PENSION FUND EMPLOYERS (SCOTTISH BORDERS COUNCIL) CONTRIBUTION RATE

Report by Director of Finance & Procurement

PENSION FUND COMMITTEE AND PENSION BOARD

17 January 2024

1 PURPOSE AND SUMMARY

1.1 **This report provides the Pension Fund Committee and Board with a proposal for setting the Scottish Borders Council employers contribution rate from 2024/25 onwards. The report will be referred on to Scottish Borders Council to be considered as part of the 2024/25 financial planning process.**

1.2 As part of the key risk management activities of the Pension Fund, a triennial actuarial revaluation exercise is undertaken. This exercise ensures the Fund complies with legislation, analyses actual experiences versus assumptions over the previous 3 year period, reviews the funding strategy statement, is part of the continual health check on the solvency of the Fund and is used to calculate the employer contribution rates.

1.3 The last triennial revaluation was undertaken by Hymans Robertson based on the position at 31st March 2020 when the fund was assessed as being 110% funded.

1.4 On commencing the revaluation process for 2023, an assessment has been made on asset and liability movements since 2020 up to 31st March 2023. The Fund has experienced significant asset returns in the first half of the inter-valuation period, due to the bounce-back from the Covid-19 market fall in February/March 2020. This positive picture has been compounded by a material fall in liability values in the second half of the inter-valuation period due to rising interest rates. **This most recent revaluation assessed the fund to be 134% funded.**

1.5 A range of scenarios considering contribution rates have been undertaken and based on these it is recommended that, in order to recognise the positive results from the triennial revaluation but to maintain an appropriate level of prudence, that the Scottish Borders Council contribution rate moves to 17% from 2024/25 through to 2027/28. The position will be kept under review annually.

2 RECOMMENDATIONS

2.1 It is recommended that Pension Fund Committee:

(a) Notes the revaluation process undertaken by Hymans Robertson;

(b) Notes the contribution rate scenarios modelled; and

(c) Agrees that the requested level of contribution from Scottish Borders Council from 2024/25 is 17%.

3 BACKGROUND

3.1 As part of the key risk management activities of the Pension Fund, a triennial actuarial revaluation exercise is undertaken by the Pension Fund Actuary, Hymans Robertson. The aim of the revaluation process is to assess the value of the Fund's assets (assets held today plus future investment returns and contributions) and liabilities (benefits earned to date and in the future) and to set a contribution rate for all participating employers in the fund. The fund needs to strike a balance between higher contributions and lower investment risk or lower contributions and higher investment risk. This is the key valuation decision.

3.2 The last triennial revaluation was undertaken at 31st March 2020 when the fund was assessed as being 110% funded. This most recent revaluation is based on the position at 31st March 2023 which assessed the fund as being 134% funded.

4 CHANGES SINCE 2020

4.1 On commencing the revaluation process for 2023, an assessment was made on asset and liability movements since 2020. The Fund has experienced significant asset returns in the first half of the inter-valuation period, due to the bounce-back from Covid-19 market fall in February/March 2020. This positive picture has been compounded by a material fall in liability values in the second half of the inter-valuation period due to rising interest rates.

4.2 Key assumptions are made on the following aspects of the Fund and include:

- Future investment return expectations including discount rate assumptions (assessing the present value of future benefits)
- Benefit increases
- Longevity trends

4.3 The following table shows the key revaluation assumptions for 2023.

Financial assumption	31 March 2023	Required for	31 March 2020
Discount rate	5.2% pa	To place a present value on all the benefits promised to scheme members at the valuation date. The Fund's assets are estimated to have a 80% likelihood of returning above the discount rate.	3.8% pa*
Benefit increases/CARE revaluation	2.3% pa	To determine the size of future benefit payments.	1.9% pa
Salary increases	3.0% pa	To determine the size of future final-salary linked benefit payments.	2.6% pa

*Based on a 70% likelihood of success in 2020

	31 March 2023	31 March 2020
Male pensioner	20.6 years	20.9 years
Male non-pensioner	21.2 years	21.9 years
Female pensioner	23.3 years	23.5 years
Female non-pensioner	24.9 years	25.4 years

Pensioners are assumed to be aged 65 at the respective valuation date and non-pensioners are assumed to be aged 45.

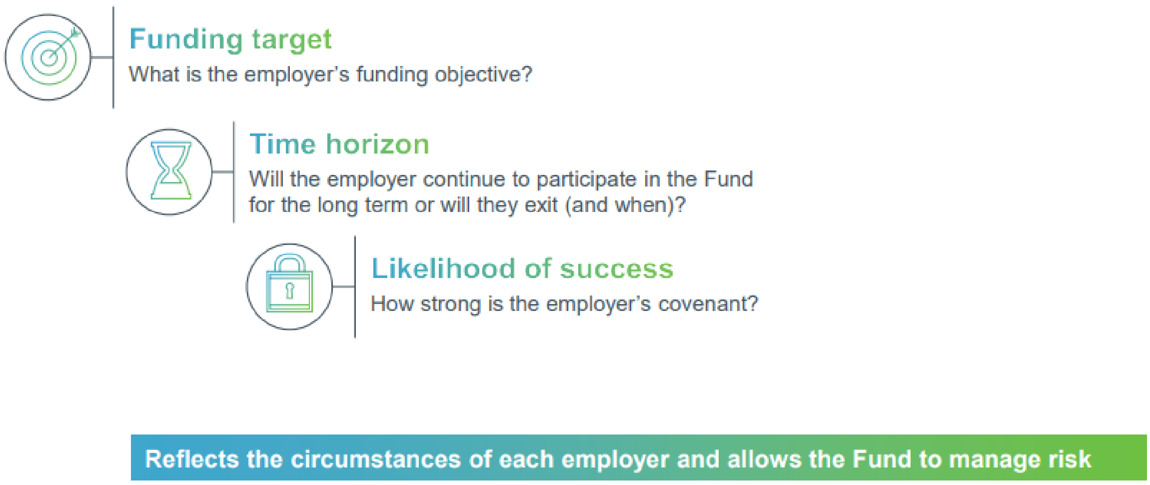
Robust and evidenced based approach to agreeing assumptions

4.4 When assessing the impact of changes from 2020 to 2023, in net terms, the key change has been the change in assumed future investment returns as a result of the change in market conditions over the period.

