Pensions Committee

2.00 p.m., Wednesday, 28 September 2016

Funding Update and Preparation for 2017 Actuarial Valuation

Item number	5.8
Report number	
Executive/routine	
Wards	All

Executive summary

Despite good growth in the investments of Lothian Pension Fund and Lothian Buses Pension Fund since March 2014, liability values have grown faster as yields have fallen. Hence, the overall funding levels have fallen.

In advance of the 2017 actuarial valuation, the view of the Fund's Actuary on the suitability of the Contribution Stability Mechanism used for long-term secure employers in Lothian Pension Fund has been sought.

An update on the funding positions for Lothian Buses Pension Fund and Scottish Homes Pension Fund is also provided.

Greater oversight and scrutiny of pension funding plans by Scottish Ministers is expected as a result of changes in the Public Sector Pensions Act 2013. This may influence the approach to the 2017 actuarial valuation.

Links

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Report

Funding Update and Preparation for 2017 Actuarial Valuation

Recommendations

Committee is requested to:

1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;

1.2 Approve the continued use of the Contribution Stability Mechanism (CSM) for long-term secure employers within Lothian Pension Fund for the 2017 actuarial valuation;

1.3 Note the advice from the Actuary to review the Contribution Stability Mechanism at the 2020 actuarial valuation;

1.4 Note the updated funding positions for the Lothian Buses Pension Fund and the Scottish Homes Pension Fund;

1.5 Note that greater oversight and scrutiny of pension funding plans by Scottish Ministers is expected and this may influence the approach to the 2017 actuarial valuation.

Background

2.1 The Funding Strategy Statement of Lothian Pension Fund states "The policy of the Fund is to operate a contribution stability mechanism on an ongoing basis subject to regular reviews".

2.2 At its meeting on 18 December 2013, Pensions Committee approved the Contribution Stability Mechanism which used at the 2014 actuarial valuation. A copy is attached at Appendix 1.

2.3 In developing the Contribution Stability Mechanism, the Actuary undertook, detailed financial modelling of liability and asset cashflows under a range of employer contribution scenarios. Forecasts were made over the long term horizon relevant to the Local Government Pension Scheme.

2.4 Key financial assumptions reflected a prudent approach to funding obligations. The assumed replacement ratio of new entrants reflected an anticipated long term reduction in the public sector workforce. Expected investment returns and the future level of gilt yields were critical elements of the modelling.

2.5 The modelling work enabled quantification of the likelihood that a given contribution strategy would lead to the Fund being fully funded in the long term.

2.6 At the 2014 actuarial valuation, the funding level of Lothian Pension Fund was 91.3%. The 2014 actuarial valuation set employer contribution rates for 2015/16 to 2017/18 and the under the Contribution Stability Mechanism, indicative rates were provided for 2018/19 to 2020/21. For the employers included in the Contribution Stability Mechanism, contribution rates for 2015/16 to 2017/18 were generally unchanged from 2014/15 and indicative rates for 2018/19 to 2020/21 increased by 0.5% p.a., with scope for reduction of 0.5%p.a. should market conditions improve.

2.7 Lothian Pension Fund retained the right to review or withdraw the Contribution Stability Mechanism as protection against extreme adverse financial experience.

2.8 For Lothian Buses Pension Fund, the funding level at 31 March 2014 was 116.7% on an ongoing basis and 88.2% on a more prudent gilts basis.

2.9 For Scottish Homes Pension Fund, the Target Funding Level (TFL), as set out in the Scottish Government Guarantee, was 91.5% at 31 March 2014, the date of the last formal actuarial valuation. The actual funding level was below target at this date. Therefore Scottish Government will pay a contribution of £675,000 p.a. from April 2015 to March 2018. The results of the review of the Scottish Homes Pension Fund investment strategy were previously reported to Committee. Work is underway on updating the funding agreement with Scottish Government.

Main report

3.1 In preparation for the 2017 actuarial valuation, the Actuary's advice on the sustainability of the Contribution Stability Mechanism has been sought. This is provided in Appendix 2. The Actuary will attend the Committee meeting to present the report.

