AGENDA ITEM 7

FALKIRK COUNCIL

Subject:	**FUNDING UPDATE**
Meeting:	**JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD**
Date:	**26 JUNE 2015**
Author:	**CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report updates the Pensions Committee and Pension Board on the latest funding position of the Falkirk Council Pension Fund.

2. BACKGROUND

2.1 The funding position is established every three years as part of the statutory valuation process. However, in the interests of good governance, the funding position is also reviewed annually.

2.2 The funding position shows the extent to which the Fund's liabilities are matched by its assets. Fund assets are the investments held by the Fund, whilst liabilities are the benefits promised to members in the future.

2.3 A funding level of less than 100% means that assets are less than liabilities and there is a funding deficit. A funding level of over 100% means there is a surplus and a funding level of exactly 100% means that assets are equivalent to liabilities.

2.4 In assessing the funding position, assets are calculated at their market value and liabilities on the return on government bonds (i.e. the lower the return on bonds, the higher the value placed on liabilities).

2.5 An estimate of the funding position at 31 March 2015 has been calculated by Hymans Robertson, the Fund's Actuary. This has been based on based on cash flows and investment returns arising since the triennial valuation at 31 March 2014.

2.6 A copy of the funding report is attached as an Appendix to this report.

3. FUNDING UPDATE

3.1 The policy of the Fund is to achieve a funding level of 100% so that the Fund's liabilities are matched exactly by the assets.

3.2 The funding position at 31 March 2014 and the current funding position are set out below:

	As at 31/03/2014	As at 31/03/2015
Fund Assets	£1,577m	£1,820
Fund Liabilities	£1,860m	£2,297
Funding Deficit	£283m	£477m
Funding Level	**84.8%**	**79.3%**

3.3 The decline in the funding level is attributable to an increase in liabilities which has been triggered by a fall in gilt yields from 5.1% at March 2014 to 3.8% at March 2015.

3.4 Whilst the funding level is a useful measure of financial standing, it is volatile and can change by several percentage points in just a few months. For example, the funding level in late 2011 was 67% but recovered to 86% by March 2014. The strength of employer covenants within the Fund mean that it can afford to take a long term approach to funding liabilities and not feel obliged to react to every change in the funding level.

3.5 The funding level is also an important factor in setting investment strategy. The Committee has agreed to de-risk and reduce the Fund's exposure to market volatility. However, whilst it is sensible to have a de-risking plan in place, implementation will have to await better financial conditions (i.e. an improving funding level and more attractive pricing of bonds).

4. CONCLUSION

4.1 The funding position has deteriorated to 79% since the 2014 valuation. Despite asset returns being ahead of actuarial assumptions, falling gilt yields have triggered a rise in fund liabilities.

5. RECOMMENDATION

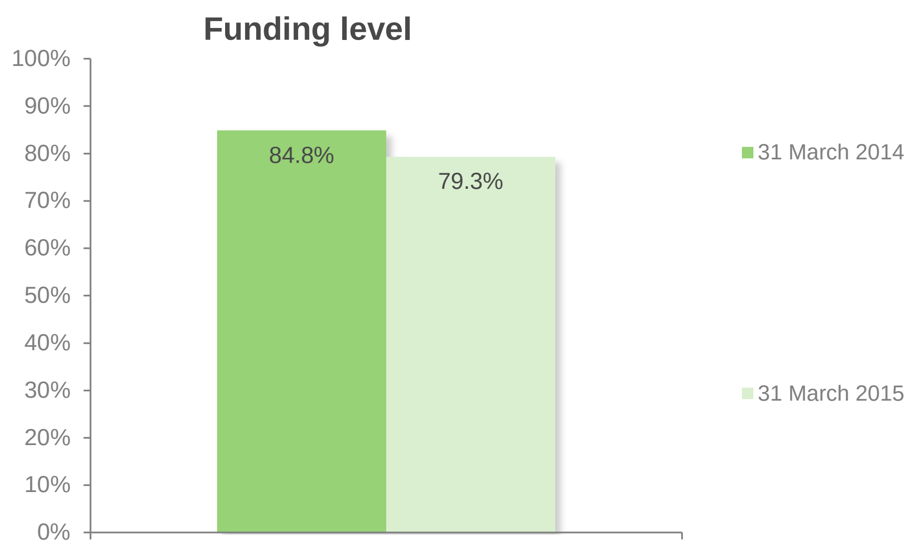
5.1 The Committee and Board are asked to note the funding position as at 31 March 2015 and are invited to comment as appropriate.

