Shropshire Council

| Committee and date | Item No |
|---|---|
| Cabinet<br><br>22nd December 2010<br><br>12.30 pm | 7<br><br>Public |

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# LOCAL GOVERNMENT PENSION SCHEME

## Summary

The Shropshire County Pension Fund has recently undergone its triennial actuarial valuation and continues to have an above average funding level compared to its peers and one of the lowest employer contribution rates in the country. The Shropshire County Pension Fund was 81% funded at the 2010 actuarial valuation compared to 85% in 2007. To constrain costs the Independent Actuary is comfortable with the deficit recovery period being extended to 25 years for Shropshire Council. This will result in a small increase in the employer contribution rate of 0.6% (from 16.7% to 17.3% of salaries) which will represent a saving on our budget planning assumptions of £670,000 (made up of savings of £544,000 for General Fund and £126,000 for schools). The Independent Public Service Pensions Commission chaired by Lord Hutton will make final recommendations in Spring 2011 which are likely to result changes to the benefit structure of the Local Government Pension Scheme and employees funding an increased share of the costs of the scheme.

## Recommendations

Cabinet are asked to;-

A. Note that the Shropshire County Pension Fund has a funding level above average compared to its peers and that as a result Shropshire Council's employer contribution rate is one of the lowest in the country.

B. Agree that the Shropshire Council uses a 25 year deficit recovery period at the 2010 actuarial valuation which results in a budget saving of £670,000 (£544,000 for General Fund and £126,000 for schools) compared to the Budget Strategy presented to Cabinet in September.

C. Note that the employer contributions will be collected as a percentage of salaries for future service and a lump sum deficit recovery amount from 2011/12 onwards.

D. Note the interim report of the Hutton Review and its potential implications for the Local Government Pension Scheme.

## Background

1. All Council employed staff with the exception of teachers are eligible to join the Local Government Pension Scheme (LGPS). Shropshire Council acts as Administering Authority for the Local Government Pension Scheme in Shropshire. Over 70 employers in Shropshire are members of the Shropshire County Pension Fund. These include Shropshire Council and Telford & Wrekin Council as well as colleges, parish and town councils and other admitted bodies.

2. The Shropshire County Pension Fund's 70 employers have over 33,000 scheme members. The average pension paid by the Shropshire County Pension Fund is around £4,400 per annum.

3. Every three years the Shropshire County Pension Fund is required to undergo an actuarial valuation conducted by an Independent Actuary. The Fund has recently received the results of the 2010 actuarial valuation which determines the employer contribution rate payable by Shropshire Council over the next three years starting in 2011/12.

4. Public sector pensions have been the focus of much media coverage in recent years. In June the Government appointed Lord Hutton to chair the Independent Public Service Pensions Commission (IPSPC) with a view to ensuring pension arrangements remain sustainable and affordable in the long term for both the public sector workforce and the taxpayer. The Review made interim recommendations in October and final recommendations will be made prior to the 2011 Budget.

## Actuarial Valuation 2010

5. The Local Government Pension Scheme is in a fortunate position in that it is a funded scheme. This means that employee and employer contributions are invested and generate income to pay for pensions in future years. Over time investment returns fund almost three quarters of the benefits paid out. This means that the most of the pension costs for our employees is met from investment returns.

6. The Shropshire County Pension Fund undergoes an independent actuarial valuation every 3 years. At the actuarial valuation in 2007, the Independent Actuary determined that the Fund had a funding level (the relationship between the estimated future pension payments and the funds held to pay for these pensions) of 85%.

7. Members will be aware that since 2007 there has been a global economic downturn which impacted has impacted on investment returns. Whilst there was a significant recovery in stock markets around the world in 2009/10 and the value of the Fund's investments increased significantly the liabilities of the Fund (the requirement to pay pensions in future years) have also increased.