3.2 The conclusions of the Actuary's report are as follows:-

- The funding level of Lothian Pension Fund is estimated to be 85% as at 31 August 2016 compared to 91% at 31 March 2014;
- Changes to market conditions and the outlook for investment returns will have reduced the certainty that, with the continued use of Contribution Stability Mechanism, the Fund will achieve 100% funding over the longer term. The likelihood of achieving full funding over the longer term should still be above a 2 in 3 chance;
- Therefore, at present the Contribution Stability Mechanism remains appropriate for long-term secure employers at the 2017 actuarial valuation;
- At the 2017 actuarial valuation, the Fund should set contributions for the following three years (i.e. 2018/19, 2019/20 and 2020/21) but provide only indicative contributions for the following three years;

- A full review of the Contribution Stability Mechanism, with updated asset liability modelling, should be undertaken as part of the 2020 actuarial valuation.

3.3 Committee should note that contributions for the employers who are not included in the Contribution Stability Mechanism will be considered as part of the review of the results of 2017 actuarial valuation in the normal manner.

Lothian Buses Pension Fund

3.4 The funding level of the Lothian Buses Pension Fund is estimated to be 104% on an ongoing basis and 76% on a more prudent gilts basis as at 31 August 2016 (reduced from 117% and 88% respectively at 31 March 2014). Contributions will be considered as part of the review of the results of 2017 actuarial valuation in the normal manner.

Scottish Homes Pension Fund

3.5 The funding level of Scottish Homes Pension Fund is monitored regularly by the internal team using an on-line system provided by the Fund's actuary. The progression of the estimated funding level since 31 March 2014 is shown below.

Source: Hymans Robertson

3.6 The target funding level for March 2017 is 93.0% and at the time of writing, the estimated funding level is in excess of that level.

3.7 Discussions regarding potential changes to the funding agreement have been held with the Scottish Government. Options to change the funding approach, including an option where contributions would be determined by fund cash flows rather than funding level are being considered. Work is currently ongoing with the Actuary and investment advisers and progress is expected to be reported to Pensions Committee in December.

Review of Scottish LGPS Actuarial Valuations

3.8 Section 13 of the Public Service Pensions Act 2013 introduced a new requirement for a report on local fund actuarial valuations to be undertaken. This introduces greater oversight and scrutiny of funding plans for all LGPS funds.

3.9 The aims are to assess:

> compliance: whether the fund's valuation is in accordance with the scheme regulations;

> consistency: whether the fund's valuation has been carried out in a way which is not inconsistent with the other fund valuations within the LGPS;

> solvency: whether the rate of employer contributions is set at an appropriate level to ensure the solvency of the pension fund; and

> long term cost efficiency: whether the rate of employer contributions is set at an appropriate level to ensure the long-term cost efficiency of the scheme, so far as relating to the pension fund.

3.10 The Government Actuary's Department, on behalf of the Department of Communities and Local Government, have carried out a 'dry-run' section 13 analysis on the English & Welsh funds' 2013 valuations. An equivalent report on the Scottish LGPS funds' 2014 valuations in expected later in 2016 for the Scottish Public Pensions Agency on behalf of Scottish Ministers.

3.11 Committee should note that this greater oversight and scrutiny of funding plans for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. The analysis may influence the approach to the 2017 actuarial valuation and updates will be provided to Committee over the coming months.

Measures of success

4.1 The principal objective of the Fund is to ensure its long-term solvency. The Fund therefore targets full funding on an ongoing basis over the long-term. Employer contribution stability is also a policy commitment of the Fund.

Financial impact

5.1 The Contribution Stability Mechanism provides certainty of pension contributions to certain Fund employers for future years, together with appropriate assurance of funding level to the Fund.

Risk, policy, compliance and governance impact

6.1 Detailed financial modelling of liability and asset cashflows informed the decision to adopt the Contribution Stability Mechanism in 2013.

