BABERGH DISTRICT COUNCIL

From: Director of Finance	**Report Number: L100**
To: Overview and Scrutiny (Stewardship) Committee	**Date of meeting: 15 November 2011**

PENSION FUND

1. Purpose of Report

1.1 To advise on the Pension Fund position in relation to the potential for any savings or reductions in employer contributions over the next 3 years.

1.2 To further advise on other aspects of the Pension Fund and specifically the impacts of reducing staffing levels as part of the integration and transformation programme.

2. Recommendations

2.1 That no further action can be taken in relation to requesting the actuary to review and reduce the council's contributions to the Pension Fund between 2011/12 and 2013/14.

2.2 That any adjustments relating to the Government's proposed changes that could affect Pension Fund contributions, as assessed by the actuary, be reported to Members and fed into future strategic and financial planning processes as necessary.

2.3 That Members note the information on other aspects of the Pension Fund and specifically the impacts of reducing staffing levels as part of the integration and transformation programme.

The Committee is able to resolve this matter. The matter will also be reported to the SFP Task Group and other Members as part of the strategic and financial planning process.

3. Financial Implications

3.1 None directly from this report.

4. Risk Management

4.1 This report is most closely linked with the Council's Corporate / Significant Business Risk No. 2, Efficiencies and Savings and No. 6, Performance & Cost Management. Key risks are listed below:

Risk Description	Likelihood	Impact	Mitigation Measures
Overall longer-term viability of the Pension Fund and increase contributions in future years	Very High	Critical	None. Ceasing or reducing Babergh's deficit contributions will have an impact on the viability of the Fund and increase future contribution levels.
Negative Unison/staff reactions	Very High	Critical	Communication, but likely to be seen as a raid on staff pensions at a time when national strike action is being proposed on what is a major issue for staff.

5. Consultations

5.1 Views of Babergh Unison – see appendix A.

6. Equality Analysis

6.1 Not required.

7. Shared Service / Partnership Implications

7.1 Mid Suffolk are not considering the contributions issue. Although different councils can adopt differing stances and approaches, this has to be within the overall Pension Funding strategy set by the County Council and the statutory Pension Fund requirements.

8. Key Information

8.1 Members have asked for clarification on a number of aspects of the Pension Fund and contributions into it by the Council.

8.2 The matter was last reported to this Committee in January 2011 (Paper K191) when the proposed contribution rates for the next 3 years (2011/12 to 2013/14) were agreed and fixed for that period.

8.3 Key points related to that paper are as follows:

- Babergh's deficit had increased from £6.7m (at the last full valuation 3 years ago) to £11.5 million.
- In addition, future annual contributions for ongoing benefits needed to increase from the current level
- Annual contributions towards the deficit could however be kept the same - but only by spreading the deficit over 20 years instead of 15 years
- If the period for spreading the deficit remained at 15 years, an increased cost of around £200k a year would arise.

8.4 The actuary determined employer contributions at the 2007 valuation based on an expectation that the scheme deficit would be recovered over a period of around 15 years for the major public sector employers. The deficit contributions that have been made by employers over the period to 2010 mitigated to some extent the adverse effect of the other changes over the inter-valuation period. The period of 20 years for spreading the deficit is the maximum permitted under the current County Council Funding Strategy – see Appendix B.

8.5 Discussions have been held with County Council officers in relation to whether it would be possible and appropriate to reduce the Council's contributions to the Pension Fund. Their response is as follows. Appendix C contains further information about this:

"Even a 1% fall in the funding level for the pension fund would wipe out the projected benefit to Babergh's funding level as a result of the additional contributions it is making over the period to March 2014. There is no basis on which the actuary or the County Council's Pension Fund Committee would be justified in reducing Babergh's pension fund contributions in the current circumstances."

8.6 This, along with Unison's response, seems conclusive. However, there are some current proposals on the table from the Government for increases in average employee contribution rates of between 1% and 1.5% by 2014/15 that could result in an equivalent but relatively modest reduction in the cost of employer contribution rates. These changes will have no effect on the deficit contributions that are required which remain the employer's responsibility. It will be down to the actuary and the County Council to advise further in due course as to whether any reductions are appropriate and sensible in the light of the Government's eventual decisions on these matters.

8.7 In terms of other aspects of the Pension Fund, a number of additional questions have been posed to County Council officers. These, together with their responses are contained in Appendix D.

9. Appendices

Title	Location
(a) Unison views	Attached
(b) Pension Funding Strategy 2010	Attached
(c) Suffolk Pension Fund – 2010 valuation	Attached
(d) County Council response to further questions	Attached

10. Background Documents

None.