8. The Independent Actuary has recently presented the results of the 2010 Actuarial Valuation to the Pensions Committee. As at the end of March 2010, the Fund had a funding level of 81% (i.e. the assets held to meet future liabilities were valued at 81% of those liabilities), slightly less than at the 2007 actuarial valuation.

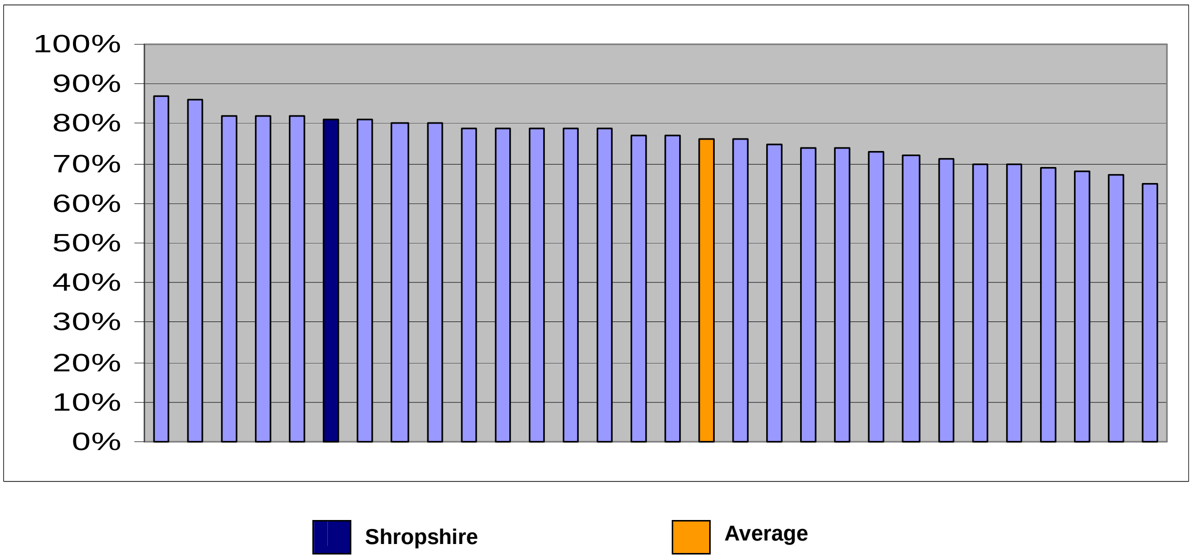
9. The Actuary has used the Shropshire mortality experience to assess the most appropriate longevity assumptions in the 2010 valuation. The expectation for future real salary growth has been reduced in light of likely lower pay inflation in the public sector

in the future and account has been taken of the short term pay freeze in the public sector.

10. The Actuary has also factored into the actuarial valuation the impact of the government announcement to inflate public sector pensions by the Consumer Price Index (CPI) rather than the Retail Price Index (RPI). The Actuary believes that CPI will be 0.5% lower than RPI in the future and this has the impact of reducing the liabilities of the Fund by around 7% than would otherwise have been the case.