Equalities impact

7.1 There are no adverse equality impacts arising from this report.

Sustainability impact

8.1 There are no adverse sustainability impacts from this report.

Consultation and engagement

9.1 Consultation on the contribution stability mechanism was undertaken with the Fund employers in 2013. The Pension Board, comprising of employer and member representatives, is integral to the governance of the Funds.

Background reading/external references

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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	Appendix 1 – Contribution Stability Mechanism 2013 Appendix 2 – Update from Actuary

Lothian
PENSION FUND

Contribution Stability Mechanism 2013

November 2013

Background

The 2011 triennial actuarial valuation 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.

The funding objectives as stated in the Funding Strategy Statement include:

- to ensure the long-term solvency of the overall Fund and that of sub-funds;
- to minimise the degree of short-term change in employer contribution rates;
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities;
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

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

The principal issues facing the solvency of the Fund include the ability to finance liabilities as and when they arise, the rate or volatility in the rate of contribution paid by the employers, the pace at which deficits are recovered (or surpluses used up) and the returns on the Fund's investments.

The Fund therefore targets full funding on an ongoing basis over the long term with an acceptable likelihood of success and attempts to keep risks within tolerable limits, whilst ensuring contributions are as affordable and stable as possible.

An explicit commitment has been made to operate a contribution stability mechanism on an ongoing basis subject to regular reviews.

Contribution Stability

The cost of the benefits is not known in advance. The approach to funding determines the pace at which employers pay for the benefits and the ways in which the Fund ensures that it will have enough money to pay the benefits due to its members.

Accordingly, the Fund has received detailed modelling of liability and asset cashflows under a range of employer contribution scenarios from the Fund's actuary. The scenarios included consideration of different levels and duration of contribution stability.

Financial assumptions were tailored to reflect specific factors. These included the anticipated long term level and volatility of gilt yields, equity and other investment returns plus inflation. A reduction in the public sector employer workforce was also reflected. The Fund has thereby taken appropriate steps to assess the implications of potential contribution strategies to ensure compliance with professional standards, the relevant actuarial principles being prudence, affordability, stability and stewardship. The Fund can provide any employer with more detail on the actuarial modelling if required.

Risks to the Fund & Employers

The risk to the Fund in providing contribution stability is that the likelihood of achieving full funding is reduced. This has been a key consideration and the actuarial modelling has provided sufficient comfort on this matter.

The risk to employers is that, if they pay less than the theoretical contribution rates now, they would face increased pensions costs in future years, (As a reminder, however, the contribution rates agreed at actuarial valuations represent minimum contributions. Employers retain the discretion to pay more.)

Conversely, a risk facing employers should the level of stabilised contributions prove to be overly prudent, is that outlays will have been greater than actually required. In this case, employers would benefit from any accrued surplus in future years by reduced contributions.

A further risk to the Fund is the potential inability of employer(s) to finance increased pension costs in the future and stabilising contributions may increase this risk. As a multi-employer scheme, this is, in effect, a risk to all the employers in the Fund. This proposal allows for the specific circumstances of employers in an attempt to manage this risk. (See below)

Allowance for Different Employers

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. The strength of the employer covenant influences the extent to which it would be appropriate for the Fund to accord contribution stability to individual or groups of employers.

Councils and other statutory bodies have tax-raising powers, a large membership and will be in existence for a long period of time. There is therefore a low risk that such authorities will fail to meet pension obligations. Other large employers may also offer good financial security to the Fund and some employers with the Fund are guaranteed by the Scottish Government.

Employers to whom the Fund will not accord Contribution Stability:

- Employers which have closed the Lothian Pension Fund to new entrants (or are deemed by the Fund to have closed based on experience).

  As the duration of Fund membership of these employers is finite, it is not considered prudent to offer the discretion of contribution stability to these employers.

- Transfer Admission Bodies (i.e. Public Service Contractors)

  Such employers again have a finite duration of membership of the Fund, i.e. limited to the contract period with the awarding authority. Contractors should continue to pay contributions that target full funding by the end of the participation period.

