Agenda No

AGENDA MANAGEMENT SHEET

Name of Committee	**Pension Fund Investment Board**
Date of Committee	**20 November 2006**
Report Title	**Actuarial Report on the Funding Level at 31 March 2006**
Summary	The report considers the Pension Fund's level of funding at 31 March 2006.
For further information please contact:	Phil Triggs Group Manager (Treasury and Pensions) Tel: 01926 412227 philtriggs@warwickshire.gov.uk
Would the recommended decision be contrary to the Budget and Policy Framework?	No.
Background papers	Report from Mercer Human Resource Consulting.

CONSULTATION ALREADY UNDERTAKEN:- Details to be specified

Other Committees	☐	....
Local Member(s)	☐	....
Other Elected Members	☒	Cllr Davis, Chair of Pension Fund Board
Cabinet Member	☐	....
Chief Executive	☐	....
Legal	☒	Tony Maione
Finance	☒	David Clarke, Strategic Director of Resources (reporting officer)
Other Chief Officers	☐	....
District Councils	☐	....
Health Authority	☐	....
Police	☐	....

Other Bodies/Individuals	☐	....

FINAL DECISION YES

SUGGESTED NEXT STEPS:		Details to be specified
Further consideration by this Committee	☐	....
To Council	☐	....
To Cabinet	☐	....
To an O & S Committee	☐	....
To an Area Committee	☐	....
Further Consultation	☐	....

Agenda No

Pension Fund Investment Board 20 November 2006

Actuarial Report on the Funding Level at 31 March 2006

Report of the Strategic Director of Resources

Recommendation
That the Board note the report.

1. Introduction

1.1 The purpose of this document is to present the results of the interim review of the Warwickshire Pension Fund ("the Fund") as at 31 March 2006. A full actuarial valuation of the Fund was undertaken as at 31 March 2004, so the period under review is two years. The review is intended to give an estimate of the financial position of the Fund as at 31 March 2006, and an approximate update as at 31 August 2006. The actuarial assumptions and method for this review are consistent with the 2004 actuarial valuation.

1.2 Mercer has also produced costings of the implications of the new LGPS 2008 proposals and considered these in the context of the potential results for the 2007 actuarial valuation. The full Mercer document is attached at **Appendix A**.

1.3 The results are based on summary data and readily available accounting information, and can therefore only be considered as approximate in nature.

2. Past Service Position

2.1 The approximate past service position of the Fund as at 31 March 2006 is as follows:

Market value of assets (excluding AVCs)	£945 million
Total past service liabilities	£1,068 million
Deficit	£123 million

2.2 The funding level is 89%, which compares with 82% at the 2004 valuation The increase in funding level is mainly due to the actual investment return over the period being more than assumed at the 2004 valuation.

2.3 Mercer has also projected the valuation funding position to 31 August 2006, based on market index returns for the period from 31 March 2004 to 31 August 2006. The estimated funding level as at 31 August 2006 was approximately 83%. This represents a worsening of the funding level of 6% during the six-month period to 30 September 2006.

2.4 The decrease in the funding level since 31 March 2006 is due to the falls in investment markets, particularly overseas equities, over the six-month period. It should be noted that market movements have been extremely volatile recently, giving rise to a high level of variability in the measured funding position.

3. Future Service Contributions

3.1 The Common Contribution Rate in respect of future service is 10.4% of pensionable pay. This is the rate calculated at the 2004 valuation, including allowance for administrative expenses. For this review, Mercer has been unable to take account of any changes that have taken place in the membership profile of the active members. Any effect of this on the future service rate will be assessed at the 2007 valuation.

3.2 The 10.4% future service rate allowed for the removal of Rule of 85 from 1 April 2005, but included the protections for members attaining age 60/rule of 85 age by 2013. Following revocation, the core of the latest proposals is that removal of Rule of 85 and the protections are effectively all shifted forwards by 3 years to 2008/2016. Thus the 10.4% rate remains an appropriate benchmark for future service costs, on the assumption that the overall membership profile at the 2007 valuation will be not materially different to that at the 2004 valuation.

4. Deficit Recovery Contributions

4.1 The average addition required to recover the past service deficit over a period of 23 years, being the remaining period of the 25 years adopted following the 2004 valuation, is 3.0% of pensionable pay, effective from 1 April 2007.

4.2 Thus, the total required average contribution rate would be as follows:

Future Service Rate	10.4%
Deficit Recovery Contributions (over 23 years)	3.0%
Average target contribution rate required by the participating employers (before phasing)	13.4%

4.3 Additional capital contributions are payable in relation to non ill-health early retirements.

4.4 This compares to an average target employers' rate (before phasing) at the 2004 valuation of 14.4% of pensionable pay i.e. an average decrease of 1% of pensionable pay per annum.

4.5 If instead the 25-year recovery period was maintained at this review (i.e. extended by two years) the Deficit Recovery Contributions required would be 2.8% of pensionable payroll, giving an average target employers' rate of 13.2%. Alternatively, if a 20-year recovery period was introduced, the Deficit Recovery Contributions would be 3.4% giving an average employers' rate of 13.8%.

5. LGPS 2008 Proposals and Impact on 2007 Actuarial Valuation

5.1 Mercer has costed the various options put forward in the LGPS 2008 consultation based on the calculations carried out for the 2006 interim review results set out in the previous section of this report. It should be noted that these costs are based on the 2004 valuation membership data, and are assessed for the Fund as a whole.

5.2 There are five options with regard to the LGPS 2008 scheme and details of these are contained in a separate report attached with this agenda. Mercer's report (attached as **Appendix A**) looks at the individual costings associated with each of the five options.

5.3 At the present time Mercer is unable to take a view on whether the assumptions adopted in the DCLG consultation are realistic.

5.4 Mercer has mentioned that the mortality tables used for the 2004 valuation may ultimately not make sufficient provision for future improvements in longevity and, as a result, Mercer may recommend the use of revised mortality rates at the 2007 valuation.

6. Recommendation

6.1 It is recommended that the Board note the report.

DAVID CLARKE
Strategic Director of Resources

Shire Hall
Warwick
November 2006

September 2006

Interim Review as at 31 March 2006

Warwickshire County Council Pension Fund

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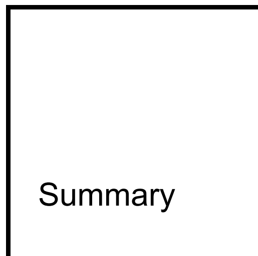

Interim Review 31 March 2006

Past service

The Fund shows a deficit of £123 million at the interim review date using the actuarial assumptions detailed in this report. This represents a funding level of 88.5%, which compares to 80.8% at the 2005 review and 81.5% at the 2004 valuation.

