# Pension Fund Investment Board
# 12 November 2012

# 2013 Valuation Planning

## Recommendation

That the Board considers and decides which of the various options presented in the report it wishes to adopt for the 2013 actuarial valuation.

## 1. Introduction

1.1 Approaching the next actuarial valuation in 2013, there is a high probability that some employers will continue their programme of early retirements as has been the case since 2010. In the event of an early retirement, where benefits are not reduced, there is a "strain" payment to cover the cost of the pension being paid earlier than retirement age.

1.2 The 2010 valuation allowance for non ill health early retirements for four employers, whereby the strain costs were funded by additional contributions, this will cease from the 2013 valuation in favour of the options proposed in this report.

1.3 This report puts forward various ways of paying the early retirement strains in 1.2 above it will not alter the funds policy for remaining employers. The policy for charging strain costs to employers is set out in LGPS Regulations giving the Fund complete discretion.

## 2. Options for meeting strain costs

2.1 The fund actuary has outlined different ways of collecting strain costs. Each option has advantages and disadvantages to consider.

**Option A – One off lump sum charged to the employer**

2.2 This option is easy to understand, administer, and would mean that the full strain amount is paid as and when the early retirement occurs i.e. there is no spreading of the strain cost over time. It also gives the highest level of security to the fund as the full cost is met at retirement.

2.5 The disadvantages of this method would be an immediate financial strain on employers as it is a move from the current approach.

**Option B – A chargeable lump sum spread over a number of years**

2.6 As option A, but with the flexibility of paying the capitalised cost over a small number of years. The main implications would be an interest cost for the employer and additional time taken to recover the strain for the fund.

**Option C - Spreading the costs over a small number of years through an increased contribution rate**

2.7 As long as the period is short (e.g. 5 years or less), the security to the Fund of this approach is still reasonably strong although not as strong as option A or B. Some employers may like this option as costs are spread, the reduced period on offer is also in line with similar schemes that use this policy.

2.8 There is an inconsistency in timings of the strain and the money to meet this strain i.e. the strain will happen at the start of year 1 but the full amount of money paid to meet this strain will not be paid until year 3 or 5. This will mean that the Fund will subsidise the strain until the full amount is paid. Also there may be discontent between those employers who pay a strain cost up front and those who are allowed to spread the payment through contribution rates.

**Option D – Paying a percentage of pensionable pay each year to pay for any strains that arise**

2.9 The fund will receive payment in advance of meeting strains and will be simple to administer. This method may suit small employers in particular as there will be no 'one off' large payments to be made (although, from the Fund's perspective, this option is generally more appropriate for larger employers where the numbers of members taking early retirement are much more predictable from year to year).

2.10 This method would involve an increase to employer contribution rates which may cause some discontent. Also costs would be borne by the fund at each valuation to review the percentage being paid. A further disadvantage would be where strains arise early on when not enough money has been raised to meet them.

## 3. Other consideration

3.1 There may be transitional issues when work begins on the 2013 valuation. A decision will need to be made on whether any new funding approach applies only to new retirements or whether the new approach will apply to past retirements too.

## 4. Conclusion

4.1 The Fund has discretion over the way in which these strains are met. If security of benefits is key then option A involves the least risk. However the Fund may want to balance the relationship with employers by moving to an option, or a number of the proposed options that offer greater flexibility.


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