- Community Admission Bodies included with the smaller employer “pool”

  As part of a pool of employers with similar membership characteristics, a degree of inherent stabilisation of contributions and risk mitigation is already provided. The Fund also has to consider the potential volatility in the smaller employer pool should some employers cease membership and exit the Local Government Pension Scheme.

Contribution Stability Mechanism – Proposal

What level of contributions?

- **"Frozen contribution rate until 31 March 2018 then +0.5% / -0.5% p.a."**
  i.e. contributions frozen at the total 2014/15 combined rate (as determined by Actuarial Valuation as at 31 March 2011) until 31 March 2018. Thereafter, for the next actuarial valuation period of three years, rates could only vary from this rate by a maximum of 0.5% per annum (or minimum of -0.5% per annum).
- This total rate above would be inclusive of contributions to recover the deficit in the Fund i.e. Past Service Deficit. This Past Service Deficit, however, would continue to be based on fixed monetary sum at each Actuarial Valuation. Suitable actuarial adjustment therefore would be made to the Future Service Rate to achieve requisite parity with total payable 2014/15. This is to guard against significant falls in Fund membership between actuarial valuations.

To Whom ?

- "Open" employers with individual contribution rates as at 2011 actuarial valuation:
  - Subject to assessment by Lothian Pension Fund of employer covenant as satisfactory.
  - Subject to agreement by guarantor(s) to inclusion of employer in Contribution Stability Mechanism.
  - Subject to the impact of the new Local Government Pension Scheme in Scotland from 2015 leading to a materially higher cost of future service benefit accrual as assessed by Lothian Pension Fund.

Continuing inclusion in the Contribution Stability Mechanism between actuarial valuations is subject to ongoing review. Factors which would lead to review / removal of an employer from Contribution Stability Mechanism would be:

- Significant adverse change in financial status (covenant) as assessed by Lothian Pension Fund. This could include, e.g. threatened or actual loss in funding or banking facilities / terms.
- Significant change in active membership payroll from previous actuarial valuation, e.g. payroll falls by more than 20%.
- Employer becomes closed to new entrants (or is deemed closed).

On removal from Contribution Stability Mechanism, an employer would immediately revert to the relevant rate as determined by the most recent actuarial valuation.

Duration of the Contribution Stability Mechanism

- The Contribution Stability Mechanism should be designed to cover a reasonable period of time in order to demonstrate value to its employers and meet its objectives.
- The proposal is therefore that the duration of the Contribution Stability Mechanism should be two actuarial valuation periods, i.e. the remaining period of the Actuarial Valuation as at 31 March 2011 plus six years. The Actuarial Valuation as at 31 March 2011 encompasses the current year 2013-14 and also 2014/15.
- The Contribution Stability Mechanism would therefore apply for:
    - 2014/15, as previously determined by Actuarial Valuation 2011
    - 2015/16, Actuarial Valuation 2014 – year 1
    - 2016/17, Actuarial Valuation 2014 – year 2
    - 2017/18, Actuarial Valuation 2014 – year 3
    - 2018/19, Actuarial Valuation 2017 – year 1
    - 2019/20, Actuarial Valuation 2017 – year 2
    - 2020/21, Actuarial Valuation 2017 – year 3

- However Lothian Pension Fund retains the right to review or withdraw the Contribution Stability Mechanism as protection against extreme adverse financial experience. Lothian Pension Fund shall monitor the overall funding level and theoretical contribution rate on an annual basis to ensure these remain within the acceptable parameters.

Actuarial "sign off"

- Regulations and professional standards require that the Fund's Actuary be content with the minimum level of contributions levied by the Fund. Suitable assurance has been received from the proposed Contribution Stability Mechanism from the Fund's Actuary, Hymans Robertson LLP.