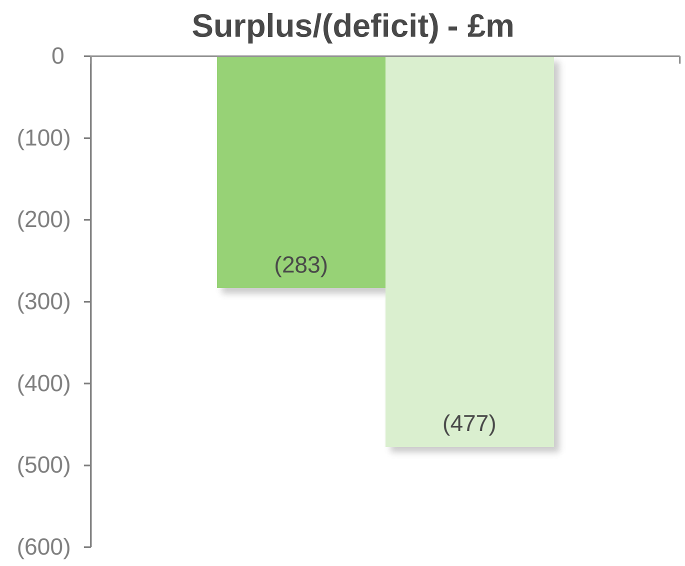
……………………………………….
Chief Finance Officer

Date: 10 June, 2015

BACKGROUND PAPERS
NIL

Funding update as at 31 March 2015
Falkirk Council Pension Fund





HYMANS ROBERTSON

Summary

This funding update is provided to illustrate the estimated development of the funding position from 31 March 2013 to 31 March 2015, for the Falkirk Council Pension Fund ("the Fund"). It is addressed to Falkirk Council in its capacity as the Administering Authority of the Falkirk Council Pension Fund and has been prepared in my capacity as your actuarial adviser.

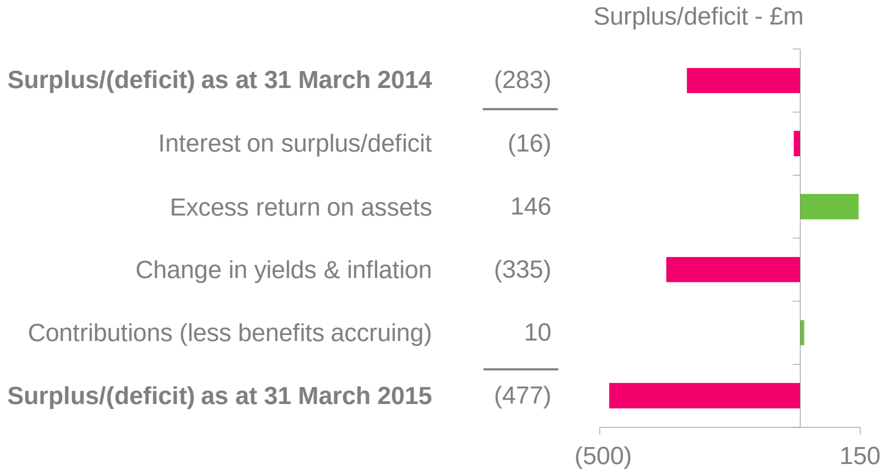
The funding level at the latest formal valuation was 84.8%. As at 31 March 2015 the funding level has decreased to 79.3%. This is largely as a result of a decrease in bond yields, and subsequent discount rate, which places a higher value on the Fund's liabilities. This has been offset by a decrease in expectations of inflation.

