

## **P07 – Appendix A2 – Advance payment of pension deficit and pension contributions**

### **1. Background and Context**

- 1.1 As a Local Government organisation, Bristol City Council provides a defined benefit pension scheme to its employees (past, present and future). A defined benefit pension scheme guarantees future benefits to its members based on the number of years worked for the employer. Bristol City Councils provides this benefit by being a member/employer in the Avon Pension Fund.
- 1.2 Within the Local Government Pension Scheme (LGPS), it is a statutory requirement for a valuation of the pension fund to be carried out every three years. This valuation is carried out by an Actuary appointed by the Administering Authority of the pension fund. In the case of the Avon Pension Fund (APF) the Actuary is Mercers LLC. The key aim of the valuation is to ensure that there are enough assets in the fund to pay all members of the LGPS in that fund the benefits that they become entitled to. The Actuary will look at the assets held and the liabilities for all the individual members and will make assumptions on future investment returns and inflation rates and how long benefits will be paid for. The Actuary then decides what level of employer contributions are required so that the fund remains able to pay member benefits into the future.
- 1.3 The results of the 2022 valuation have just been published by the APF. These revised calculations will impact on employer contributions from 1 April 2023.
- 1.4 The principal objective underlying the triannual valuations are ensuring there are sufficient assets to pay benefits when they fall due. The valuation exercise calculates whether the fund has enough assets to cover expected benefits built up to date and how much employers will have to pay towards benefits built up for the future. This is calculated both on a fund and individual employer basis. Any deficits or shortfalls between assets and liabilities will fall on the employer to make up that deficit via increased employer contributions. (Employees are guaranteed the value of their pension)

### **2. 2022 valuation**

- 2.1 The assumptions the Actuary will consider include:
  - Investment returns (the discount rate)
  - Inflation
  - Pension increases
  - Salary increases

- Normal/early retirement
- Life expectancy
- Leavers
- Impact of the McCloud Judgement

## Inflation Risk

2.2 The Fund's liabilities are linked to inflation making it a key risk and increases in inflation can have a considerable impact on the Fund's position. Even a one-off spike in inflation will impact on all future years pay outs for existing members. The Actuary will take a long-term view as to average inflation rates, which for the 2022 valuation have moved to 3.1% per annum, compared with 2.4% at the 2019 valuation.

## The McCloud Judgement

2.3 The McCloud judgement relates to age discrimination in public sector pension schemes when changes were made in 2015, effectively protecting older members. Consultation with the LGPS re the McCloud remedy to remove age discrimination across all public sector schemes is on-going. However, the remedy will increase both the deficit and future employer contributions. In so far as the Actuary can estimate the impact, these have been included in the 2022 valuation.

## Balance Sheet Comparison between valuations

Detailed Results	Final results at 31 March 2019	Final results at 31 March 2022
Assets	£1,755,485,080	£2,062,705,770
Liabilities	£1,838,376,480	£2,117,170,580
Surplus/(Deficit)	-£82,891,400	-£54,464,810
Pension Liabilities (exc teachers)	£938,027,470	£1,018,945,580
Funding Level	95.50%	97.40%
Employer Future Service Rate (%of pay)	17.60%	18.30%

2.4 The pension liability represents the value of what the Council owes across future years offset by the value of assets invested in the pension fund. This is the liability that appears on the Council's balance sheet and would only crystallise if the Council ceased to be a member of the APF.

2.5 The deficit position has significantly reduced during the period between valuations. This is due to investments returns during this period being in excess of those anticipated at the last valuation which has led to an improvement in the funding position and, by extension, a reduction in deficit recovery.

2.6 The employer future service rate is impacted by both demographic changes and the financial assumptions made by the actuary as part of the valuation process. Demographic assumptions will include estimates of mortality rates while financial assumptions will include a longer-term view taken by the Actuary achieve a funding plan which balances affordability of contributions versus the long term sustainability of contributions at future valuations. This will include long term assumptions around inflation and return on investments.

### 3 Recovery of deficits on the Fund

3.1 If the funding level of an employer is below 100% at the valuation date (i.e., the assets of the employer are less than the liabilities), a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall. The deficit recovery period is generally reduced at each triannual valuation. At the 2019 valuation, the recovery period was 14 years. This has now been reduced to 12 in the 2022 valuation. Recovery periods do not normally fall below 12 years.

3.2 Generally, deficit payments are made to the Fund on a monthly basis along with regular pension contributions, however the Fund allows those employers in deficit to make an early repayment of the deficit. This can be an annual payment at the start of each of the three financial years covered by the valuation, or a three-year upfront payment at the start of April 2023. These arrangements, where affordable, generate savings for the Council. The table below sets out the potential cash savings for each option. The total cost of making these payments on a monthly basis for three years is £14,907,700.

Deficit Prepayment Options	Each April	April 23
Monthly Payments (total over 3 years)	£14,907,700	£14,907,700
2023/24 Deficit Recovery Amount	-£4,641,940	-£13,925,810
2024/25 Deficit Recovery Amount	-£4,855,480	
2025/26 Deficit Recovery Amount	-£5,078,800	
<b>Saving</b>	<b>£331,480</b>	<b>£981,890</b>

At a cost of capital of 4%, making a three year upfront payment generates a positive cashflow and is therefore the recommended approach.

## **4 Advance Payment of the Future Service Cost**

4.1 The future service rate is the cost of providing the pension benefits members build up each year and is split between employer and employee contributions. Traditionally these are paid on a monthly basis by both parties. However, there is also the opportunity for employers to make an 80% upfront payment each year at the beginning of April. This is based on an annually refreshed pensionable pay figure. Typically, the net annual saving to the Council is around £300k.

### **Proposal and Recommendation**

To pay the deficit amount at the beginning of 2023 enabling a total saving cash saving of £981,890 over the period and to pay 80% the future service cost at the beginning of each year for the next three years generating a further annual cash saving of approximately £300k

### **Other Options Considered**

Not applicable

### **Risk Assessment**

The Avon Pension fund has presented the key risks to the Pension fund at the November 2022 meeting Audit Committee.

### **Public Sector Equality Duties**

None necessary for this report

### **Legal and Resource Implications**

#### **Legal**

None arising from this report

#### **Financial**

Approving the upfront payment of the deficit will generate savings of £982k over the following three years. Approval of the annual upfront payment of the future service cost will generate an annual saving of approximately £300k for each of the next three years.

#### **Land**

Not applicable

**Personnel**  
Not Applicable

**Appendices:**

None

***LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985***

***Background Papers:***

*2022 Mercer Valuation Report*