Government Actuary's Department

Local Government Pension Scheme Scotland

Section 13 Report as at 31 March 2020

March 2023

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Contents

At GAD, we seek to achieve a high standard in all our work. We are accredited under the Institute and Faculty of Actuaries' Quality Assurance Scheme. Our website describes **the standards** we apply.

1 Executive Summary

1.1 The Government Actuary has been appointed by Scottish Ministers to report under section 13 of the Public Service Pensions Act 2013 in connection with the actuarial valuations of the funds in the Local Government Pension Scheme (Scotland) ("LGPS Scotland" or "the Scheme").

1.2 Section 13 requires the Government Actuary to report on whether the following aims are achieved:

> Compliance

> Consistency

> Solvency

> Long-term cost efficiency

1.3 This is the second formal section 13 report. Section 13 was applied for the first time to the fund valuations as at 31 March 2017. We refer to this as the 2017 section 13 report. The 2017 section 13 report was published in December 2019.

1.4 This report is based on the actuarial valuations of the funds together with other data provided by the funds and their actuaries. We are grateful to all stakeholders for their assistance in preparing this report. We are committed to preparing a section 13 report that makes practical recommendations where appropriate to advance the aims listed above. We will continue to work with stakeholders to advance these aims and expect that our approach to section 13 will continue to evolve to reflect ever changing circumstances and feedback received.

Progress since 2017

1.5 We made two recommendations as part of the 2017 section 13 report. In summary we recommended that:

1. SPPA should consider how funds disclose information in a standard way.

2. SPPA should develop a basis for standardised calculations for comparative reasons only.

1.6 We are pleased to note good progress in relation to both recommendations. All funds produced standardised results on an agreed basis and a summary of the standardised information can be found in the GAD dashboard summary (see separate funding analysis report)

Overall Comments

1.7 In aggregate the funding position of the LGPS Scotland has improved since 31 March 2017; despite a sharp drop in asset values immediately prior to the 31 March 2020. The scheme appears to be in a strong financial position, specifically:

- Total assets have grown in market value from £43 billion to £46 billion
- The total value of liabilities disclosed in the 2020 local valuation reports amounted to £44 billion using prudent local assumptions
- The aggregate funding level on prudent local assumptions has improved from 102% to 104% (at 2020)
- It should be noted that assets experienced a sharp drop in value in March 2020. There had been a small recovery prior to the valuation date 31 March 2020 but we note that assets did continue to recover further after the valuation date.
- The aggregate funding level on GAD's best estimate basis is 129% (at 2020). GAD's best estimate basis is the set of assumptions derived by GAD without allowance for prudence. There is a 50:50 likelihood of the actual experience being better or worse than the best estimate assumption, in our opinion.
- We note that funds in LGPS Scotland, like those in LGPS England and Wales, are expected to grow over time given the profile of the funds which have a substantial number of active members. The amount of funding available to local authorities may not keep pace which and could create a risk to the local employers.

1.8 We set out below our findings on each of the four aims and our recommendations.

1.9 Under solvency and long-term cost efficiency we have designed a number of metrics and raised flags against these metrics to highlight areas where risk may be present, or further investigation is required, using a red/amber/green rating approach. Where we do not expect specific action other than a general review, we have introduced a white flag.

Compliance

1.10 Our review indicated that fund valuations were compliant with relevant regulations. Whilst most fund valuations were clear we note there are some cases where greater clarity on the assumptions used to determine contributions in the Rates and Adjustment certificate would be helpful.

Consistency

1.11 We interpret "not inconsistent" to mean that methodologies and assumptions used, in conjunction with adequate disclosure in the report, should facilitate comparison by a reader of the reports. Local circumstances may merit different assumptions. For example, financial assumptions are affected by the current and future planned investment strategy, and different financial circumstances might lead to different levels of prudence being adopted.

1.12 Further to our recommendation as part of the 2017 section 13 report, we are pleased to note all funds have calculated liabilities on a standard basis and provided consistent "dashboard" information. We consider this a useful resource to aid stakeholders' understanding, because information is presented in a consistent way. We have consolidated this information in the GAD dashboard summary (see separate funding analysis report).