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Appendix A

Unison views

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Babergh Branch

3rd November 2011

Dear Barry

Unison Consultation – O&S Committee Report Reviewing Babergh's Employer Contributions to the Local Government Pension Scheme

Thank you for inviting Unison to make comment regarding Members wishing to review the employer contributions made by Babergh into the Local Government Pension Scheme (LGPS). We understand that the intention was to look at whether it is possible to unilaterally reduce employer contributions, specifically those relating to the deficit on the Pension Fund. Unison's statement in relation to this is as follows:

> The Local Government Pension Scheme (LGPS) is an integral part of Babergh employee's package of contractual terms and conditions and is something highly valued by Unison members. We strongly oppose any changes that would affect the long term financial viability of the LGPS.
>
> As context, at a national level, Unison is in formal dispute with the Government regarding proposals to fundamentally change the LGPS. The aim of these proposals is to save the treasury £900 Million over the next three years. Despite eight months of protracted negotiations, the Government have been unwilling to make any meaningful concessions regarding their proposals and as a consequence talks have unfortunately broken down.
>
> In the light of the widespread press coverage regarding Unison's national pension dispute it seems a somewhat odd time for Babergh's elected Members to even contemplate cutting the employer contributions to the LGPS.
>
> The Babergh Branch of Unison is already reluctantly contemplating industrial action as a consequence of the Governments unreasonable attack on our pension scheme. We are not a militant branch and generally prefer to resolve any disagreements through dialogue, negotiation and mutual compromise in respectful recognition of each side's point of view. For Unison members, any decision to get involved in strike action would not be taken lightly and it is a measure of the seriousness of this matter that we are now prepared to consider such action. Whilst this is primarily a national dispute, the suggestion that some Members might also see the staff pension scheme as a convenient piggy bank that can be raided to achieve savings is most disappointing.
>
> There are plenty of other opportunities to make savings through more efficient ways of working that have the potential to give both enhanced service quality outcomes and increased productivity. Unison has worked closely with management in the past to seek positive solutions to problems and there is no reason to doubt whether we are willing and capable of rising to any similar challenges thrown at us in the future as a consequence of the proposed staff integration with Mid Suffolk DC.

We note from Report K191 that the Suffolk LGPS is currently underfunded by 18% and is running a deficit of £305 Million. In the context of a scheme whose liabilities exceed its financial reserves by this amount it seems bizarre to be even contemplating reducing contributions.

It is notable that the amount of deficit has almost doubled in the last three years. Whilst this can be attributed to an unprecedented stock market crash, there is no sign of significant market recovery, at least not in the short to medium term and as such steps need to be taken to ensure that the pension fund has sufficient resilience to weather this ongoing financial turbulence.

However the most important feature that seems to have been overlooked is that the LGPS is a statutory scheme with clear requirements to fund this, including deficits, based on tri-ennial actuarial reviews. Babergh Members can, of course, seek changes to the contribution rates that the actuary recommends and challenge the County Council's funding strategy e.g. how long the deficit is spread over. We understand that this process was followed (including involvement of the Scrutiny Committee) when the rates for the next 3 years were set and that there is, therefore, no discretion that they can exercise about the value of contributions that will be paid into the LGPS over the 3 year period.

We also understand that the contribution rates are determined centrally by Suffolk County Council's Pension Fund Committee, as professionally advised by the scheme's actuary, Hymans. These rates reflect what is actually needed to fund the deficit in accordance with a consistent approach adopted across the County. Looking ahead, Unison would want to be consulted and fully involved should Members wish to challenge or amend future recommendations by the actuary

In summary, Unison considers that any reduction in contribution rates to the LGPS would be unwise given it's current financial position and we support the recommendation of this paper to "*take no further action in relation to requesting the actuary to review and reduce the councils contributions to the pension fund between 2011/12 and 2012/13*."

I would be grateful if you would be prepared to include this statement as an appendix to your report due to be presented to O&S on 15th November 2011. I trust that these views will be taken into consideration before a decision is taken regarding this matter.

Yours sincerely

Tom Ost
Chairman, Unison Babergh Branch

Appendix B

PENSION FUNDING STRATEGY 2010

The Funding Strategy sets out the Suffolk Pension Fund Committee's strategy to ensure that the pension fund will be fully funded over the long term. The Funding Strategy Statement has been developed on the basis of three broad principles:

a) Prudence. The objective is to ensure the right balance between risk and reward in setting the funding and investment strategy of the fund, and in setting the individual employers' contributions to the fund.

b) Stability. The objective is to ensure, as far as possible, that employer contributions should not vary significantly from one valuation to the next.

c) Affordability. The objective is to recognise the potential impact of changes in employers' contributions on their overall budgets and resources, and to mitigate the adverse impact that any required changes might have, for example by the phasing of additional contributions, where this is feasible and prudent.