LGPS 2008

We have analysed the costs associated with the proposed LGPS 2008 options in the context of the potential outcomes for the 2007 valuation of the Fund allowing for a possible strengthening of the mortality and investment return assumptions. The results of this are set out in Section 3. In brief the options proposed, and the future service employer costs identified (allowing for the "cost neutral" employee rates proposed in the DCLG consultation document), are as follows:

		Standard retirement lump sum allowance	**50% take up of maximum retirement lump sum**
A – updated current scheme		13.8%	13.4%
B – 60ths final salary		13.9%	13.4%
C – new career average scheme:			
	C1	12.1%	11.8%
	C2	13.5%	13.1%
D – hybrid scheme		As C above (see Section 3.8)	

Funding Plan – deficit recovery

Deficit recovery contributions would continue to be required in addition to the future service contributions above. Based on this review the average required deficit recovery contribution rate is 3.0%, a reduction of 1.0% compared to the average required deficit recovery rate of 4.0% at the 2004 valuation. However, strengthening the assumptions to allow for projected mortality improvements (adopting the "medium cohort" projections) would increase the required deficit contributions to 5.6%.

Recommendations

Actual contributions payable for the period 2008/11 will be based on the results of the 2007 actuarial valuation. We recommend that prior to the valuation the Administering Authority carries out a preliminary review of the Funding Strategy Statement (FSS), taking into account the results set out in this report. The FSS would then be formally reviewed and published in conjunction with the 2007 valuation results.

The LGPS has recently been amended to allow members to choose at retirement to take an increased lump sum by commuting retirement pension, at a rate of 12:1. No allowance has been made for this in the past service funding level or the rates of deficit recovery contributions set out above. We recommend that the actual take up of the new higher retirement lump sum facility should be monitored by the Fund, to enable consideration of the appropriate allowance to make for these terms at the 2007 valuation.

We would be pleased to discuss the results of this review with the Administering Authority and to assist in preparing its response to the LGPS 2008 consultation.

C R Hull FIA
September 2006

This report is addressed to the Administering Authority. The calculations in the report use methods and assumptions appropriate for the purpose of reviewing the financial position of the Scheme and the appropriate contributions for the future. We do not accept liability to any third party in respect of this report; nor do we accept liability to the Administering Authority if the advice is used for any purpose other than that stated. We have relied on the accuracy of the data provided. Whilst reasonableness checks on the data have been carried out, they do not guarantee the completeness or accuracy of the data. Consequently we do not accept any liability in respect of our advice where we have relied on data which is incomplete or inaccurate.

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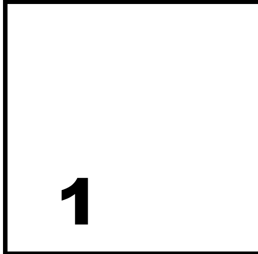


Introduction

1.1 The purpose of this document is to present the results of the interim review of the Warwickshire Pension Fund ("the Fund") as at 31 March 2006. A full actuarial valuation of the Fund was undertaken as at 31 March 2004, so the period under review is two years. The review is intended to give an estimate of the financial position of the Fund as at 31 March 2006, and an approximate update as at 31 August 2006. The actuarial assumptions and method for this review are consistent with the 2004 actuarial valuation.

1.2 We also set out in this report an analysis of the cost implications of the new LGPS 2008 proposals, and consider these in the context of the potential results for the 2007 actuarial valuation.

1.3 This review updates the 2004 full valuation to take account of benefit changes and experience since that date. As such this document has not been prepared to be compliant with the Board of Actuarial Standard's Guidance Note 9 – "Funding Defined Benefits – Presentation of Actuarial Advice".

1.4 The results set out in this document are based on summary data and readily available accounting information. The review can, therefore, be considered as only approximate in nature.

1.5 The review is based on data provided by the Administering Authority which is summarised below and in Appendix A.

	31 March 2004	31 March 2006	% Change (31.3.04 to 31.3.06)
Number of actives as at year end	13,985	14,104	0.9%
Number of pensioners (including dependants)	6,721	6,996	4.1%
Number of preserved pensioners (including undecideds and frozen refunds)	6,807	8,995	32.1%

1.6 The figures as at 31 March 2004 are as provided for the 2004 valuation. The figures at 31 March 2006 have been taken from the AXISe movement analysis prints for 2005/06.

1.7 In addition we have used a total annual pensionable payroll for the Fund of £210 million as at 31 March 2006 which has been derived from the employee contributions for the year ended 31 March 2006. This compares to a figure of £200 million at the 2004 valuation.

1.8 As at 31 March 2006 the market value of the Fund (excluding AVCs) was £945 million. A summary of the assets held by the Fund is set out in Appendix A.

2

Interim Review Results as at 31 March 2006

Past Service Position

2.1 Adopting the assumptions set out in Section 4, the approximate past service position of the Fund as at 31 March 2006 is as follows:

Market value of assets (excluding AVCs)	£945 million
Total past service liabilities	£1,068 million
Deficit	£123 million

The funding level is 88.5%, which compares with 81.5% at the 2004 valuation (see summary of the 2004 valuation results in Appendix B). The increase in funding level is mainly due to the actual investment return over the period being more than assumed at the 2004 valuation. An analysis of the change in deficit is set out in Appendix D.

2.2 We have also projected the valuation funding position to 31 August 2006. This projection is based on market index returns for the period from 31 March 2006 to 31 August 2006, in line with the investment strategy benchmark set out in Appendix A. It is "broad brush" in nature, as it takes no account of any other experience factors.

2.3 The estimated progression of the funding level from 31 March 2004 to 31 August 2006 is illustrated in the graphic output shown in Appendix E. This shows that the funding level as at 31 August 2006 was approximately 83%.

2.4 The decrease in the funding level since 31 March 2006 is due to the falls in investment markets, particularly overseas equities, over the 5 month period. It should be noted that market movements have been extremely volatile recently, giving rise to a high level of variability in the measured funding position.

Future Service Contributions

2.5 The Common Contribution Rate in respect of future service is 10.4% of pensionable pay. This is the rate calculated at the 2004 valuation, including allowance for administrative expenses. For this review we are unable to take account of any changes that have taken place in the membership profile of the active members. Any effect of this on the future service rate will be assessed at the 2007 valuation. The impact of the LGPS 2008 options is addressed in Section 3 of this report.

2.6 The 10.4% future service rate allowed for the removal of Rule of 85 from 1 April 2005, but included the protections for members attaining age 60/rule of 85 age by 2013. Following revocation, the core of the latest proposals is that removal of Rule of 85, and the protections, are effectively all shifted forwards by 3 years to 2008/2016 (see Appendix C for further details). Thus the 10.4% rate remains an appropriate benchmark for future service costs, on the assumption that the overall membership profile at the 2007 valuation will be not materially different to that at the 2004 valuation. (Technically, there will be a slight additional cost effect on the future service rate for the further tapering protection between 2016 and 2020, but we do not consider this to be significant in the context of this interim review; of the order of 0.1% of pensionable pay).

Deficit Recovery Contributions

2.7 The average addition required to recover the past service deficit over a period of 23 years, being the remaining period of the 25 years adopted following the 2004 valuation, is 3.0% of pensionable pay, effective from 1 April 2007.

2.8 Thus, the total required average contribution rate would be as follows:

Future Service Rate	10.4%
Deficit Recovery Contributions (over 23 years)	3.0%
Average target contribution rate required by the participating employers (before phasing)	13.4%

Additional capital contributions are payable in relation to non-ill health early retirements.

