Report to:	Police Authority
Agenda item:	5
Date:	22 September 2010
Subject:	Pensions Valuation
Sponsor:	Authority Finance Director
For:	Discussion and Agreement

BTPA
British Transport Police Authority

The Forum
5th Floor North
74-80 Camden Street
London NW1 0EG

T: 020 7383 0259
F: 020 7383 2655

www.btpa.police.uk

1. Purpose of Paper

1.1 The purpose of this paper is to present to the Authority the proposed set of assumptions used for placing a value on the Fund's Technical Provisions (or liabilities) as part of the latest triennial valuation of the British Transport Police Staff section of the Railways Pension scheme.

1.2 Members are asked to agree the Funds draft valuation results which are set out in section 3, where an analysis of the movements since the last valuation in 2007 is included.

1.3 Members are also invited to discuss and agree the treatment of the provisional pension surplus as at 31 December 2010.

2. Assumptions

2.1 The last formal valuation (carried out as at 31 December 2007, the "2007 valuation") showed a deficit of £0.8m on an asset base of £44.7m. As a result of this deficit, it was recommended that the joint contribution rose from 23.66% (members 9.2%; employer 14.46%) to 25.15% (members 10.06%; employer 15.09%).

2.2 The initial draft results of the actuarial valuation as at 31 December 2010 (the "2010 valuation") were reviewed by the Executive and the assumptions around future pay and promotional allowance were reduced in line with our proposition. This was approved by the RPS Benefits and Funding Committee in June.

2.3 Unlike the valuation of the 2009 Police Officers scheme, which is a stand alone section, the assumptions for our section of the RPS scheme are much more generic and the only flexibility given on changing the assumptions is around the covenant rating and the pay / promotion assumptions.

2.4 The key assumptions are set out below:

Key Assumptions – Long Term	Nominal	Relative to RPI	Notes
Discount Rates			
- Pre Retirement	7.59%	4.25%	
- Post Retirement	5.78%	2.50%	
Other Key Assumptions			
RPI	3.20%	-	
CPI	2.40%	(0.78)%	
Pay Inflation	4.23%	1.00%	See below para 2.5
State pension increases	4.50%	1.26%	
Expense inflation	4.50%	1.26%	

The discount rates used are dependent upon the covenant strength and we were deemed to have the strongest covenant. The future investment returns assumed are therefore the highest available in the scheme across the sections. A movement of 1% would change the surplus by £500k.

2.5 The only key assumption that could be changed, independently from the other schemes, relate to pay assumptions, as these vary by section. The original assumption was that wage inflation would be RPI plus 1.5% from January 2011. As the outcome of the Winsor review is still unknown, it was recommended that the following pay assumptions were adopted:

Pay year commencing:	
1 July 2011	3% increment (to represent one spine point increase) and nil pay grade increase
1 July 2012	3% increment (to represent one spine point increase) and nil pay grade increase
1 July 2013 and thereafter	RPI plus 1% as a prudent estimate of future pay awards

We informed the trustee that the position post 1 July 2013 is deemed by the BTPA to be a prudent assumption. Given the savings that we will have to make over the next five years, we would envisage that any pay settlement will be well below this level but as nothing is yet agreed, this is a prudent assessment of future pay increases. This was accepted by the Trustee and incorporated in this valuation.

3. Actuarial Valuation – Results

3.1 The draft results, incorporating the assumptions are summarised below:

	£m	£m
Value of Benefits arising from Service to 31 December 2010.		
- Pensioners	10.5	
- Deferred Pensioners	9.6	
- Serving members	30.4	
- BRASS	2.7	
Total Technical provisions		**53.2**
Assets at market value (exc. BRASS)	55.7	
BRASS funds	2.7	
Assets for funding purposes		**58.4**
Surplus in relation to Technical Provisions		**5.2**
Value of additional contributions as set out in the rules		2.2
Surplus under the rules (allowing for contributions payable)		**7.4**
Rate funding level		**114%**

The scheme is therefore has a surplus of £7.4m after taking into consideration the future contributions already agreed, at the last valuation, to 30 June 2012.