2017 valuation – Contribution Stability Mechanism

Addressee and purpose

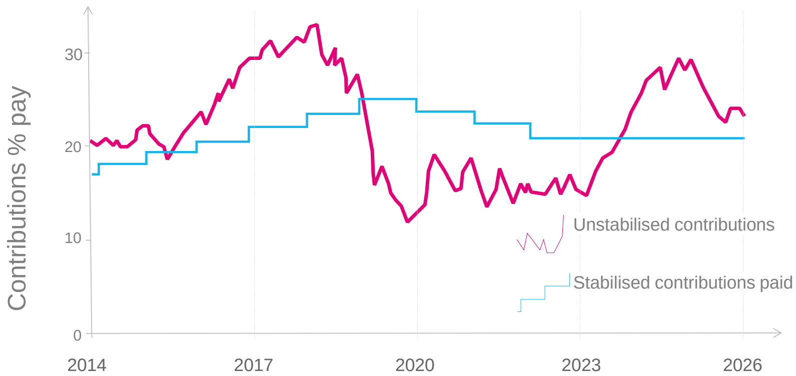
This paper has been commissioned by and is addressed to the City of Edinburgh Council in its role as the Administering Authority to the Lothian Pension Fund ("the Fund"). It has been prepared in our role as Fund Actuary in preparation for the 2017 actuarial valuation.

This paper provides justification for the continued use of the existing Contribution Stability Mechanism (CSM) when setting contribution rates for secure long-term employers at the 2017 valuation. The contributions in question cover the period from 1 April 2018 to 31 March 2021 only.

Purpose of the CSM

Variable market conditions and volatile deficits mean that contribution rates payable to Defined Benefit pension schemes can vary materially from time to time. The Contribution Stability Mechanism (CSM) is an approach adopted by the Fund to setting contribution rates for secure, long-term employers which achieves stability of contributions whilst ensuring that the long-term funding position remains secure. Employers appreciate the budgeting certainty that the CSM delivers.

The illustrative chart below shows how the CSM works in practice. Despite volatile movements in the non-stabilised contribution rates (i.e. those calculated using single valuation assumptions), the CSM ensures that employers pay a stable contribution rate.



The intention is for the CSM to apply over the longer term. Frequent revisions to CSM parameters should not be required unless warranted by a change in market conditions or some significant shift in the demographic or risk profile of the participating employers.

Current CSM

Asset Liability Modelling was carried out prior to the 2014 valuation to establish the CSM approach and to set the parameters by which contribution rates can change each year. At the 2014 valuation, the following CSM was set for secure, long-term employers;

- For the period 1 April 2015 to 31 March 2018 – Freeze in contribution rates.
- For the period from 1 April 2018 – change in rates limited to ±0.5% of pay each year.

The change in rates from year to year is determined by comparing the valuation rate (i.e. that assessed on the single set of valuation assumptions) against the rate in payment in the prior year. For example, if an employer is paying 20% of pay in year 1, and the valuation rate is assessed to be 25% of pay, contribution rates for years 2 to 4 will be set as 20.5%, 21.0% and 21.5% respectively.

Employers were advised of the contribution rates payable over the period from 1 April 2015 to 31 March 2021, i.e. for a period of 6 years following the commencement of the new Rates and Adjustments certificate. As is required by the LGPS Regulations, the R&A certificate only showed the contributions payable for the 3-year period to 31 March 2018. The Administering Authority retained the right to review the CSM at any time.

Asset Liability Modelling

Our report dated 25 October 2013 sets out the results (and associated assumptions and limitations) of the latest Asset Liability Modelling. This modelling showed that application of the CSM for secure, long-term employers led to;

- a very high likelihood of these employers achieving full funding in the long term,
- a relatively low downside funding risk, and
- stable and affordable future contributions.

As with all modelling, the results are dependent on the assumptions adopted for that exercise. One of the key assumptions made was in relation to the future projection of yields on long-dated Government bonds (which affect the value of the liabilities). The 25 October 2013 report explains this assumption in detail. In summary, a range of possible future yield projections were allowed for in the modelling, with the central projection (i.e. the median) of long-dated real (nominal) yields tending to 1.8% pa (5.0% pa) over the longer term. The real (nominal) long-dated bond yield at the time of the modelling was 0.0% pa (3.4% pa) (based on market conditions at 30 June 2013).