2.9 This compares to an average target employers' rate (before phasing) at the 2004 valuation of 14.4% of pensionable pay i.e. an average decrease of 1% of pensionable pay per annum. If instead the 25 year recovery period was maintained at this review (i.e. extended by two years) the Deficit Recovery Contributions required would be 2.8% of pensionable payroll, giving an average target employers' rate of 13.2%. Alternatively if a 20 year recovery period was introduced, the Deficit Recovery Contributions would be 3.4% giving an average employers' rate of 13.8%.

Results on Alternative Assumptions

2.10 We have also considered the results emerging on more cautious alternative assumptions allowing for:

a. Improved mortality assumptions (applied to both past and future liabilities), based on the "92 series" (year of birth tables) with short and medium cohort projections (see Appendix F for further details), but with a one year age adjustment in respect of LGPS specific experience; and

b. A reduced long term assumed return on investments for future service by ½ % from 6 ½ % to 6% (which is in line with the more cautious assumptions adopted by the Government Actuary's Department for the LGPS 2008 consultation).

2.11 The alternative results on these bases (retaining the 23 year deficit recovery period) are set out in the following tables:

Base Results

Past service deficit	£ 123m
Funding level	88.5%
Future service rate	10.4%
Deficit recovery rate	3.0%
Average target employer rate	13.4%

a. With improved mortality assumptions

Short Cohort (+ 1 year)		**Medium Cohort (+1 year)**	
Past service deficit	£ 208m	Past service deficit	£ 226m
Funding level	82.0%	Funding level	80.7%
Future service rate	11.3%	Future service rate	11.5%
Deficit recovery rate	5.2%	Deficit recovery rate	5.6%
Average target employer rate	16.5%	Average target employer rate	17.1%

b. Also with ½ % reduction in future service investment return assumption

Short Cohort (+1 year)		**Medium Cohort (+1 year)**	
Past service deficit	£ 208 m	Past service deficit	£ 226 m
Funding level	82.0%	Funding level	80.7%
Future service rate	13.3%	Future service rate	13.6%
Deficit recovery rate	5.2%	Deficit recovery rate	5.6%
Average target employer rate	18.5%	Average target employer rate	19.2%

2.12 We have also estimated the reduction in past service liabilities if allowance is made for a 50% take up of the new maximum retirement lump sum, at a rate of exchange of 12:1. Such an allowance would act to reduce the deficit shown in paragraph 2.11 on the Base Results by approximately £15 million, with an improved funding level of 89.8%. The Deficit Recovery Contribution would fall by 0.3% to 2.7%. Making the same allowance for commutation in the results above with the stronger mortality assumptions would give a slightly greater reduction in the deficit and recovery contributions.

2.13 At this stage we would not propose making any allowance for additional lump sums (over and above the 3/80ths level) pending a review of the actual take up experience for the Fund. However, we illustrate the effect in Section 3 in order to consider what rate may emerge from the 2007 valuation.

2.14 Other assumptions will be reviewed at the 2007 valuation including the rates of ill health and withdrawal. If it was decided to increase the allowance made for withdrawal from service, for example, this would serve to offset the impact of mortality and investment return changes to a limited extent.

3

LGPS 2008 Proposals and Impact on 2007 Actuarial Valuation

3.1 We have costed the various options put forward in the LGPS 2008 consultation (see Appendix G for details) based on the calculations we have carried out for the 2006 interim review results set out in the previous section of this report. It should be noted that these costs are based on the 2004 valuation membership data, and are assessed for the Fund as a whole. The relative costs of the new benefit options for individual employers, as a percentage of payroll, will vary depending on the age/service profile of the organisation's employee base. In addition, the impact of the various options (for example the career average options compared to the final salary options) will vary from one employer to another depending on the nature of the workforce involved, particularly in relation to expected levels of future salary increases and career progression.

3.2 All the proposed options include the recently introduced facility which allows members to commute part of their pension at retirement for a higher lump sum, based on a rate of exchange of 12:1. This 12:1 rate of exchange is such that members taking up the option will give rise to cost savings to the Scheme, and an assumed 50% take up has been factored into the GAD calculations on which the options have been based. For the purpose of these figures below, we have looked at the results on two possible assumptions for commutation namely:

a. All members only take the standard 3/80ths lump sum at retirement;

b. A 50% take up of the new maximum retirement lump sum available, with the remaining 50% opting for the existing standard 3/80ths lump sum.

3.3 We recommend that the actual take up of the new higher retirement lump sum facility should be monitored, to enable consideration of the appropriate allowance to make at the 2007 valuation.

3.4 Our costings in respect of the LGPS 2008 proposals have been carried out in respect of future service benefits only, using the same projected unit funding method as adopted at the 2004 valuation. In line with the consultation paper, we have assumed that there will be no financial cost impact of the LGPS 2008 in relation to past service benefits, and so no direct impact on the deficit in the Scheme revealed at the 2007 valuation, or the deficit contributions required to recover the funding position. As regards employee contributions we have assumed initially in this analysis that they would be at the "cost neutral" level for each option as identified in the consultation paper, and as discussed in Appendix G.

3.5 The benefits valued under each option are also as described in Appendix G. In particular, we have allowed for the new two tier ill health arrangements to be such that 15% of ill health retirements would qualify under tier 1, with the remaining 85% under tier 2. This is discussed further in paragraphs 3.17 to 3.19 below.

3.6 All the costings include the same 0.55% administrative expenses allowance as made at the 2004 valuation.

3.7 In analysing the costs under the new Scheme, we have provisionally assumed that we would make some strengthening changes to the funding assumptions at the 2007 actuarial valuation. These strengthening assumptions are in line with those described in paragraph 2.10 in the previous section of this report, namely a ½% reduction in the future service investment return assumption, and mortality on the medium cohort basis (with a one year age adjustment). Any such strengthening in the assumptions remains subject to discussion at the 2007 valuation, but we do believe that some strengthening is indicated, particularly in the light of further evidence for improving mortality trends. The reduction in the future service investment return broadly corresponds to the continuing falls in real bond yields since the 2004 valuation.

	Option A	**Option B**	**Option C1**	**Option C2**
Total contribution rate cost (standard 3/80ths lump sum taken)	18.9%	20.5%	18.4%	19.7%
"Cost neutral" employee contribution rate	(5.1%)	(6.6%)	(6.3%)	(6.2%)
Employer future service contribution rate	13.8%	13.9%	12.1%	13.5%
Saving from additional 50% commutation take up	(0.4%)	(0.5%)	(0.3%)	(0.4%)
Employer future service contribution rate with additional commutation savings	13.4%	13.4%	11.8%	13.1%

3.8 As regards option D, the intention as described in the consultation is that this should have the same cost basis as option C1/C2. In other words the additional

3% employee contributions which would apply for those selecting the final salary option should meet the costs of the higher retirement benefits arising. However, we have concerns that the additional 3% employee contributions would not be sufficient to deliver cost neutrality to employers, particularly so if Option D was adopted using the "C1" CARE scheme version.