5 CONTRIBUTION RATE

5.1 Following the agreed assumptions around investment income, consideration needs to be given to the appropriate contribution rate, over the following 3 year period, to meet the cost of benefits that continue to be earned and to ensure the fund will have sufficient assets to pay pensions over the long term. The current contribution rate for Scottish Borders Council is 18.5%. Based on the results of the triennial revaluation contribution rates now need to be reviewed for the 3 financial years from 2024/25.

5.2 There are 3 steps to setting a funding strategy as shown below.



5.3 The Fund operates a Contribution Stability Mechanism (CSM) for its long-term secure employers. The CSM is designed to keep contributions stable through the peaks and troughs of market cycles. Any annual changes to contribution rates are therefore restricted to +/- 0.5% of pay. Stabilisation takes a long-term approach to setting contribution rates which cuts through short-term funding 'noise' ("underpay in the bad times, overpay in the good") and is an explicit mechanism documented in the FSS. At each revaluation, the Fund must check that the funding plan remains appropriate and use that plan to set contribution rates for the Pool.

5.4 The very high level of success measures confirmed by the current funded level of 134% suggests that there may be room for further reductions in contribution rates. This is due to the expectation that investment returns in the future will be higher than at the previous revaluation.

Modelling of contribution rates from 1st April 2024 has been undertaken utilising 4 scenarios:

- Maintain a rate of 18% until 2027
- 0.5% step down per annum until 2027
- 1% step down per annum until 2027
- Immediate reduction to 15% until 2027

This suggests that any of the contribution scenarios modelled for the next 3 years are appropriate with a likelihood of success of over 80%. The proposal to reduce the contribution also confirms that maintaining the contribution stability mechanism remains appropriate in the long-term.

5.5 Moving to a target funding level of 117% has also been modelled to consider the extent of surplus retention within the contribution rate strategies (ie retaining half of the current surplus to act as a buffer against future adverse experience). The first three contribution scenarios noted in 5.3 continue to meet the minimum likelihood of success threshold (80%). There is also no change in downside risk compared to a 100% funding target. This suggests that any of the first three contribution scenarios modelled for the next 3 years are appropriate and means the Fund can adopt any of the first three contribution rate scenarios to achieve:

- An explicit aim of retaining some surplus

- A reduction in contribution rates
- Retaining a contribution rate stability mechanism

5.6 Based on the results above it is recommended that, in order to recognise the positive results from the triennial revaluation but to maintain an appropriate level of prudence, that the Scottish Borders Council contribution rate moves to 17% from 2024/25 through to 2027/28. Taking a cautious position at a contribution rate of 17% rather than moving straight to 15% provides an appropriately prudent level of annual income to pay the majority of pensioner benefits, thereby reducing the pressure on investment returns to pay current pensions. Contribution levels will be kept under review as we move forward.

6 IMPLICATIONS

6.1 Financial

There are no additional anticipated financial implications on the Scottish Borders Council Pension Fund, with the recommended Scottish Borders Council contribution rate of 17% being assessed as sufficient to ensure a fully funded position over the 20 year horizon with a high degree of confidence as explained in 6.2 below. Financial implications for Scottish Borders Council will be reflected in the Council's 2024/25 financial planning process.

6.2 Risk and Mitigations

There is a risk that the assumptions made to inform the Scottish Borders Council contribution rate may be incorrect resulting in a lower or higher contribution rate being applied than that required. This is mitigated by the Actuary's use of asset liability modelling, giving 5,000 different outcomes for future market and economic conditions giving a distribution of outcomes. The approach taken results in 80% of the 5,000 scenarios showing the Fund in a fully funded position in 20 years time.

This particular Risk is captured within the Funding risk category of the refreshed Pension Fund Risk Register, a summary of which was most recently presented to the Committee/Board in December 2023, along with the control measures and mitigation actions stated above that are designed to reduce the likelihood and impact of the risk materialising.

6.3 Integrated Impact Assessment

It is anticipated there will be no adverse impact due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals contained in this report.

6.4 Sustainable Development Goals

There are no significant effects on the economy, community or environment.

6.5 Climate Change

The contribution rate strategies modelled have been tested against three climate change scenarios. The contribution rate strategies remain appropriate under the scenarios modelled.

6.6 Rural Proofing

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

6.7 Data Protection Impact Statement

There are no personal data implications arising from the proposals contained in this report.

6.8 **Changes to Scheme of Administration or Scheme of Delegation**

There are no changes to the Schemes of Administration or Delegation as a result of this report.

7 CONSULTATION

7.1 The Monitoring Officer/Chief Legal Officer, the Chief Officer Audit and Risk, the Director (People Performance & Change), the Clerk to the Council and Corporate Communications are being consulted on this report and any comments will be incorporated into the final report.

Approved by

Suzy Douglas **Signature ....**
Director of Finance & Procurement

Author(s)

Suzy Douglas	Director of Finance & Procurement 01835 824000 X5881

Background Papers:
Previous Minute Reference: Pension Fund Committee & Board 12th December 2023

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