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Item 11
Council
Date: 13 December 2018

Review of pension scheme funding

Purpose of paper	To present for agreement the result of the triennial valuation of the pension scheme and a recommendation for the amount of additional contribution to the scheme and future employer contributions.
Action	For decision.
Status	Public session
Corporate Strategy 2016-19	Objective 2: To improve our management of resources so that we become a more efficient regulator.
Business Plan 2018	Objective 2: Manage, the GDC's finances effectively, maintaining sufficient reserves to ensure resources are available to manage our statutory functions.
Decision Trail	The Finance & Performance Committee discussed the results of the triennial valuation, future employer contributions and the timing and amount of the level of an additional employer contribution to the scheme at its meeting on the 19 November 2018. The committee recommended the following for Council approval: • Agreement of the triennial valuation of the DB section of the scheme; • Employer contribution levels be set at 20.3% of pensionable salaries from 1 April 2019; • An additional employer contribution to the scheme of £2.3m
Recommendations	Council is asked to • Approve the triennial valuation of the DB section of the scheme, proposed by the actuary and accepted by the Trustee, be agreed. This will constitute approval of the principles underlying the valuation and the assumptions used by the actuary to arrive at a draft valuation surplus of £0.3m.; • Approve employer contribution levels be set at 20.3% of pensionable salaries from 1 April 2019 until reviewed by a subsequent valuation.

	• Approve an additional employer contribution to the scheme of £2.3m.
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Appendices	None

1. Executive summary

1.1. The results of the 2018 triennial valuation indicate that the scheme surplus has deteriorated from £1.5m (as at 1 April 2015) to £0.3m (as at 1 April 2018). Based on these initial results, the employer contribution rate will need to increase by 4.9%, rising from the current rate of 18% to 22.9%. Based on the current active membership, this would increase the annual cost to the GDC by £200k to £950k over the next five years.

1.2. The Finance & Performance Committee has previously suggested that additional contributions to the Plan, funded by the higher than budgeted 2017 GDC operating surplus, might go some way to addressing the deterioration in the funding level of the Plan, and that the maximum amount of additional funding should be £2m.

1.3. As a result, in the 2019 GDC budget the employer contribution rate was budgeted to increase from 18% to 20.3% from April 2019, and provision for an additional contribution of £2m in 2018 was made. Council considered these assumptions at their October meeting and requested that an increase in the additional contribution from £2m to £3m be explored, although provision for the maximum possible cost of which has been made in the 2018 Q3 forecast.

1.4. Lane, Clark, Peacock (the GDC's actuary) has been asked to provide professional advice to confirm that the valuation and its assumptions are appropriate, and to assist the GDC in its decision on whether to accept any proposal by the Trustee on changes to future employer contribution levels. They have advised that the Plan is well-funded on a prudent set of assumptions. However, the GDC should make clear that the assumptions remain subject to further review for future valuations.

1.5. Moreover, a one-off contribution from the GDC could be used to either offset part of the increase in the future service contributions and/or enable a lower risk investment strategy to be pursued.

1.6. LCP has suggested that the Trustee is asked to use the £308k surplus to subsidise the increase in future service contributions until the next triennial valuation, reducing the cost of the £950k per annum employer contribution (at 22.9%) by £100k to £850k per annum. £850k is equivalent to the 20.3% that has been budgeted. This leaves a decision to be made on the amount of any additional one-off contribution since the Committee must satisfy itself that after any contribution, the GDC's reserves are sufficient to meet the needs of the reserves policy.

1.7. The Trustee has considered different investment strategies presented by the scheme's investment adviser, offering different risk return trade-off characteristics for both the scheme and the GDC as the scheme sponsor, and the Trustee's choice of strategy has now been made. All strategies have a lower overall risk than the current strategy.

2. Introduction and background

2.1. Every three years, a formal valuation of the DB section of the pension scheme is carried out on behalf of the Trustee to assess and examine the ongoing financial position of the Plan (the triennial valuation). The 2015 triennial valuation was carried out by Quantum (the scheme's actuary responsible to the Trustee) and indicated a surplus of £1.5m as at 1 April 2015.

2.2. Annual funding updates were issued in 2016 and 2017. As at 1 April 2016, the annual funding update indicated that the DB section of the Plan had a deficit at that date of £0.5m – a c.£1.9m drop in the estimated funding level. The annual funding update as at 1 April 2017 indicated that the DB section's deficit was £2.4m – an extremely volatile funding level over a two-year period, leading to concerns that in the absence of any improvement by the 2018 triennial valuation, the GDC could see a significant increase in contributions to eliminate any deficit.

2.3. In Autumn 2017, the Finance and Performance Committee suggested that additional contributions to the Plan, funded by the higher than budgeted 2017 GDC operating surplus, might go some way to addressing the deterioration in the funding level of the Plan and requested work be undertaken to establish the GDC's options for accelerating any recovery plan for the scheme by making additional contributions.

2.4. Council agreed that the results of the triennial valuation as at 1 April 2018 would need to be known prior to making any decision on the amount of any additional cash injection.

3. The 2018 triennial valuation

3.1. The initial results of the 2018 triennial valuation were presented to the July 2018 trustee meeting. On a basis consistent with the 2015 valuation, with updated assumptions, the scheme surplus has deteriorated from £1.5m to £0.3m:

Funding result as at 1st April £000s	**2015** triennial	**2016** annual update	**2017** annual update	**2018** triennial
Technical provisions	22,800	26,383	33,546	34,252
Assets	24,262	25,917	31,186	34,560
Surplus/(Deficit)	**1,462**	**(466)**	**(2,360)**	**308**
Funding level	106%	98%	93%	101%

3.2. This deterioration is largely due to a worsening of market conditions, namely falling gilt yields (increasing the value of liabilities) and increased inflation (increasing the impact of index-linking pensions).