To understand the sensitivity of the modelling to possible future changes in projected yields, the model outcomes were also determined on a 'stressed' yield assumption. In particular, it was assumed that the central projection of future long-dated real yields would tend to 0.5% pa in the long term, i.e. that yields would be significantly lower in the future than that implied by the 'standard' assumption. This sensitivity modelling showed that the CSM remained sufficiently prudent even in the scenario where yields remain at a low level for a long period of time.

The table below shows a summary of the modelling results for the current CSM.

CONTRIBUTION STRATEGY	Prudence			Stewardship		Affordability
	LONG TERM LIKELIHOOD OF SUCCESS		AVERAGE OF THE WORST 5% OF FUNDING LEVELS IN 2035	MEDIAN FUNDING LEVEL IN 22 YEARS		HIGHEST MEDIAN CONTS DURING THE NEXT 22 YEARS
	FULL YIELD REVERSION	REAL YIELD OF 0.5% p.a.	FULL YIELD REVERSION	FULL YIELD REVERSION	REAL YIELD OF 0.5%	
3 year freeze then ±0.5 p.a.	78%	65%	45%	165%	135%	20.7%

Our modelling focused on results from 4 key areas: Prudence, Affordability, Stewardship and Stability ("PASS"). Different possible contribution scenarios were compared under measures from each of these areas and allocated a Green (acceptable), Amber (potentially acceptable) or Red (unacceptable) result.

The Red / Amber / Green ratings assigned to 2013 modelling outcomes were based on the following rules:

Likelihood of full funding (full yield reversion)	>67%	55% - 66%	<55%
Average worst 5% of funding levels	>50%	40% - 50%	<40%
Median funding level (full yield reversion)	>120%	100% – 120%	<100%
Highest median contribution rate	<23.0%	23.0% - 26.0%	>26.0%

Prudence

As actuaries we must satisfy professional requirements for funding valuations to be carried out on a prudent basis. To fund prudently is to adopt a strategy that has a greater likelihood of succeeding than it does of failing. The Asset Liability Modelling work enables us to quantify the likelihood that a given contribution strategy would lead to the Fund being fully funded in the long term.

In 2013 we assessed prudence by projecting potential funding levels in 22 years' time and determining the likelihood of being fully funded at that time as well as examining the average of the worst 5% of potential funding levels.

Affordability

The cost of pension benefits is a major expense for employers. Our affordability analysis shows the range of potential outcomes for the common employer contribution rate in the longer term and allows us to assess the likelihood that the rate exceeds a particular threshold.

In 2013 we assessed affordability by projecting potential contribution strategies over the next 22 years and determining the highest median contribution rate payable under each strategy.

Stewardship

Our stewardship analysis shows the expected funding level and the range of potential outcomes for the funding level in the longer term. This provides a measure of the overall financial health of the Fund and enables us to assess the likelihood that each scenario is consistent with the safe stewardship of the Fund.

In 2013 we assessed stewardship by projecting the median funding level in 22 years' time.

Stability

Our stability analysis illustrated the expected future variability in contributions from one valuation to the next. Unexpected significant rises in the contribution rates are highly undesirable for employers and it is a requirement of the LGPS Regulations that the funding approach should recognise the need for stability in contributions from year to year. A narrow distribution of outcomes centred on zero indicates good stability.

Experience since the 2014 valuation

The Administering Authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced at 31 August 2016. It showed that the funding level (excluding the effect of any membership movements) was 85% (compared with 91% at 31 March 2014). The reasons for the change in funding level are:

- Since the 2014 valuation, yields on Government bonds have continued to fall. The yield on long-dated government bonds has fallen from 3.5% pa at 31 March 2014 to 1.2% pa at 31 August 2016. This places a higher value on the liabilities. The future RPI inflation assumption has also fallen (from 3.5% pa to 3.0% pa) which partially offsets the effect of this.
- Alongside this has been significant asset outperformance relative to the 2014 valuation discount rate. The Fund has achieved returns of around 42% since 31 March 2014 (to 31 August 2016) which is around 26% greater than that expected. The solid asset performance helps to offset some of the negative influence of falling bond yields.

