

Pensions Committee

2 pm, Tuesday, 24 September 2013

Funding and Contribution Stability

Item number	5.4
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Executive summary

Funding and Contribution Stability

Summary

The purpose of this report is to inform Committee of the ongoing work to develop a contribution stability mechanism in accordance with the Funding Strategy Statement (FSS) commitment.

Background

As is stated in the Lothian Pension Fund's Funding Strategy Statement, its purpose is:

- “to establish a **clear and transparent Fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and
- to take a **prudent longer-term view** of funding those liabilities.

These objectives are desirable individually, but may be mutually conflicting.”

An explicit commitment is “The policy of the Fund is to operate a contribution stability mechanism on an ongoing basis subject to regular reviews”.

The last triennial actuarial valuation at 2011 set employer contribution rates for the three years to 31 March 2015. Pension schemes, however, have a long-term time horizon. Lothian Pension Fund wishes both to avoid volatility in contribution rates based on fluctuations in short-term funding levels and also, where possible, to assist employers with their budgeting.

Development of Contribution Stability proposals

Accordingly, detailed financial modelling of liability and asset cashflows under a range of employer contribution scenarios has been commissioned from the Fund's actuary. This model will use probability distributions to project a range of possible outcomes for the future behaviour of asset returns and economic variables. This financial forecast will be used to assess the prudence, affordability, stability and stewardship implications of any proposed contribution strategy to ensure compliance with professional standards.

Key modelling assumptions will include the level and volatility of gilt yields, equity and other investment returns and inflation. The forecast gilt yields, in particular, will significantly impact the projected value of liabilities. Currently, long term real interest rates are at historically low levels, thereby increasing the present value of liabilities and therefore funding pressures. The extent of any change in gilt yields in future will be therefore a major consideration. To ensure appropriate alignment with the investment strategy assumptions, the Investment Strategy Panel will also be consulted.

Employer risk profile and covenant

In parallel with the actuarial modelling, ongoing work to assess the financial security offered to the Fund by its respective employers is being undertaken. This includes guarantor and admission agreement reviews, as well as analysis of financial covenant and membership profiles. This will influence the extent to which it would be appropriate for the Fund to accord contribution stability to individual or groups of employers.

Oral update

An oral update will be provided to Committee on the progress of this work.

Next Steps

The next steps in this work are:

- consult with both Fund employers and the Consultative Panel on a proposed contribution stability mechanism over the autumn.
- a training session on pension funding will be held for Committee and Panel on 12th November with the Fund's Actuary;
- report to the Pensions Committee in December 2013.

This timing would align with the annual budgetary cycle of the Councils and other major employers.

Recommendations

Pensions Committee is requested to note this report and note the date of the next internal training session on 12 November.

Measures of success

Employer contribution stability is a policy commitment of the Fund.

Financial impact

There are no direct financial implications as a result of this report. The costs of actuarial modelling are being met from existing budgetary provision.

Equalities impact

There are no adverse equalities impacts arising from this report.

Sustainability impact

There are no adverse sustainability impacts arising from this report.

Consultation and engagement

The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Consultation with Fund employers and the Consultative Panel will be undertaken over the next few months.

Background reading / external references

None

Links

Coalition pledges

Council outcomes CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.

Single Outcome Agreement

Appendices None