This report has been produced exclusively for the Administering Authority. This report must not be copied to any third party without our prior written consent.

This report looks at the whole fund position and does not allow for the circumstances of individual employers. The results for individual employers can be quite different to the Fund as a whole depending on their own experience and the profile of their liabilities. Differences in the relationship between the ratio of accrued liabilities and the payroll can have a large influence on changes in contributions.

Steven Scott
Fund Actuary

What's happened since the last update – ongoing funding basis



Differences between this funding update and a full actuarial valuation

The accuracy of this type of funding update calculation is expected to decline over time as the period since the last valuation increases. This is because this funding update does not allow for changes in individual members' data since the last valuation.

Details of the approach used in this funding update are given in the appendix.

The figures in tables throughout this document may not add up due to rounding.

HYMANS ROBERTSON LLP

Estimated financial position at 31 March 2015

Ongoing funding basis

£m	31 Mar 2014	31 Mar 2015
Assets	1,577	1,820
Liabilities	1,860	2,297
Surplus/(deficit)	**(283)**	**(477)**
Funding level	84.8%	79.3%

Gilts funding basis

£m	31 Mar 2014	31 Mar 2015
Assets	1,577	1,820
Liabilities	2,572	3,209
Surplus/(deficit)	**(996)**	**(1,389)**
Funding level	61.3%	56.7%

Investment Return

Quarter Ending	%
30/06/2014	2.3%
30/09/2014	2.4%
31/12/2014	3.1%
31/03/2015	5.7%

The estimated returns (to 31 March 2015) are based on the most recent asset allocation shown on page 6 and the indices set out on

Basis summary

	31 Mar 2014	31 Mar 2015
Pre retirement discount rate		
Nominal	5.1%	3.8%
Real	1.6%	0.6%
Post retirement discount rate		
Nominal	5.1%	3.8%
Real	1.6%	0.6%
Salary increase rate	4.0%	3.7%

