrutiny which we hope will improve funding standards, increase transparency and enhance the understanding of stakeholders and commentators. In carrying out S13, GAD undertook a detailed process examining a number of metrics, some of which involve complex actuarial calculations, and produced a lengthy report. We believe that the report would be more accessible to stakeholders if both the number of metrics were reduced and the report simplified.

We disagree that consistency of funding assumptions or funding methods between funds is desirable or required under this legislation. Each LGPS fund is responsible for meeting its own liabilities and should be able to, in conjunction with its advisors, implement a funding approach that reflects its local situation, priorities, beliefs and attitude to risk. In our opinion, considerable risks are introduced by taking an approach which encourages funds to set their funding plan by reference to either a standard basis or to give undue weight to the approach adopted by other LGPS funds. These risks include less engagement and ownership of funding decisions, loss of diversification within the LGPS leading to a concentration of funding risk, loss of innovation and creative solutions to funding challenges and the adoption of unsuitable assumptions (for example, longevity experience is significantly different in different areas of the country). Perhaps the most potentially damaging risk is the risk of herding towards a ”minimum funding requirement” that actually doesn’t address the funding requirements of each LGPS fund – often described as a “race to the bottom”.

We do not believe the wording regarding consistency included in S13 should be interpreted as requiring funds to adopt identical assumptions or an identical approach to funding. We believe rather that inconsistent interpretation of the Regulations should be addressed and that DCLG should ensure appropriate definitions are robust. We, and other LGPS fund actuaries, have input into consultations to refine key definitions where required. We are also happy to facilitate a standard disclosure of key funding results on a consistent basis - as we have in the past in order to support the ability to compare funds.

We take our professional obligations as actuaries to LGPS funds very seriously and consider that ensuring the solvency and long term cost efficiency of funds are addressed as part of the valuation process are key responsibilities. GAD has examined a number of metrics to assess these criteria under Section 13, all at whole of fund level. However administering authorities and fund actuaries address funding challenges at individual employer level and try to optimise both solvency and long term cost efficiency for every employer in the fund through the valuation process. There are considerable complexities in this process which will not be captured by examination of high-level whole fund results.

Finally, the primary purpose of the triennial funding valuations is to allow each administering authority to put in place a funding plan that levies adequate contributions from employers and invests assets appropriately in order to meet the liabilities of their individual LGPS funds. S13 can play a valuable role in reassuring stakeholders that the LGPS as whole is in a position to meet the liabilities owed to members and to flag where individual funds appear to be outliers from the main pack. ***However, it would be counter-productive if, by having undue regard to how they appear under S13, funds compromised their funding valuations and reduced their chances of meeting their liabilities cost effectively - the tail should not wag the dog!***