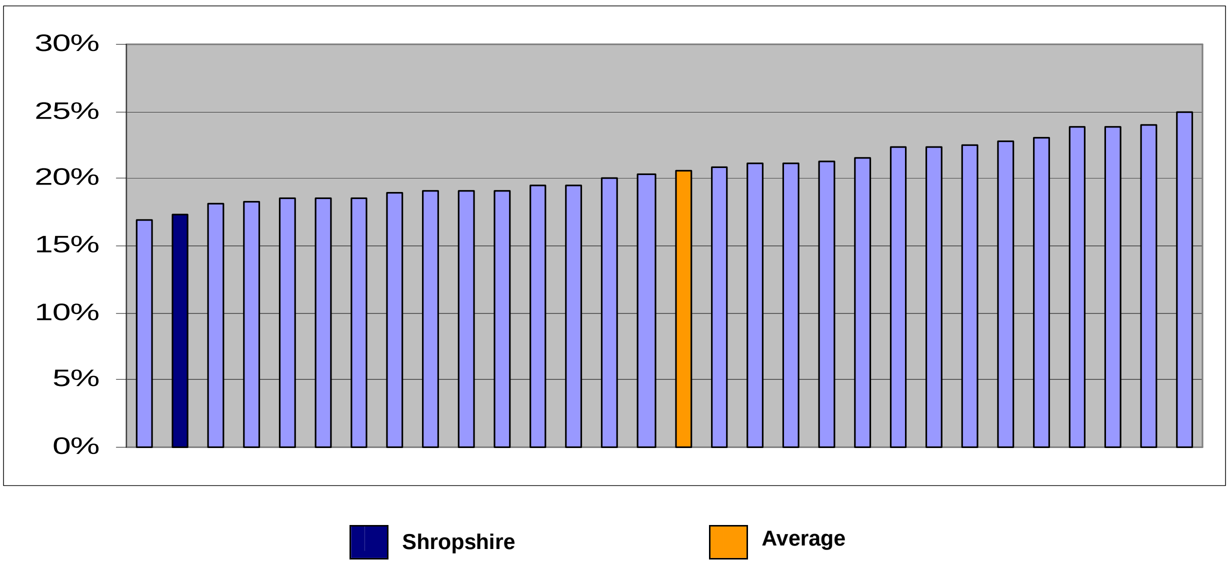
11. The Society of County Treasurers has conducted a survey of the initial results of the 2010 Actuarial Valuation. Whilst not all councils have responded and the results are only indicative it does show that Shropshire continues to have one of the highest funding levels.

**TABLE 1 – ACTUARIAL VALUATION FUNDING LEVELS 2010**
**INTERIM RESULTS OF SOCIETY OF COUNTY TREASURERS SURVEY**
**(**Includes responses from 29 of the 39 local authorities that are members of SCT).




12. Shropshire also has the second lowest employer contribution rate of the 29 councils that have responded to the survey.

**TABLE 2 – EMPLOYER CONTRIBUTION RATES 2011/12**
**INTERIM RESULTS OF SOCIETY OF COUNTY TREASURERS SURVEY**
**(**Includes responses from 29 of the 39 local authorities that are members of SCT).



## Deficit Recovery Period

13. The Council is able to take a long term approach to the funding of future pensions. The Council's younger employees may not be drawing their pension for another 30 to 40 years. The Fund is therefore able to ride out short term market fluctuations and recover any deficit in a managed and gradual way.

14. The Independent Actuary is required to assume a length of time over which the current deficit in the Fund is recovered. This has a direct impact on the employer contribution rate payable and the Shropshire Council budget strategy. At the 2007 actuarial valuation an employer contribution rate was set on a wide range of assumptions that aimed to recover the deficit by 2029. A 22 year deficit recovery period was used for Shropshire Council and this resulted in an employer contribution rate of 16.7% of salaries.

15. Maintaining this plan would require a 19 year deficit recovery period at the 2010 actuarial valuation. However, on affordability grounds the Independent Actuary is comfortable with employers with a strong covenant, such as Shropshire Council, using a deficit recovery period of up to 25 years on condition that it does not result in a reduction in the employer contribution rate. This option is outlined in the Shropshire County Pension Fund Funding Strategy Statement which was agreed by Pensions Committee in November 2010.

## Financial Implications

16. Maintaining the plan to recover the deficit by 2029 would result in an increase in the employer contribution rate from 16.7% to 18.7% of salaries. This would require an additional budget allocation of £1.2 million (£978,000 for General Fund and £226,000 for schools) in 2011/12 compared the budget strategy presented to Cabinet in September.

17. On affordability grounds the Independent Actuary is comfortable with a deficit recovery period of up to 25 years for Shropshire Council. Adoption of a 25 years deficit recovery period (i.e. plan to repay by 2035) would result in an increase in the employer contribution rate from 16.7 % of salaries to the equivalent of 17.3% of current salaries.