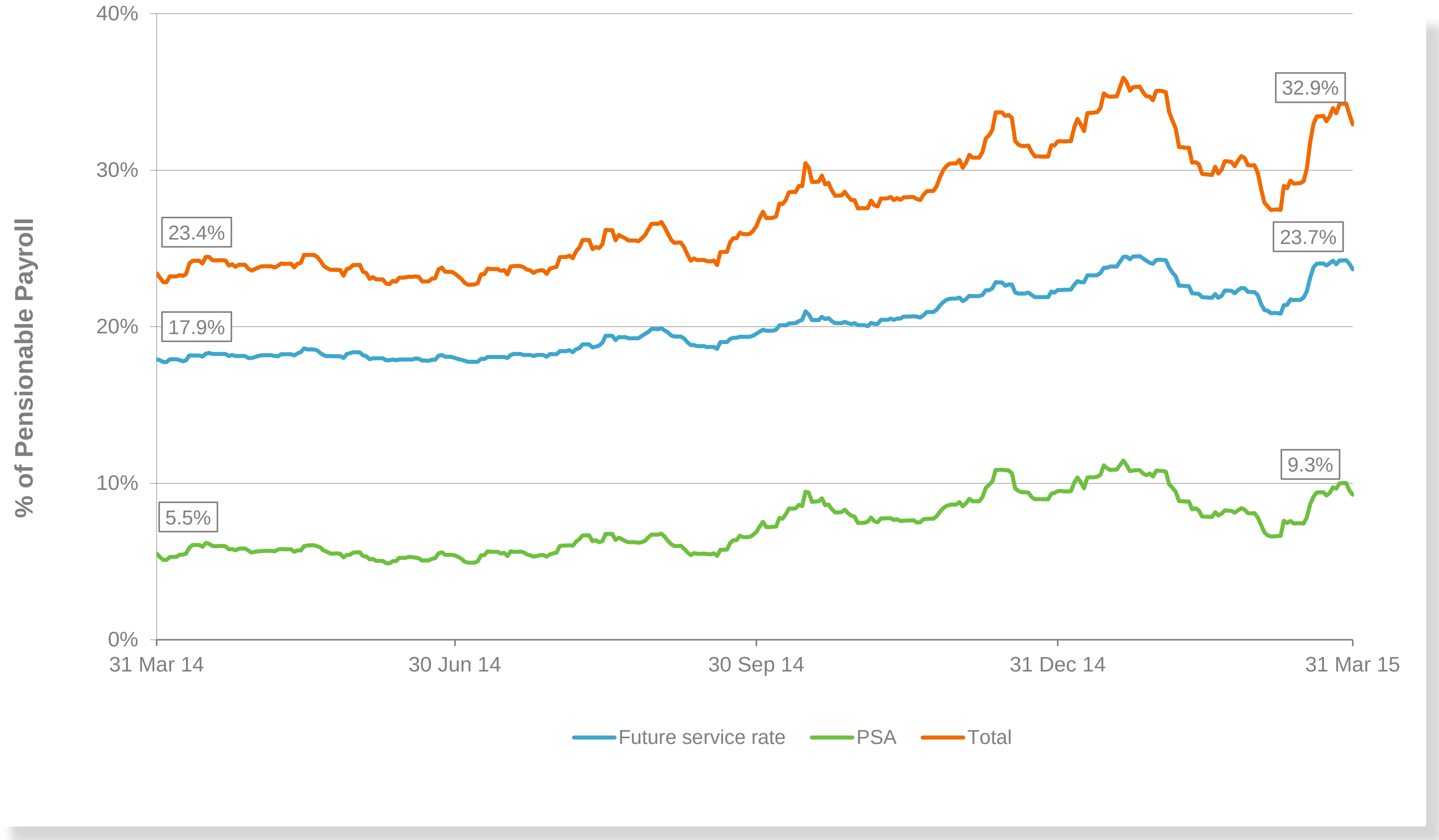
The assumptions underlying the funding bases are set out in the Funding Strategy Statement. They are those set for the 2013 valuation of the Fund updated for market conditions as at the calculation date.

Market indicators

	31 Mar 2014	31 Mar 2015
Market yields (p.a.)		
Fixed interest gilts	3.46%	2.24%
Index linked gilts	-0.04%	-0.90%
Implied inflation (RPI)	3.50%	3.20%
Implied inflation (CPI)	2.70%	2.40%
AA corporate bonds	4.30%	3.10%
AOA	1.60%	1.60%
Price indices		
FTSE All Share	3,556	3,664
FTSE 100	6,598	6,773

Change in funding level since last valuation

Change in contribution rate



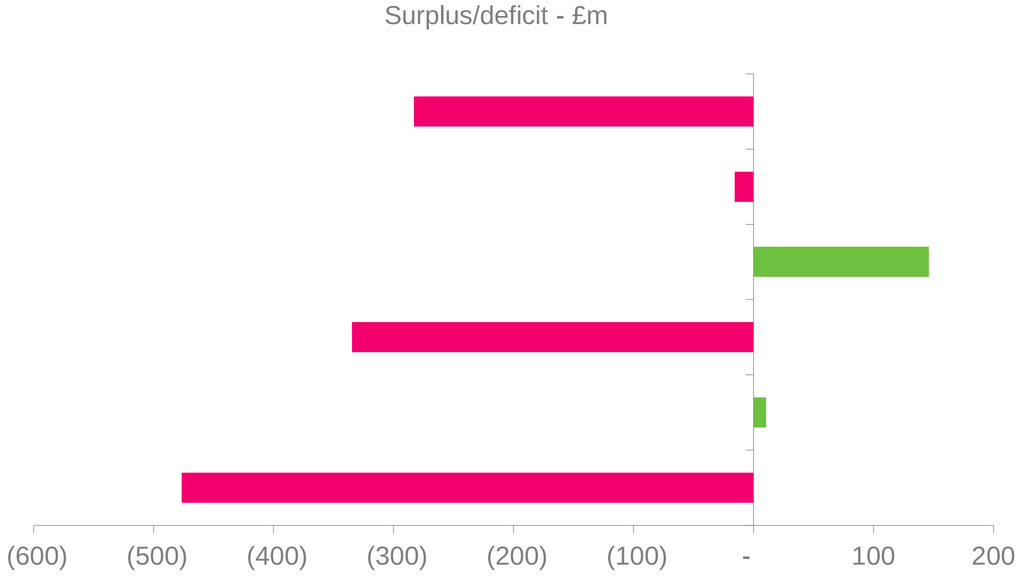
What's happened since last valuation? – ongoing funding basis