3.9 The costs identified above for the various options can be compared with:

- The 10.4% future service contribution rate revealed at the 2004 valuation, which is based on the scheme as it existed after the removal of rule of 85 age (subject to protections) but does not reflect the strengthening in the assumptions as discussed above; and

- The rate of 13.6% for future service contributions shown in paragraph 2.11(b) which updates the 2004 valuation future service rate in line with the stronger assumptions set out above.

3.10 It can therefore be seen that Options A, B and C2 have a broadly similar cost base to the current scheme, assuming the different "cost neutral" employee contribution rates would be implemented for each option. The costs would reduce to the extent that an allowance for additional commutation savings was made in setting the employer contribution rates. However, costs would be increased if the effect of "recycling" is factored in (either as a result of additional/higher benefits or a reduction in employee contributions). The Government Actuary's Department have identified the extra value from recycling these savings to be equivalent to an increase in employer contributions of 0.8% of payroll per annum.

3.11 Option C1 is shown to represent a cost reduction relative to the other options. This comes about mainly because of technical differences between the method we consider appropriate for funding valuations (the Projected Unit method) and the method adopted by the GAD for the consultation cost comparisons (the Attained Age method). The relative difference in cost between C1 and C2 is dependent particularly on the withdrawals assumption used in the valuation. A higher withdrawals assumption will reduce the cost of C2 relative to C1, and vice versa.

Impact on 2007 Actuarial Valuation

3.12 The results in Section 2 of this report show the required deficit recovery contributions are 3.0% of pensionable payroll payable over 23 years from 1 April 2007. Alternatively, adopting more cautious assumptions the deficit recovery requirement could be of the order of 5.2% to 5.6%, based on the analysis in paragraph 2.11, but might be somewhat reduced at roughly 4.9% to 5.3% if some allowance is made for past service commutation savings (paragraph 2.12).

3.13 Taking 5.0% of pensionable salaries as an indicative level of deficit recovery contributions required following the 2007 valuation (recognising the range of possible results and the presently unknown market conditions at 2007), the total target required employer contributions on the LGPS 2008 options would be as follows:

	Option A	**Option B**	**Option C1**	**Option C2**
Total contribution rate cost (standard 3/80ths lump sum taken)	18.9%	20.5%	18.4%	19.7%
Deficit recovery contributions	5.0%	5.0%	5.0%	5.0%
"Cost neutral" employee contribution rate	(5.1%)	(6.6%)	(6.3%)	(6.2%)
Employer target contribution rate	18.8%	18.9%	17.1%	18.5%
Saving from additional 50% commutation take up	(0.4%)	(0.5%)	(0.3%)	(0.4%)
Employer target contribution rate with additional commutation savings	18.4%	18.4%	16.8%	18.1%

3.14 This can be compared with the average target employer contribution rate following the 2004 valuation of 14.4% of pensionable payroll. The 2004 valuation rates of employer contributions were being phased in over a maximum period of 6 years from 1 April 2005 such that the target contributions for each employer are scheduled to be achieved in 2010/11.

3.15 On this basis then the 2007 valuation would see an increase in the average required employer contribution rate under all the options, with a lower level of increase arising under C1 compared with the other options. However, as noted in paragraph 3.7, the assumptions to be adopted for the 2007 valuation would be subject to further discussion at that time. If, for example, the reduction in the future service investment return assumption (as described in paragraph 2.10b) was not considered necessary, then the employer contribution rates set out in the table at 3.13 above would reduce by broadly 2% of payroll.

3.16 The consultation paper also highlights the possibility of higher levels of employee contributions being payable under any of the proposed options, giving rise to a lower level of employer cost. Thus, a 1% higher employee contribution than the cost neutral contributions shown in the table at 3.13 above would give rise to a 1% lower average target employer contribution rate. We understand from our discussions with the DCLG that they anticipate the actual level of employee contributions applicable, under whichever option is ultimately implemented, will be determined through negotiation between employers and unions at the national level. There is no proposal for employee contribution rates to be agreed locally, either at Fund or individual employer level.

Two Tier Ill Health Retirement Assumptions

3.17 The figures set out above, and the calculation of the "cost neutral" employee contribution rates in the consultation paper, are dependent on assumptions for the incidence of ill health retirements under the proposed new two tier arrangements going forward. The most important factor in this will be the exact criteria which will be used to assess these retirements. We understand the DCLG intends to develop and issue a "code of practice" to govern this process, but the details are at present unknown.

3.18 The assumptions currently being used (15% tier 1 and 85% tier 2, and with overall ill heath retirements remaining in line with the 2004 valuation assumptions) give rise to a cost saving for the two tier approach of around 1.0% of payroll, based on the GAD figures. In other words, if the actuality of the new ill health arrangements was different (for example a greater proportion falling in tier 1, or an overall higher incidence of ill healths) then the 1% saving might not arise in full, and in the extreme costs could potentially be increased by more than the supposed saving. Ultimate funding costs would then be higher than those shown above.

3.19 At the present time we are unable to take a view on whether the assumptions adopted in the DCLG consultation are realistic. The delivery of any such savings will depend critically on the detail of the "code of practice" which is ultimately adopted. We have raised this with the DCLG and suggested that there could be some back testing of past ill health retirements, on a sampling basis, to provide supporting evidence or otherwise for the anticipated 15%/85% distribution.

4

Actuarial Assumptions as at 31 March 2006

4.1 Following the same approach as adopted at the 2004 valuation, the base assumptions for calculating past service liabilities derived from the UK gilt yield curves on 31 March 2006 (with 31 March 2004 and 2005 shown for comparison) are:

	31 March 2006	*31 March 2005*	*31 March 2004*
▪ Market annual rate of discount (gilt returns)	4.1%	*4.5%*	*4.6%*
▪ Implied annual rate of price inflation	2.9%	*2.9%*	*2.8%*

4.2 The key financial elements of the basis for past service liabilities are the asset outperformance assumption (AOA) and assumed rate of real pay increases. We have retained the assumptions made for these elements at the 2004 valuation, as follows:

- Asset outperformance assumption
  - pre-retirement — 2.5% per annum
  - post-retirement — 1.0% per annum
- Real pay growth assumption — 1.75% per annum

4.3 Based on the above, we have therefore adopted the following assumptions for the valuation of past service liabilities (2004 and 2005 assumptions shown for comparison):

	31 March 2006	*31 March 2005*	*31 March 2004*
▪ Valuation annual rate of discount			
– pre-retirement	6.6%	*7.0%*	*7.1%*
– post-retirement	5.1%	*5.5%*	*5.6%*
▪ Assumed annual rate of future increases in Pensionable Pay	4.65%	*4.65%*	*4.55%*
▪ Assumed annual rate of future pension increases	2.9%	*2.9%*	*2.8%*

4.4 We have retained the same assumptions for the future service rate (i.e. the Common Contribution Rate) as those adopted for the 2004 valuation, as they are intended to reflect investment conditions over a period of time in the future (subject to review at the 2007 valuation) as follows:

▪ Valuation rate of discount	6.5% per annum
▪ Assumed rate of future increases in Pensionable Pay	4.25% per annum
▪ Assumed rate of future pension Increases	2.5% per annum

However, we have considered some strengthening of these assumptions when assessing the impact of the LGPS 2008 proposals in Section 3 of this report.