3.3. Based on these initial results, Quantum recommends that for five years, from 1 April 2019, the employer contribution rate will need to increase 4.9% from 18% currently to 22.9%. Based on the current active membership, this would increase the annual cost to the GDC by £200k to £950k over the next five years.

3.4. Since a £2m additional contribution to the scheme had already been considered pending the result of the triennial valuation, Quantum established that £2m would require an increase in the future service employer contribution rate from 18% to 20.3% over the future working lifetime, which is lower than the 22.9% proposed.

3.5. As a result, in the GDC 2019 budget the employer contribution rate has been budgeted to increase from 18% to 20.3% from April 2019, and provision for an additional contribution of £2m in 2018 has been made.

3.6. Council considered these assumptions at their October meeting and requested that an increase in the additional contribution from £2m to £3m be explored although provision for the maximum possible cost of which has been made in the 2018 Q3 forecast. Quantum have advised that a £3m additional contribution to the scheme would require an increase in the future service employer contribution rate from 18% to 19.2%, 1.1% lower than the 20.3% budgeted based on a £2m additional contribution.

4. LCP's advice to the GDC on the valuation's assumptions

4.1. Council must agree any actuarial assumptions with regard to the scheme and the financial implications of any proposed changes to pension arrangements

4.2. Lane, Clark, Peacock (LCP) has been asked to provide professional advice to confirm that the valuation and its assumptions are appropriate, and to assist the GDC in its decision on whether to accept any proposal by the Trustee on changes to future employer contribution levels.

4.3. LCP have provided their comments on the trustee's proposals which can be summarised as follows:

- The Plan is well-funded on a prudent set of assumptions;
- It would be appropriate for the GDC to accept the assumptions. However, GDC should make clear that the assumptions remain subject to further review for future valuations;
- The proposal to increase the terms for commutating pension for cash at retirement will increase the actual cost of benefits payable from the Plan but is consistent with the general trend, and the proposed rate of 22.7 at age 65 lies within a reasonable range.
- A one-off contribution from the GDC to the Plan could be used to offset part of the increase in the future service contributions

4.4. LCP has suggested that the Trustee could be asked to use the £308k surplus to subsidise the increase in future service contributions until the next valuation as at 1 April 2021. This would reduce the cost of the £950k per annum employer contribution (rate of 22.9%) by £100k to £850k per annum, for the next three years. £850k is equivalent to the 20.3% budgeted. A decision must then be made on the amount of any additional one-off contribution – to either reduce the employer contribution rate further or enable a lower risk investment strategy to be pursued.

5. Alternative investment strategy

5.1. At the March FPC meeting, LCP gave a presentation setting out advice to the Committee to assist with a review of the GDC's longer term objective for the DB section of the scheme and the GDC's views on a suitable balance between risk and return in the Plan's investment strategy.

5.2. In addition, LCP have previously advised that the GDC could propose investment changes to the Trustee that would be lower-risk than its current investment strategy. Discussions took place between the Head of Finance & Procurement and the Trustee on the options for de-risking the scheme, to which the Trustee was very receptive. It had already been agreed that Broadstone, the scheme's investment adviser would undertake an investment strategy review following the triennial valuation exercise.

5.3. On 29 August a meeting between the Head of Finance & Procurement, the Trustee, scheme actuary and investment adviser was held to discuss a plan for moving the scheme forward to where both employer and Trustee want it to be, which could include some hedging to reduce future funding volatility.

5.4. An investment strategy review is an appropriate next step following a triennial valuation and presents an opportunity to reduce the risk to the funding position. De-risking the scheme and reducing volatility has been previously discussed with the Committee as a key objective.

5.5. The scheme's investment adviser presented different investment strategies to the meeting which reduce the investment risk of the scheme and increase the level of hedging in the scheme investments against inflation and interest rate risk. This will have the effect of reducing the volatility of the scheme funding by ensuring that the scheme assets move in value in the same way as scheme liabilities. All parties are currently working together to design a new strategy that includes hedging, reduces investment risk and maintains enough opportunity for growth.

6. Additional employer contribution to the scheme

6.1. The Finance & Performance Committee has previously suggested that additional contributions to the Plan, funded by the higher than budgeted 2017 GDC operating surplus, might go some way to addressing the deterioration in the funding level of the Plan.

6.2. In setting the 2019 GDC budget, the employer contribution rate was budgeted to increase from 18% to 20.3% from April 2019, and provision for an additional contribution of £2m in 2018 was made. Council considered these assumptions at their October 2018 meeting and requested that an increase in the additional contribution from £2m to £3m be explored.

6.3. The current solvency figure for the scheme as of today has been estimated to be £13.7m by the Trustee's actuary. This is the estimated cost of facilitating a full insurance buy out of the scheme.

6.4. The Finance & Performance Committee considered options around an increased contribution at its November 2018 meeting, in tandem with their review of the financial reserves policy. A decision was reached to recommend an additional contribution of £2.3m, which ensures that we remain in line with our policy to retain a minimum of three months of operating expenditure in reserve. (This decision was reached by looking at our reserves on an unrestricted/free reserves basis).

7. Recommendation

7.1. Council is invited to:

- Agree the triennial valuation of the DB section of the scheme, proposed by the actuary and accepted by the Trustee. This will constitute approval of the principles underlying the valuation and the assumptions used by the actuary to arrive at a draft valuation surplus of £0.3m.
- Approve an increase in the employer contribution to 20.3% of pensionable salaries from 1 April 2019, until reviewed by a subsequent valuation.
- Agree an additional employer contribution of £2.3m to the scheme.