Assets		£m
Asset value as at 31 March 2014	**1,577**	
Contributions paid in:		76
Benefit payments:		(60)
Expected return on assets:		81
Excess return on assets:		146
Asset value as at 31 March 2015	**1,820**	

Liabilities		£m
Liability value as at 31 March 2014	**1,860**	
Cost of benefits accruing:		66
Interest on liabilities:		97
Change in yields & inflation:		335
Benefit payments:		(60)
Liability value as at 31 March 2015	**2,297**	

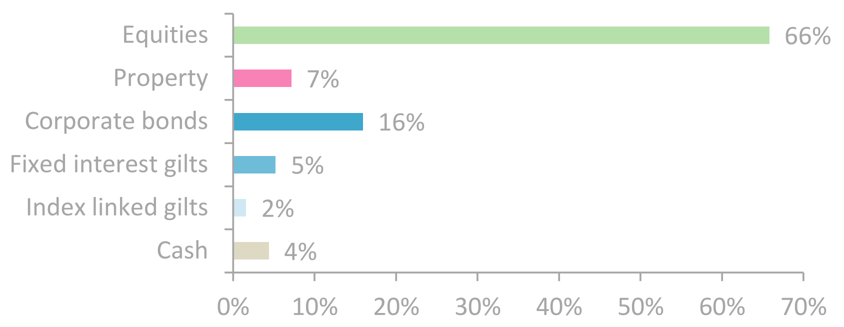
Overall effect

Surplus/(deficit) as at 31 March 2014	(283)
Interest on surplus/deficit	(16)
Excess return on assets	146
Change in yields & inflation	(335)
Contributions (less benefits accruing)	10
Surplus/(deficit) as at 31 March 2015	(477)

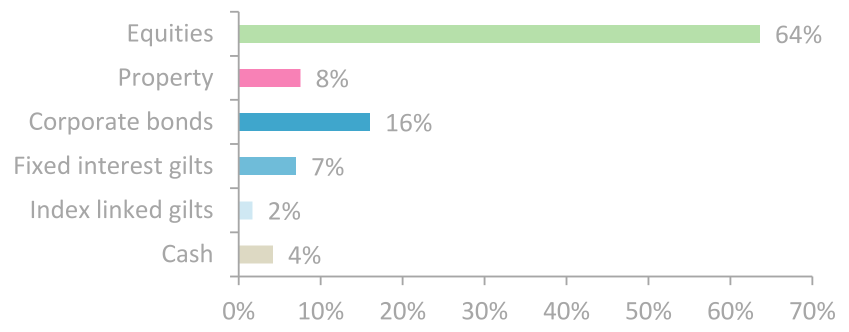


What caused your assets to change?