Comment on financial assumptions

Past Service

4.5 In assessing the past service position the financial assumptions retain the same allowances as to future anticipated investment performance, measured relative to gilt yields, as were adopted for the 2004 valuation, but have been amended to reflect market conditions as at 31 March 2006.

4.6 As set out in the Funding Strategy Statement the current overall investment out-performance required on the Fund's assets to keep pace with the past service liabilities is 1.9% per annum (net of expenses). This is the additional return needed relative to a "least risk" gilts strategy, as discussed in Sections 5.3 to 5.5.

4.7 The Fund's current strategic investment benchmark is set out in Appendix A, and is broadly 75% equities and 25% bonds. Adopting a simplified analysis, if the 1.9% out-performance is assumed to be derived entirely from the Fund's equity holdings, this requires equity out-performance relative to gilts of roughly 2.5% per annum.

Future Service

4.8 In relation to the cost of future accruals (i.e. the Common Contribution Rate) we have retained exactly the same assumed real return over inflation as in the 2004 valuation. This follows the approach adopted at the 2004 and 2001 valuations, focusing on stability in the Common Contribution Rate, rather than linking this directly to variable gilt yields at each valuation. Based on current gilt yields, a higher overall investment return is anticipated for contributions relating to future accruals than for accrued past service liabilities. If, instead, identical assumptions were used for future service as for past service a higher Common Contribution Rate would result.

4.9 At each valuation and interim review the cost of the benefits accrued since the previous valuation will become a past service liability. At that time any mis-match against gilt yields and the asset outperformance assumptions for past service is fully taken into account in assessing the liabilities.

4.10 At this interim review there has been some tightening of financial conditions since 31 March 2004 as shown by the decrease in the yields on gilts and an increase in the derived rate of assumed inflation/pension increases. As a result, the future service assumptions now require a higher overall real return relative to gilt yields than was the case at the 2004 valuation. Broadly speaking, the required level of out-performance for the future service assumptions, relative to current gilt yields, is between 2.5% and 3.0% per annum (net of expenses).

4.11 We remain comfortable with this approach, assessing the cost of future accruals on a different basis to past service liabilities, given there are no current assets invested to meet future accruals, and the future investment conditions in which these contributions will be invested are uncertain. A key strength of this approach is that it provides stability in the Common Contribution Rate, as a market based approach would result in significant volatility from relatively small changes in market yields. Nevertheless, the financial assumptions for future service should be kept under review, and we would in any case revisit these at the next full valuation of the Fund. The impact of adopting a more cautious future service investment return assumption is illustrated in the results in Section 2.11. We have also adopted a more cautious assumption for future service in assessing the impact of the LGPS 2008 proposals in Section 3 of this report.

Comment on mortality assumptions

4.12 It should be noted that the mortality tables used for the 2004 valuation may ultimately not make sufficient provision for future improvements in longevity, and we may well be recommending the use of lighter mortality rates at the next actuarial valuation. Appendix F provides a more detailed discussion of current mortality assumptions and projections. The impact of adopting lighter mortality assumptions than these used at the 2004 valuation is considered in section 2.11. We have also adopted lighter mortality assumptions in assessing the impact of the LGPS 2008 proposals in Section 3 of this report.

5

Review of 2004/06

5.1 The following key factors have impacted on the progression of the Fund over the period.

Investment returns

5.2 The following table sets out comparative investment return details:

	Return 2004/05	**Return 2005/06**	**Cumulative Return 2004/06**
Warwickshire Pension Fund	9.7% (gross of expenses)	26.3% (gross of expenses)	38.6% (gross of expenses)
WM Local Authority Universe Average	11.7%	24.9%	39.5%
UK All Share (Total Return) Index	15.6%	28.0%	48.0%
UK Index Linked Gilts (over 5 years)	5.7%	9.0%	15.2%
UK Fixed Interest Gilts (over 15 years)	5.4%	10.7%	16.7%

5.3 One way of considering the effect of investment return is to look at the “least risk” portfolio of Fund assets. The least risk portfolio would be constructed to provide a cashflow (by way of income and maturity proceeds) that exactly mirrored the benefit outgo for the Fund’s accrued liabilities. In practice such an exactly matched portfolio represents an ideal, because of the limits of the existing gilt markets, and the very long term nature of the Fund’s liabilities. Using a simplified model, a notional portfolio invested 85% in index linked gilts and 15% in fixed interest gilts (in line with the relevant gilt indices) would approximately

match the nature of the Fund's liabilities, but not the term (i.e. the duration of the benefits outgo).

5.4 Investing the Fund's assets in line with this simplified least risk portfolio would reduce fluctuations in the Fund's ongoing funding level as those assets would then be more closely related to the liabilities. Some volatility would remain however because the gilt indices have a significantly shorter discounted mean term than the pension scheme liabilities. The portfolio would also not protect against other liability risks, for example, higher real pay increases or further mortality improvements.

5.5 The actual Fund performance has been above the "least risk" return and also above the 2004 valuation assumptions which assumed outperformance relative to the least risk return of 2.5% per annum in respect of active and deferred member liabilities, and 1.0% per annum in respect of pensioner liabilities (currently equivalent to 1.9% per annum overall).

Ill health retirements

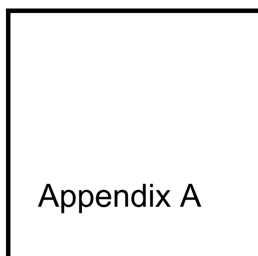
5.6 Actual ill health retirements over the two year period 2004/06 numbered 64, compared to 204 "expected" on the basis of the 2004 assumptions, a ratio of 31.4%. Therefore, the ill health retirement experience has been favourable, although in terms of impact on the overall funding level, the two-year experience is not material. The ratio of actual to expected ill health retirements over 2001 to 2004 was 51.0% so there appears to be a downward trend in the frequency of ill health retirements.

5.7 We would propose reviewing the ill health retirement assumptions at the next full valuation when three years' experience can be considered, and more information is available on the exact criteria to be applied for the new two tier arrangements under LGPS 2008.

Pay and pension increases

5.8 The retail price index rose 5.6% over the two years. The 2004 valuation made allowance for pay increases (including promotional elements) of 1.75% in excess of inflation i.e. a total of 9.3% over the period (4.55% p.a). There is insufficient data available to confirm whether the experience over the year has been more or less favourable than our assumption. However, we have no reason to believe that the impact of the actual salary increases during the year on the overall funding level is likely to be significant.

5.9 The valuation assumptions make allowance for pension increases in line with price inflation and the method of valuing liabilities implicitly allows for any change in the outlook for inflation. As pension increases are granted at the level of price inflation, there is effectively no profit or loss from this source.



Summary of assets and strategic benchmark

	31 March 2006	
	£(000s)	**%**
UK Equities	316,000	33.4
Global Equities	295,500	31.3
Fixed Interest Securities	117,900	12.5
Index Tracker – Multi asset	200,200	21.2
Net Current Assets	15,600	21.2
Total	**945,200**	**100.0**

The above summary excludes money purchase AVCs.