Deficit Recovery Periods

The Committee has agreed to adopt the following approach in setting employer contributions for individual scheme employers at the 2010 valuation:

Type of Employer	**Maximum Length of Deficit Recovery Period**
Statutory bodies with tax raising powers	a period to be agreed with each employer not exceeding 20 years
Transferee Admission Bodies	a period reflecting the remaining period of the contract
Community Admission Bodies that are closed to new entrants	a period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers
All other types of employer	a period to be agreed with each employer, not exceeding 15 years

Appendix C

SUFFOLK PENSION FUND - 2010 VALUATION

Babergh DC

1. The actuarial valuation for the Suffolk Pension Fund at March 2010 reported a deficit for Babergh DC of £11.5 million. In addition, the cost of ongoing service (the future service rate) had increased from 16.0% of pay at the 2007 valuation to 18.1% of pay at the 2010 valuation.

2. The funding strategy following the actuarial valuation, that was adopted by the Pension Fund Committee, provided for the extended deficit recovery period of 20 years for the local authority employers in the pension fund. In the case of Babergh, the application of this approach resulted in the following employer contributions being determined for the 3 years starting April 2011:

Year ended 31 March	Contribution rate (% payroll)	Deficit contribution (£000)
2011	16.0%	933
2012	16.7%	933
2013	17.4%	933
2014	18.1%	933

3. At the time of the 2010 valuation, the application of this approach was expected to result in a reduction in Babergh's actuarial deficit by £600,000 from £11.5 million to £10.9 million.

4. The funding level of the Pension Fund has been adversely affected by the highly volatile movement in stockmarkets in the period since March 2011, especially in August. The FTSE 100 index ended March 2011 at 6,009, but during August 2011 it fell at one point below 5,000. It is currently (as at 2 November) standing at around 5,400, still 10% below its level at March 2011.

5. Hymans (the actuary) have estimated that the average funding level of local authority funds generally has fallen by around 3% as a result of the stockmarket movements between March 2011 and end October 2011. It is possible, of course, that stockmarkets will recover from their current levels.

6. However based on the current position of the pension fund, Babergh's funding level at the next valuation (March 2013) is likely to be worse than at March 2010. In view of this, it would not be prudent to make a reduction in Babergh's contributions to the pension fund from the level agreed following the 2010 valuation.

Appendix D

County Council responses to further questions

Q1 – What is the age profile, number of fund members (active and retired) and average salary for Babergh?

A – Numbers of scheme members: Actives 242, Deferred 207, Pensioners 266 (at March 2010)

Average age of scheme members: Actives 52.9, Deferred 49.6, Pensioners 68.6 (at March 2010)

Q2 – How does this compare to other Suffolk Councils and is Babergh's fund a 'mature' fund?

A – This is probably best expressed by a comparison of the scheme liabilities for actives and deferreds/pensioners for each employer at March 2010

	Actives	Deferred	Pensioners	Total
Suffolk County Council	47%	16%	37%	100%
Waveney District Council	25%	16%	59%	100%
Forest Heath District Council	35%	18%	47%	100%
St Edmundsbury Borough Council	39%	13%	48%	100%
Mid Suffolk District Council	38%	13%	49%	100%
Suffolk Coastal District Council	38%	13%	49%	100%
Babergh District Council	46%	13%	41%	100%
Ipswich Borough Council	39%	12%	49%	100%

As the above table shows, the active (employee) pension liabilities for Babergh at March 2010 were around 46% of its total pension liabilities, higher than that of the other district councils, which made Babergh relatively 'immature' in actuarial terms compared with the other councils.

However if Babergh's own position at March 2010 is compared with that at March 2007, it is clear that Babergh is becoming increasingly mature in actuarial terms over time. The employee (active) liabilities have fallen from 51.5% at March 2007 to 46.2% at March 2010, so the pensioner/deferred liabilities are now the larger share of the Council's total pension fund liabilities.

Babergh: Pension Fund Liabilities				
	March 2007		March 2010	
	£000	%	£000	%
Actives	25,316	51.5	24,895	46.2
Deferred	6,458	13.1	6,882	12.8
Pensioners	17,392	35.4	22,132	41.0
Total	**49,166**	**100.0**	**53,190**	**100.0**

Q3 – What is the risk profile of the Babergh fund in terms of life expectancy, the current deficit and future prospects?

A – The actuary does not estimate life expectancy figures separately for each employer.

Based on the actuarial valuation at March 2010 and the employer contributions that were determined following the valuation, Babergh's actuarial deficit was expected to reduce by around £600,000 over the 3 years to March 2013. However it should be noted that a fall in the funding level of 1% is equivalent to around £500,000, so unless there is an improvement in investment returns and other actuarial factors between October 2011 and March 2013, the actuarial deficit for Babergh is likely to be higher at March 2013 than at March 2010.