Allocation at valuation date



Allocation at 31 March 2015



Sterling total returns of major asset classes

Sensitivity matrix – ongoing funding basis

Better outcomes →

Bond yields (% p.a.)	4,741	5,418	6,096	6,773	7,450	8,128	8,805
2.85	68.7% (636)	75.1% (507)	81.4% (377)	87.8% (248)	94.2% (118)	100.6% 11	106.9% 141
2.65	66.6% (707)	72.7% (578)	78.8% (448)	84.9% (319)	91.0% (189)	97.2% (60)	103.3% 70
2.44	64.4% (784)	70.3% (654)	76.2% (525)	82.1% (395)	87.9% (266)	93.8% (136)	99.7% (7)
2.24	62.3% (865)	68.0% (736)	73.6% (606)	79.3% (477)	84.9% (347)	90.5% (218)	96.2% (88)
2.04	60.3% (952)	65.7% (823)	71.1% (693)	76.5% (564)	81.9% (434)	87.3% (305)	92.7% (175)
1.84	58.2% (1,046)	63.4% (916)	68.6% (787)	73.7% (657)	78.9% (528)	84.1% (398)	89.3% (269)
1.64	56.2% (1,146)	61.2% (1,016)	66.1% (887)	71.1% (757)	76.0% (628)	81.0% (498)	85.9% (369)

Equity level (using FTSE 100 Price Index as a proxy)

Better outcomes ↑

79.3%	Funding level
(477)	Surplus/(deficit) – £m

Appendix: Scope, methodology, reliances, limitations and market data

Scope

This funding update is provided to Falkirk Council as the Administering Authority of the Falkirk Council Pension Fund to illustrate the funding position as at 31 March 2015. It should not be used for any other purpose. It should not be released or otherwise disclosed to any third party except with Hymans Robertson LLP's prior written consent, in which case it is to be released in its entirety. Hymans Robertson LLP accepts no liability to any third party unless we have expressly accepted such liability in writing.

Compliance with professional standards

The method and assumptions used to calculate the updated funding position are consistent with those used in the latest formal actuarial valuation, although the financial assumptions have been updated to reflect known changes in market conditions. As such, the advice in this report is consistent with that provided for the last valuation, as set out in the:

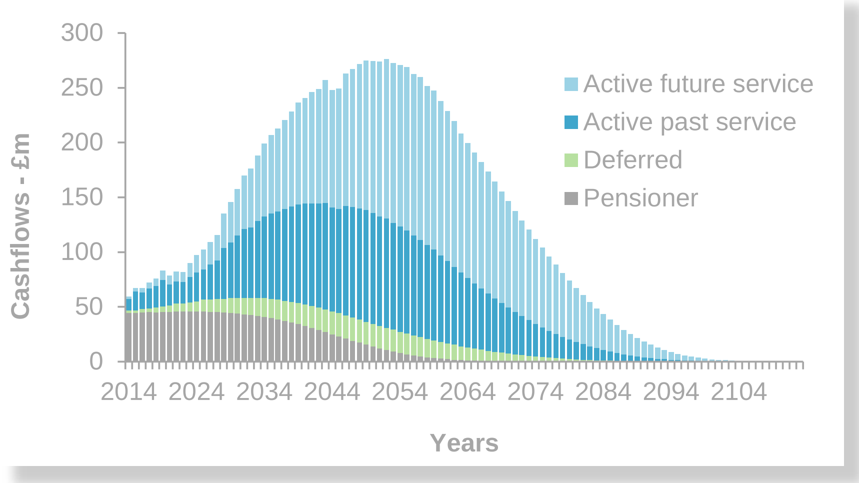
- Valuation Assumptions Briefing Note
- Funding Strategy Statement
- Valuation Report
- Rates and Adjustments Certificate

This update therefore complies with the following Technical Actuarial Standards (TASs):

- Reporting ("TAS R")
- Modelling ("TAS M")
- Data ("TAS D")
- Pensions TAS

How liabilities are calculated

- The future benefits that are payable from the Fund ("cash-flows") were calculated on a specific set of assumptions at the last valuation date.
- These cash-flows (on the ongoing funding basis) are shown below.
- These cash-flows were adjusted using available financial and Fund information to produce estimated cash-flows at post valuation dates.
- The specific information used for this update is set out on the next page.
- Market information is used to produce discount rates at these dates.
- The estimated cash-flows are discounted to produce the estimated liability value at a specific date.