The investment return (before deducting investment expenses) obtained over 2004/05 was 9.7% and over 2005/06 was 26.3%

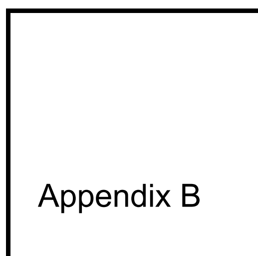
Strategic Benchmark

The Fund's current strategic benchmark is set out below:

		Strategic Benchmark
		%
UK Equities		37.5
Overseas Equities		37.5
European	15.0	
North America	11.25	
Far East/Emerging Markets Pacific Basin	11.25	
Total Equities		**75.0**
UK Corporate Bonds		10.0
UK Fixed-Interest		10.0
UK Index-Linked		5.0
Total Non-Equities		**25.0**
Total		**100.0**

Note;

The Fund has decided to initiate a switch in strategy to include 5% allocations to each of property and hedge fund investments.



Appendix B

Summary of 2004 Valuation

B.1 The financial assumptions adopted for the calculation of the past service liabilities at the 2004 valuation were set on a market-related basis. The assumptions were based on yields derived objectively from long-term yields on Government bonds available in financial markets at the valuation date, together with two subjective elements:

- The extent to which the Fund's investments are expected to outperform a portfolio of Government bonds (the "asset outperformance assumption" or AOA). An AOA of 2.5% per annum for the period pre retirement and 1.0% per annum for the period post retirement were used.
- The expected rate of Pensionable Pay increases above price inflation ("real Pensionable Pay growth"). This was assumed to be 1.75% per annum.

B.2 Full details on the assumptions adopted for the 2004 valuation are set out in our actuarial valuation report.

B.3 The results of the 2004 valuation can be summarised as follows:

	£m	
Market value of assets (excluding AVCs)	670	
Past service liabilities	822	
Past service deficit	£152	million

The funding level was, therefore, 81.5%.

B.4 The Common Contribution Rate required for future service benefits was 10.4% of pensionable pay. This future service rate allowed for the removal of the Rule of 85 from the LGPS with effect from 1 April 2005 (but with protection for members attaining age 60/Rule of 85 age by 2013), as described in Appendix C.

B.5 The average employer contribution rate (before allowing for the phasing of increases) adopting a 25 year recovery period was 14.4% of pensionable pay.

B.6 The actual contributions required from the 2004 valuation are, where appropriate, being phased in over a 6 year period for the majority of employers. Current average contributions are therefore below the target 14.4% contribution identified above.

Appendix C

Rule of 85 changes to the LGPS

C.1 The results of the 2004 actuarial valuation were cast on the basis that the removal from the Scheme of the Rule of 85 retirement provisions was effective from 1 April 2005, with protections for members attaining age 60/Rule of 85 age by 31 March 2013. These changes had originally been brought in with effect from 1 April 2005, but were later revoked by the Office of the Deputy Prime Minister, so that the Rule of 85 provisions were reinstated. Additional costs are therefore being incurred from 1 April 2005 by employers as a result of this revocation, and these additional costs will persist until the Rule of 85 retirement terms are removed from the Scheme in the manner originally intended.

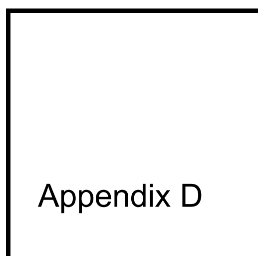
C.2 At the time of writing, the latest position on these changes to the LGPS is as follows:

- The reinstatement of Rule of 85 Age removal, to be effective from 1 October 2006 for new entrants and from 1 April 2008 for existing members, as set out in the July 2006 Amendment (No. 2) Regulations.
- Extended protection put in place for existing members attaining age 60/Rule of 85 age by 31 March 2016, with tapering protection up to 31 March 2020 for members who miss the 2016 date, also set out in the July 2006 Amendment (No. 2) Regulations.
- Other changes to the LGPS have been introduced from April 2006, in particular, additional flexibility for members to take an increased lump sum on retirement.

C.3 When revoking the original Rule of 85 Age removal the Government committed to bring forward other changes to the LGPS so that no additional costs resulting from revocation would fall on LGPS participating employers, nor on tax payers.

C.4 The April 2006 changes to the Scheme confirm the Government's proposed solution to meet this commitment. This is to allow increased flexibility for members to commute part of their pension for additional lump sum at retirement, with effect from 6 April 2006. The terms for this conversion are such that, to the extent that members take up this option, retirement benefits will be less costly to provide.

C.5 We recommend that the Fund should monitor the take-up of the increased retirement lump sum flexibility, to inform the discussion on the appropriate allowance to make for this at the 2007 valuation.



Analysis of change in past service deficit

The balance sheet results for the 2004 valuation and the 2006 review are as follows:

	31 March 2004 £m	31 March 2006 £m
Assets	670	945
Liabilities	822	1,068
Deficit	**£152m**	**£123m**

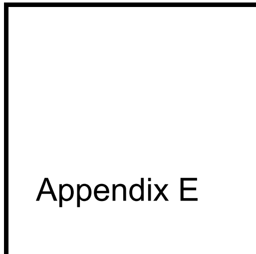
The changes in assets and liabilities from 2004 to 2006 can be broken down in simple terms as follows:

Assets at 2004	+	*Investment Return (Net)*	+	*Net New Money*	=	*Assets At 2006*
£670m	+	£261m	+	£14m	=	£945m
Liabilities At 2004	+	*Liability Growth*	+	*New accrual, benefit payments & Miscellaneous*	=	*Liabilities At 2006*
£822m	+	£200m	+	£46m(1)	=	£1,068m

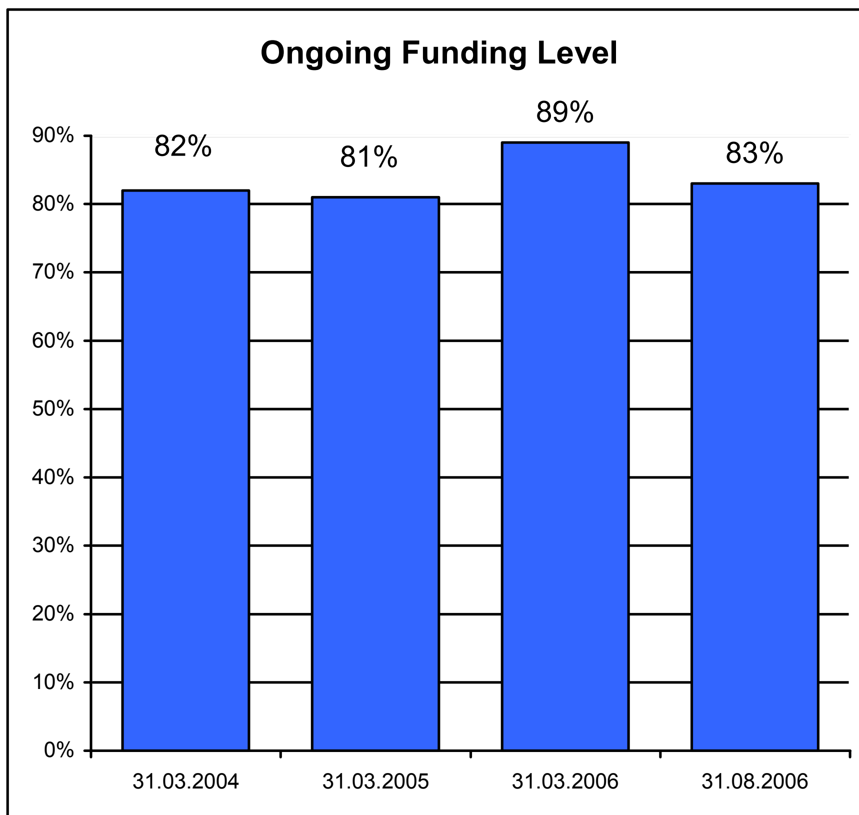
(1) Includes the cost of revocation of rule of 85 removal for the period 2005/6 (further details were provided in our 2005 Interim Review report).