Q4 – Babergh, like most Councils have already reduced staffing levels and these will reduce further over the next 3 to 4 years. What are the likely impacts on the Fund, deficits and contribution rates going forward? What impact would there be on the Pension Fund if:

- **staff numbers decrease by say 20%**
- **we move away from final salary**
- **the retirement age increases by say 5 years (and the impact of each yearly increase)**
- **we move to recover the deficit over say 25 years**

A – The impact of a reduction in staffing levels on the actuarial position of an employer is complex and cannot be fully assessed except by a full actuarial analysis. However a number of general indicators can be given.

If the reduction in staffing involves scheme members over the age of 55, then they have an immediate entitlement to receive their pension benefits without an actuarial reduction. The early payment of pension (before the normal pension age of 65 within the LGPS) involves an actuarial cost, and the Pension Fund requires the employer to make additional contributions to cover this cost.

If the reduction in staffing involves scheme members below the age of 55, then in general the impact on the employer is beneficial, because the expected value of the scheme benefits for deferred members is lower than that for active (employee) members. The amount of the saving is likely to depend on the age profile of the employees who leave the council's employment.

In addition, the Government has yet to make final decisions on some aspects (e.g. about the detailed scheme design and costs of the post-Hutton LGPS), so the impact of moving away from the final salary scheme cannot be assessed even by the actuary at present.

The recovery of the deficit over a period of 25 years (rather than 20 years) would reduce the employer contribution rate. However the amount of the reduction cannot be accurately determined without requesting a calculation for this purpose from the actuary. As a <u>rough</u> indication of the possible impact of extending the deficit recovery period, it was estimated that extending the deficit recovery period from 20 to 24 years at the March 2010 valuation might reduce the deficit contribution needed by around £50,000 per year (i.e. around £880,000 per year instead of £933,000 per year).

Q5 – Looking at last year's accounts for Babergh and the Pension Fund, where do the levels of salary increases e.g. 5.1% in 2010/11 and 5.3% in 2009/10 come from? Are these accurate or estimates? What happens if the actual figures are say half those percentages? What are the assumptions going forward? Also, why did the current service cost rise by £554,000 in 2010/11 – from £869,000 to £1,423,000?

A – The assumption about salary increases referred to relates to the FRS17 report for Babergh for 2010/11. Standardised assumptions are used for FRS17 purposes. However these figures have no relation to the actuarial valuation calculations, which are based on Suffolk-specific assumptions.

The actuary has made standard (common) assumptions across all employers in the fund, in terms of future pay increases. For actuarial purposes, the actuary has assumed average pay increases of 1% in 2010/11 and 2011/12 and 5.3% pa thereafter.

If the actual pay increases are lower than those assumed by the actuary, then that will improve the actuarial position of Babergh at the next actuarial valuation, all other things being equal. As will be appreciated, there are lots of other factors involved in determining the actuarial position of the Council at the next valuation (not least the recent poor investment performance), and it will be the combined effect of all these changes which will determine whether Babergh's overall actuarial position is better or worse at the next actuarial valuation.

The 'current service costs' as reported for FRS17 purposes is a calculation which is required solely for accounting purposes, and it has no impact on the actual employer contributions to the pension fund that are required. As noted above the FRS17 calculations are undertaken in accordance with as set of prescribed accounting assumptions. In order to ensure that the charge to the Council's General Rate Fund account is equal to the amount of the actual contributions to the Pension Fund (in accordance with the actuarial certificate), the 'current service cost' figures are replaced in the Council's accounts with the actual contributions to the Pension Fund.

Q6 – In addition, can a further explanation be provided on the actuary's sensitivity analysis and that a 0.5% salary increase equates to 2% increase in employer's liability or £1.2m?

A – The sensitivity analysis referred has been carried out for the purpose of the FRS17 accounting disclosures that Babergh is required to include within its accounts for 2010/11. It has no relevance for the purpose of considering the actuarial valuation results, because it is undertaken within the framework of certain prescribed accounting assumptions which are different from those used for actuarial purposes.

Q7 – Why is there no impact on the General Fund of the switch from RPI to CPI for future pension increases?

A - The RPI/CPI switch has already been taken into account by the actuary when he did the 2010 valuation. So the contributions that were set for Babergh following the 2010 valuation already allow for this.

Q8 – Finally, has there been any impact from the transfer of staff to the Shared Revenues Partnership and what happens pension-wise in relation to the transferred staff?

A – The staff who transferred to the Shared Revenues Partnership were transferred on a fully funded basis (i.e. assets equal to the value of their pension liabilities at the date of transfer were transferred from the Babergh part of the Pension Fund to that the Ipswich BC).

The transfer has no effect on the contribution rate or the deficit contributions that Babergh will pay over the period covered by the 2010 actuarial valuation certificate (i.e. 2011/12 to 2013/14).