The Fund's deficit has increased from £417m at the 2014 valuation to £1,118m at 31 August 2016. The expected cost of benefits (i.e. future service rate) has increased from 19.8% to 34.4%.

Expectations for the future

There is widespread belief that yields will remain low for a longer period of time than that previously expected (and assumed in the modelling carried out in 2013).

Our current expectation is that the central projection of real (nominal) yields on long-dated Government bonds will rise to 0.8% pa (4.0% pa) over the next 20 years (based on market conditions at 30 June 2016). Yields based on market conditions at 31 August 2016 were -1.8% pa (1.2% pa).

Actuarial assumptions at the 2017 valuation

The comments in the previous section make no allowance for any changes to actuarial assumptions, which will be reviewed as part of the valuation process next year.

Our experience so far of the 2016 English and Welsh LGPS valuations for the funds we advise has seen a focus on the following key assumptions:

- The discount rate – funds have either retained the same approach as applied at 2013, or increased by 0.1% or 0.2% pa.
- Salary growth – most funds have reduced this assumption significantly, to reflect continued public sector pay restraint and the expected steep run-off of benefits linked to final salary.
- Gap between RPI and CPI – this has generally been increased by 0.2% pa (from 0.8% pa to 1.0% pa) on the back of technical changes to the way the two indices are calculated.

In general, these changes to assumptions will reduce deficits and the expected cost of benefits.

Is the CSM still appropriate?

The CSM is designed to be robust for the long-term and the sensitivity modelling carried out prior to the 2014 valuation confirms this. Although market conditions have changed dramatically since the 2014 valuation, we believe that the existing CSM remains appropriate for setting contribution rates for long-term secure employers at the 2017 valuation without the requirement for further modelling to justify this at the 2017 valuation. The reasons for this are:

- The modelling results demonstrated that the CSM is likely to keep the Fund safe with a high degree of certainty. Changes to market conditions and investment return outlooks will have reduced that certainty, but to a level that should still be above a 2 in 3 chance of achieving full funding over the longer term.
- The Fund liabilities are valued using a prudent set of assumptions. Potential changes to the assumptions in 2017 could reduce liability values whilst maintaining prudence (for similar reasons to those changes that are being contemplated by funds in England and Wales). Any such changes would further improve the likelihood that the existing CSM remains fit for purpose.

Contribution rates from 2021 onwards

We suggest that the Fund does not provide any firm promises at the 2017 valuation in relation to contribution rates beyond 2020/21. In principle, whilst we believe the CSM remains appropriate in relation to short term rates for the 3 years following the 2017 valuation, we think it would be safer for the Fund to keep any projections of rates beyond that period as indicative meantime. The actual rates can be confirmed at the 2020 valuation, following updated Asset Liability Modelling at that point which will act as a full ‘healthcheck’ on the suitability of the existing CSM.

Reliances and Limitations

The advice in this paper is intended for City of Edinburgh Council to support discussions on the process of setting contribution rates at the 2017 actuarial valuation. This advice should not be passed on to any third party except as required by law or regulatory obligation without the prior written consent of Hymans Robertson LLP. If it is passed onto a third party, then it should be provided in full.

We accept no liability where the paper is used by or disclosed to a third party unless we have expressly accepted such liability in writing. Where disclosure is permitted, the paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given.

The following Technical Actuarial Standards are applicable in relation to this paper:

- Pensions TAS;
- TAS R – Reporting;
- TAS M – Modelling; and
- TAS D – Data.

The advice and information given in this paper and our Asset Liability Modelling report dated 25 October 2013 (which together with any covering emails comprise the aggregate paper for this advice for the purpose of TAS R) comply with the above Standards.

Prepared by:-

Richard Warden	Steven Scott
Fund Actuary	Fund Actuary

14 September 2016

For and on behalf of Hymans Robertson LLP