Using the details set out above, the change in deficit from 2004 to 2006 can be analysed as follows:

Deficit at 31 March 2004	**- £152 million**
Investment return versus growth in liabilities (£261m - £200m)	+ £61 million
Other (£14m – £46m)	- £ 32 million
Deficit at 31 March 2006	**- £123 million**



Approximate progression of funding level (31 March 2004 to 31 August 2006)



Appendix F

Note on mortality tables

F.1 UK population mortality is monitored by various bodies that produce mortality tables, based on the experience of different population groups. The main sources of tables have been:

- the Continuous Mortality Investigation Bureau (CMIB), which produces tables based on data from insurance companies. The CMIB produces tables about every ten years, based on the experience of people who have bought life assurance or annuities through insurance companies;
- the Government Actuary's Department (GAD), which produces tables based on census data every ten years;
- the Office of National Statistics (ONS), which produces ten-yearly mortality studies that look at population experience by various occupations, by regions and by social class.

F.2 In addition, we monitor the actual mortality experience exhibited by LGPS Funds at each triennial actuarial valuation.

F.3 The most recent set of tables published by the CMIB centred on data collected between 1991 and 1994. From this data, the CMIB produced its "92 series" of tables, so called because the data related to the period during or around 1992. The CMIB has just published a new set of tables – the "00 series" – based on data collected between 1999 and 2002.

F.4 Projections of mortality improvements, which were incorporated into the 92 series tables, were based on general expectations drawn from the experience of past generations.

F.5 In the past, projections of mortality improvements provided by these bodies have greatly underestimated the extent of the improvements actually seen. There has been some concern that the latest projections are deliberately extreme because the

bodies concerned want to avoid any further "embarrassment". While this may be an influence, there is no doubt that increased computer power and better data collection have allowed more thorough (and one would hope more accurate) analysis in recent years.

Recent mortality studies

F.6 The CMIB has studied more recent mortality data from insurance companies and some occupational pension schemes. The experience from the insurance company data that has emerged since the 1991-1994 study suggests that mortality has been improving at a faster rate than that allowed for in the standard projection model associated with the 92 series tables. Importantly, this has led to three new sets of mortality tables that vary depending on the length of time for which this faster rate of improvement is expected to continue.

F.7 The life insurance experience is substantially based on middle class professionals, whereas the occupational schemes data includes some works and staff schemes from industrial companies. The results also indicate that occupation type and size of pension have a large influence on mortality rates. This study is still "work-in-progress" and needs data collected over a longer period to become more credible.

F.8 The acceleration of mortality improvements identified in these studies relates to particular generations or "cohorts" of the population. In particular, people born between 1925 and 1945 have experienced particularly rapid improvements since the early 1980s. These people, currently in their sixties and seventies, represent a significant section of the current UK pensioner population.

F.9 Three sets of tables have been produced by the CMIB assuming that the faster rates of improvement associated with the cohort effects continue for:

a "short" period – accelerated improvement until 2010 - "short cohort"

a "medium" period – accelerated improvement until 2020 - "medium cohort"

a "long" period – accelerated improvement until 2040 - "long cohort"

F.10 The tables relating to members' years of birth with a medium cohort projection (sometimes referred to as the PA92 mc tables) are beginning to emerge as a new standard within the pensions industry.

The relationships between different populations

F.11 Historically, the CMIB has been the main source of data and tables used in the funding of occupational pension schemes. To date, no specific published tables exist based on the experience of occupational pension scheme members. It can be argued that pension schemes cover a broader social spectrum than insurance company annuitants. Since population studies carried out by the ONS suggest, for example, that manual workers tend to experience shorter life spans than professional and managerial workers, it is unlikely that all pension scheme

members will experience the most favourable levels of longevity shown by insurance company data.

F.12 If comparison is made with the general population, rather than insurance data, members of occupational pension schemes (particularly those with larger pensions) are expected to live longer. This reflects a number of effects:

- to have a significant level of pension, they must have been in employment for much of their lives - suggesting a reasonable standard of living, access to good housing etc., all of which points to better life expectancy;
- the availability of post-retirement finance in excess of State benefits extends this heightened standard of living and also provides better access to healthcare, nursing assistance and so on.

F.13 Investigations we have carried out based on the combined experience of our LGPS funds indicate that LGPS members, on average, have shorter life expectancy than occupational pension scheme members as a whole.

Future improvements

F.14 Studies have shown that life expectancy has improved fairly dramatically over the last 20 years – far faster than it did during most of the 20th century. The consensus of opinion seems to be that improvements in mortality will continue. However, the extent of further improvement is the subject of many discussions.

F.15 For example, recent articles in the national press have referred to:

- the likelihood of a flu epidemic in the near future leading to high numbers of deaths - would reduce life expectancy;
- general concerns about obesity levels and alcohol intake of younger generations - would reduce life expectancy of younger pension scheme members;
- reports that cancer should become a treatable and containable condition over the next 15 years - would greatly increase life expectancy.

F.16 The extent to which medical advances can continue to prolong life, and the speed at which improvements can occur, is far from clear. Some suggest that ultimately there is a limit to human life expectancy while others disagree. What seems certain is that the UK population has not reached a limit – our life expectancy is below that of the average country in Western Europe, and well below that in Japan, so there is plenty of scope for improvement. Whatever your view, it is right to consider the impact of making some allowance for future improvements when reserving for pensions (i.e. to assume that younger members will live to a higher age than older members), although the degree and timing of introducing such an allowance is open to debate.

Appendix G

Summary of LGPS 2008 consultation options

G.1 The Department for Communities and Local Government (DCLG) is currently consulting on options for a "new-look" Local Government Pension Scheme. The full details are set out in the consultation document dated June 2006. The closure date for consultation responses is 29 September 2006.