How assets are calculated

Assets are projected from the valuation date allowing for actual or estimated Fund cash-flows, actual quarterly returns (where available) and daily benchmark indices.

The update allows for:

1 Movements in the value of the assets as measured by index returns and data from the administering authority where available.
2 Movements in liabilities as a result of changes in yields and hence inflation and discount rate assumptions.
3 Estimated cash-flows (contributions and benefit payments).
4 Expected accrual of benefits for employee members accrued since the last valuation (based on projected salary roll).
5 Demographic experience in line with assumptions.
6 Variations in liabilities arising from the changes in RPI since the valuation date differing relative to assumptions.
7 Benefit accrual in line with the 2015 scheme.

The update does not allow for:

1 Asset allocations differing from those assumed (other than when asset data is recalibrated based on available information).
2 The asset values as at the date of this report have not been based on audited Fund accounts.
3 Variations in liabilities arising from salary rises differing relative to assumptions.
4 Differences between estimated and actual salary roll of employees.
5 Variation between actual and expected demographic experience (e.g. early retirement or mortality).

Membership data

My calculations are based on the membership data provided for the most recent actuarial valuation. Details on the quality of this data and a data summary can be found in the last formal actuarial valuation report.

Limitations of this model

In the short term, the typical main contributors to funding position volatility are movements in the value of assets held, liability changes due to yield movements, benefit changes and deficit contributions to the Fund.

The accuracy of this type of funding update calculation is expected to decline over time. Differences between the position shown in this report and the position which a valuation would show can be significant; particularly if there have been volatile financial markets or material membership changes (these are more likely to occur in smaller Funds). It is not possible to fully assess the accuracy of this update without carrying out a full actuarial valuation.

Liability calculations are performed on the valuation date, the funding update date, anniversaries of the valuation date and each month-end in between. Interpolation is used for other dates shown in graphs. Some asset classes are not easily tracked by the benchmark indices used in this model which can lead to significant differences between actual and projected asset values.

Indices used to update projected asset values

Some of the following indices have been used to update projected asset values in this funding update.

- FTSE 100
- FTSE 250
- FTSE Small Cap
- FTSE All Share
- FTSE All World Series North America (£)
- FTSE All World Series Japan (£)
- FTSE All World Series Developed Europe (£)
- FTSE All World Series Developed Asia Pacific (£)
- FTSE All World Series All World Developed Ex UK (£)
- FTSE All World Series All World Ex UK (£)
- FTSE All World Series All Emerging (£)
- UK Government Fixed Interest Gilts (Over 15 Years)
- UK Government Index-Linked Gilts (Over 5 Years)
- UK Government Index-Linked Gilts (Over 15 Years)
- iBoxx A rated UK Corporate Bonds (Over 15 Years)
- iBoxx AA rated UK Corporate Bonds (Over 15 Years)
- iBoxx AAA rated UK Corporate Bonds (Over 15 Years)
- iBoxx All Investment Grades rated UK Corporate Bonds (Over 15 Years)
- IPD Property
- Cash Indices LIBOR 1 Month

The indices are a standard list and are not necessarily the same indices that managers have been asked to track or beat. All indices used to estimate projected asset values are total return indices. However, the market indicators quoted in this report are price indices, as these are more widely recognised.

Market information used to update liability values

Some of the following market information has been used to update liabilities values in this funding update.

- FTSE Actuaries UK Fixed Interest Gilts Yields (Over 15 Years)
- FTSE Actuaries Index-Linked Gilts (3% Inflation) Yields (Over 15 Years)
- iBoxx AA rated UK Corporate Bond Yields (Over 15 Years)

Note: Market yields displayed in the market indicators table are on an annual basis.