3.2 In order to better understand the valuation and why we have such a strong financial position, it is worthwhile looking at the reasons, of the movement (in percentage terms) from the previous deficit of 98.3% to the current draft funding level of 114.0%. This is set out in the following table. It is worth noting that the change in CPI pension indexation, instead of using RPI, has improved the funding position by 13 percentage points; and this was more than offset by the poor investment returns over the three year period (down 16%).

	Net %
2007 valuation – net deficit	**98**
Movement in investments	(16)
Allowance for future mortality improvements increases to 2013	(3)
Pay increases experienced less than previous assumptions	4
Change to early retirement factors for deferred pensioners	4
Impact of pension increases with CPI	13
Higher JCR to June 2012 as agreed at last valuation	5
Other miscellaneous experience	9
2010 valuation net deficit	**114**

3.3 If there had been no change in the basis of the annual increase in the pensions order from RPI to CPI, we would be in a very different position, with a marginal surplus and no scope to reduce contributions.

3.4 Members are asked to agree the assumptions and the level of past service surplus at £7.4million, which will then be presented to the Trustee Board.

4. Treatment of the surplus

4.1 Once the assumptions have been approved and the value of past service deficit finalised, it will be necessary to agree how we deal with the surplus. The surplus can be dealt with in a number of ways

- Make an allowance for poor investment returns post June 2011.
- Use the surplus to de-risk the investment portfolio, although as this scheme is relatively young, in terms of its membership profile, this may not be supported by the Trustee.
- Reduce the JCR from 1 July 2012

4.2 There are a number of risks within the valuation; the main one is that the scheme assets were valued when the FTSE 100 was above 6,000, since the valuation date the world markets have fallen by around 10%. In addition to this, the investment returns are relatively high at 4.25% above RPI. In times of high inflation, this return becomes more difficult to achieve. That said, the valuation has a relatively large surplus which would cushion the fund from any future deterioration in the aggressive assumptions.

4.3 The actuary always recommends a schedule of future contributions which sets out what the future JCR would need to change to in order to be in a balanced position. The joint contribution rate is currently 25.15%. The schedule of contributions, both historic and recommended, is set out below:

	Member	Employer	Total
	%	%	%
Actual contribution 1/1/05 – 31/3/07	9.2	-	9.2
Actual contribution 1/4/07 – 30/6/09	9.2	14.46	23.66
Actual contribution 1/7/09 – 30/6/12	10.05	15.09	25.15
Recommended future contribution 1/7/12 – 30/6/18	7.98	11.97	19.95

4.4 If the maximum reduction is applied. The employees will benefit from increased net pay from July 2012, and the employer will have a reduction in contribution of £750k, including benefit for L Area Police staff. This would marginally reduce the benefit from pensions plus. Each percentage drop in employers' contribution represents a gross saving to BTP of around £250k, as the current section pay is £24.9 million.

4.5 The financial advantage of reducing contributions will be seen immediately, however we should also bear in mind that at the last valuation, the staff increased their contributions to more than 10%, there was very little drop out from the scheme. If we were to reduce contributions now and then because of poor investment performance, in three years time needed to increase them, it would require careful management and perhaps a consistent rate would be preferred by the employees. Any future increase in contributions is always less palatable to the employee.

4.6 We could decide to reduce the JCR to say 22.5%, which would yield some savings for both the employee and employer and prudently protect part the surplus.

5. Next steps - Valuation

5.1 The next step in the valuation process is for the Trustee to agree the assumptions underlying the calculation of the Technical Provisions and therefore the surplus.

5.2 BTPA needs to agree the treatment of the surplus and whether or not it wishes to reduce the JCR for the scheme. No decision on this is required to be finalised until early 2012. All documentation needs to be finalised by the Trustee by 31 March 2012.

6. Recommendations

Members are asked to

6.1 agree the assumptions set out in section 3 and the resulting surplus of £7.4 million and;

6.2 Discuss the merits of reducing the members and employers contribution rates and defer the final decision until the BTP budget for 2012/13 is agreed in December 2011.