G.2 In brief, the benefit structure options set out for consultation are as follows:

Option	
A – updated current scheme	Option A retains the existing 80ths pension with 3/80ths retirement lump sum structure, and final salary basis.
B – 60ths final salary	Option B again retains the final salary structure, but now moves to a 60ths pension accrual rate, with retirement lump sum provided solely by commutation of pension (at the 12:1 rate). Assuming members take a 3/80ths retirement lump sum, this would give an improvement in retirement pension of roughly 8% compared to the current 80ths scheme. In addition the spouses' benefits would be significantly improved by 33% (from 160ths to 120ths).
C – new career average scheme	This would replace the current final salary structure with a career average revalued earnings basis. Under this approach a member's retirement benefits would be based on earnings throughout their period of membership, revalued to retirement and then averaged, as opposed to being based on final salary at retirement. Two variations are proposed as follows:

Option	
C1 – Career average RPI revaluation	Under option C1 benefits would be based on RPI revalued career average earnings, with an accrual rate of 1.85% (equivalent to approximately a 54ths scheme). Lump sum would be by commutation as under option B. The spouses' pension would be 50% of the member pension (i.e. approximately 108ths).
C2 – Career average RPI revaluation plus 1.5% per annum	This would operate in the same way as option C1, but the revaluation of earnings while the member is in service would be at 1.5% per annum over and above RPI increases, thereby giving a higher career average earnings figure at retirement (or leaving) than under option C1. Consistent with this a lower accrual rate of 1.65% would apply (equivalent to approximately 61ths). As for option C1, lump sum would again be by commutation, and spouses' benefits would be at 50% (approximately 121ths).
D – hybrid scheme	Under this option D, the standard benefits would be in line with basis C (one or other of C1 or C2) but with members having a one off choice to have benefits on the basis of option B, on payment of an additional 3% contribution rate over and above the standard employee contributions (whatever employee rate, or rates, is ultimately decided).

G.3 Other changes to the current LGPS benefits which would apply under all of the proposed new options are:

- Introduction of two tier ill health retirement benefits. This would be on the basis of tier 1 giving enhanced service of 50% of the member's prospective future service, for those ill health retirees permanently unfit for gainful employment, and tier 2 providing retirement benefits purely on accrued service for those retirees whose incapacity does not preclude them taking up other gainful employment. The main assumption made in the consultation is that 85% of ill health retirees would fall into tier 2, and 15% into tier 1. This assumption that the majority would receive tier 2 benefits gives rise to an apparent overall cost reduction under Option A.

- An increased death in service lump sum benefit of three times pay would be provided (two times pay in the LGPS at present).

- Partner's pensions would be provided for cohabiting partners, compared with the current arrangement where benefits only apply to spouses and civil partnerships.

Employee contributions

G.4 The consultation does not specify actual levels of employee contributions which would apply for each option A to D. It does, however, illustrate what levels of contributions payable by employees under each option would give overall cost neutrality (from the employers' perspective), or given levels of reduction in employer costs (relative to the scheme as it was post the original 1 April 2005 Rule of 85 age changes). These illustrative levels of employee contributions are set out in the following table.

Option	Cost neutral	0.5% of payroll cost reduction	1.0% of payroll cost reduction	1.5% of payroll cost reduction
A	5.1%	5.6%	6.1%	6.6%
B	6.6%	7.1%	7.6%	8.1%
C1	6.3%	6.8%	7.3%	7.8%
C2	6.2%	6.7%	7.2%	7.7%
D	As for C1/C2 plus 3% additional employee contribution for final salary benefits.			

G.5 The consultation also raises the possibility of implementing tiered contribution rates such that employees pay a lower rate on earnings up to a particular level with a higher rate on earnings in excess of that level. The precise contribution rate would be set, depending on the change-over salary, to give the same average employee contribution rates as per the table above. The intention is to introduce a lower contribution cost for lower paid members of the Scheme.

G.6 One effect of the tiered rates, however, will be that, as a proportion of total pay, different employees will have a different proportionate contribution deduction, but benefits would be the same for all as a proportion of pay (i.e. the same accrual rate applies irrespective of the level of earnings). While a desire to favour lower paid members in this way is understandable, such an approach would seem to go against the equal pay for equal work agenda. Difficulties might also arise in relation to part time employees, where legislation requires treatment on an exact pro-rata basis to full time equivalent posts, such that the contribution rates applicable should be based on the full time equivalent pay. Complications would also arise in relation to members with multiple employments, for example, would lower tier earnings in both employments count for the reduced contribution rate, or only in one employment (and if so which employment would be selected)?

Protections

G.7 Under whichever option is implemented, the Government will also have to introduce arrangements to deliver the promised protections for members who would attain age 60/Rule of 85 age by 2016, or up to 2020 on a tapered basis. Allowance for this has been included in the GAD costs in the consultation document, and is also included in our costings in Section 3 of this report.

G.8 However, the precise manner in which these protections will be provided to the applicable members is at present not clear. In our view the most straightforward means of delivering this would be to move all members to the new LGPS 2008 structure immediately, while allowing members in protected categories to draw their retirement benefits based on their old Rule of 85 age. This would seem to be the simplest option whilst keeping within the spirit of the protections already promised.

Treatment of past service

G.9 The analysis in the consultation deals with the benefits under a new LPGS 2008 which would apply for service from 1 April 2008 onwards, and the cost comparisons are in relation to the benefit accruing for future service from that date. The fundamental principle here is that there would be no cost implications for past service benefits, or if there were any cost increases in relation to past service, these would have to be clawed back through benefit reductions (or possibly higher employee contributions) going forwards under LGPS 2008. Given this it is appropriate to base analysis of the impact on actual employer contributions under the Fund on an assumption that there is no impact on the past service deficit position arising from the LGPS 2008 proposal. This is therefore the approach we have followed in Section 3 of this report.

G.10 There are, however, a great many issues relating to the detail of how past service benefits are delivered going forward under LGPS 2008, which would need consideration in preparing a response, and which need to be considered in the context of which option will be implemented for future service, and how the promised protections (as discussed above) would be delivered.

Summary comments

G.11 In summary, it is apparent that the new Scheme benefits options, A to D, do not themselves represent any significant cost savings to employers. Indeed, looking at the benchmark cost in the consultation against which the various options are measured, this represents a cost increase over the existing scheme as assessed at the 2004 actuarial valuations, on account of the recycling of 50% of the assessed savings deriving from the removal of Rule of 85 and the introduction of the "25%" lump sum. The GAD figures in the consultation document estimate this increase in cost effect as 0.8% of payroll per annum.

G.12 Although option A is identified as being "lower cost" in the consultation (due to the assumed take up pattern of the two tier ill health benefits structure), the analysis in this report shows that total **funding** costs would be lower under option C1, other things being equal. Of course, **employer** funding costs depend critically on the level of employee contributions implemented under each option.

G.13 Any cost savings to employers deriving from the new scheme will therefore be dependent on the final determination of the appropriate level of employee

contributions payable to the Scheme. As noted above, a variety of levels of employee contributions is illustrated in the consultation.

G.14 One possible new option that is notable by its absence from the consultation paper is a change for the LGPS from its current contracted-out status to contracted-in. This absence is somewhat surprising, as the financial advantage to scheme sponsors of ceasing to contract-out of the State second tier benefits has been widely recognised for some time.

G.15 A further LGPS 2008 option could therefore be developed which of itself would provide a lower level of benefits, but would be designed to supplement the basic and second tier State benefits, as opposed to standing in place of the second tier benefits as at present.

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