18. The budget strategy presented to Cabinet in September incorporated an estimated increase in the employer contribution rate from 16.7% to 17.8%. This means that opting for a 25 year deficit recovery period will result in a saving against the budget strategy presented to Cabinet in September. Adopting a 25 year deficit recovery period will represent a saving on our budget planning assumptions of £670,000 (made up of savings of £544,000 for General Fund and £126,000 for schools). This has been incorporated into the Budget Strategy report and MTFS report.

## Employer Contributions

19. The Actuary is recommending that the results of the actuarial valuation are expressed as a percentage of salary for future service together with an amount for any deficit recovery. This is a change on the approach taken at the 2007 actuarial valuation and is aimed at ensuring that employers pay in sufficient funds to recover the deficit at a time when the payroll may be shrinking. For Shropshire Council this will result in a future service employer contribution rate of 11.7% plus an annual lump sum of £6.72 million. This is equivalent to 17.3% of the existing staff salary costs.

## Hutton Review

20. In June the Government asked Lord Hutton to conduct a fundamental structural review of public service pension provision with a view to making recommendations to the chancellor.

21. The review was asked to ensure pension arrangements remain sustainable and affordable in the long term for both the public sector workforce and the taxpayer. Lord Hutton published his **interim** report on 7th October 2010. The report:

- acknowledged that public service pension schemes are part of the overall remuneration package and have their part to play in the public sector's ability to recruit and retain the best people to deliver vital services. Ultimately, this provides adequate income in retirement which can help them sustain a reasonable standard of living without becoming a burden on the welfare state,

- acknowledged that the LGPS does not provide "gold plated" pensions. The average pension in the LGPS is around £4,000 per annum,

- recommended that the LGPS remains a funded scheme.

21. In the short term Lord Hutton suggested that member contributions be increased but to be managed so as to protect the low paid. If possible, increases in contributions should be staged with a view to preventing a significant increase in the numbers of employees opting out of the schemes. The report also acknowledged the need to protect accrued rights.

22. In the longer term Lord Hutton indicated that there may be a need to consider scheme design. In particular, final salary schemes were seen to primarily reward "high flyers" and Lord Hutton felt that this may no longer provide a robust and fair mechanism for the majority of the public service workforce. It was felt that there needed to be a fairer sharing of risk between employer and employee and that scheme design may need to change to Career Average, Collective Defined Contribution or a Hybrid Scheme.

23. In October, the government accepted the interim findings of the Independent Public Service Pensions Commission (IPSPC) led by Lord Hutton. In response to the Commission's interim recommendations, the Government agreed to:

- continue with a form of defined benefit public sector pension;

- await Lord Hutton's final recommendation before determining the nature of that benefit and the precise level of progressive contribution required;

- implement progressive changes to the level of employee contributions, equivalent to three percentage points on average to be phased in from April 2012;

24. Lord Hutton will provide a final report in the Spring of 2011 prior to the Budget and it is likely that this will have implications for the Local Government Pension Scheme. The decision to implement a phased three percentage point increase in employee contributions from April 2012 will result in employees funding an increased share of the costs of the scheme. We cannot anticipate the financial effect that these changes may have and so they will be incorporated at the time of the next actuarial valuation in 2013.

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| **List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)**<br>N/A |
| **Human Rights Act Appraisal**<br>There are none arising directly from this report |
| **Environmental Appraisal**<br>The activities identified within this report should not result in a negative environmental impact. |
| **Risk Management Appraisal**<br>Any risks associated with the actuarial valuation are considered as part of the decision making process. |
| **Community / Consultations Appraisal**<br>Shropshire Council has been consulted on the Funding Strategy Statement for the Fund. |
| **Member Champion**<br>Cllr Mike Owen |
| **Local Member**<br>All Local Members |
| **Appendices**<br>N/A |