1.13 The publication of the dashboard may be more beneficial to users if the information was published as part of the valuations, rather than alongside the section 13 report. We have suggested that SPPA consider the most efficient way to publish the dashboards going forward.

1.14 We also recommend that SPPA consider the dashboard is reviewed prior to the 2023 valuation exercise to ensure it remains a relevant and useful summary. Appendix B sets out GAD's suggestion for future dashboards.

Recommendation 1:
SPPA should consider the content and where future standardised information should be published, to enable stakeholders to access and compare funds accordingly.

1.15 The publication of the dashboard and liabilities on the SAB basis has provided a useful tool for comparison of funds. However, the SAB basis is not a substitute for the funding basis, which differs from fund to fund.

1.16 The evidential consistency on key assumptions appears to have improved since the previous valuation, which is something that GAD has welcomed. We also welcomed the publication of SPPA guidance on the allowance for McCloud remedy, which helped provide greater consistency.

1.17 Whilst we have seen improvements in this area, some inconsistency remains. GAD would encourage additional explanation on how local assumptions are derived to be included in valuation reports. Further we would recommend that SPPA continues to engage with funds to consider how emerging issues such as climate change are addressed.

Recommendation 2:
SPPA should engage with funds and other stakeholders to consider the impact of inconsistency. It should continue to consider whether a consistent approach needs to be adopted when assessing the impact of emerging issues.

Solvency

1.18 As set out on the CIPFA website in CIPFA's Funding Strategy Statement Guidance, the employer contribution rate is appropriate if:

> the rate of employer contributions is set to target a funding level for the whole fund of 100% over an appropriate time period and using appropriate actuarial assumptions

and either:

> employers collectively have the financial capacity to increase employer contributions, should future circumstances require, in order to continue to target a funding level of 100%

or

> there is an appropriate plan in place should there be an expectation of a future reduction in the number of fund employers, or a material reduction in the capacity of fund employers to increase contributions as might be needed.

1.19 We note that funds in LGPS Scotland, like those in LGPS England and Wales, are expected to grow over time given the profile of funds which have a substantial number of active members. The growth of funds relative to the size of local authority employers creates a general risk: future volatility of the relatively larger funds could have a more profound effect on the local authority employers. This could be a risk if, for example, there was to be a severe and prolonged shock to return seeking asset classes. This represents a general increase in risk for the LGPS Scotland as a whole, so we provide a general risk comment (rather than focus on any individual funds).

1.20 We understand that Aberdeen City Council Transport Fund will merge with North East Scotland Pension Fund prior to the end of March 2023, which will be backdated to March 2022. We believe that this will mitigate the risks associated with the closed maturing fund and will be a positive development.

1.21 We have no concerns over the solvency of the funds.

1.22 In GAD's view, whilst there was a recovery from the suppressed asset values immediately following the first COVID-19 lockdown in March 2020, future investment conditions may be volatile in the next few years. Therefore, funds will need to determine their risk appetite and consider this potential volatility carefully when making decisions on investment strategy or future contributions.

General risk comment

Funds in LGPS Scotland, like those in LGPS England and Wales, are expected to grow over time. The amount of funding available to local authorities may not keep pace. The growth of funds relative to the size of local authority employers creates a general risk, where future volatility of the relatively larger funds could have a more profound effect on the local authority employers. This could be a risk if, for example, there was to be a severe and prolonged shock to return seeking asset classes.

We would expect that administering authorities are aware of this risk in relation to solvency. We do not anticipate a specific action now but recommend administering authorities continue to monitor this risk over time. Administering authorities may wish to discuss the potential volatility of future contributions with employers in relation to overall affordability.

Long-term cost efficiency

1.23 As set out in CIPFA's Funding Strategy Statement Guidance, we consider that the rate of employer contributions has been set at an appropriate level to ensure long-term cost efficiency if it is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

1.24 We have no concerns over the long-term cost efficiency of the funds. As in 2017 our analysis did not raise any flags in relation to long-term cost efficiency.

1.25 We note that the majority of funds in LGPS Scotland are in surplus. Our analysis has not raised any concerns around how such surplus is being spread.

2 Introduction

What is Section 13?

The Government Actuary has been appointed by Scottish Ministers to report under section 13 of the Public Service Pensions Act 2013 in connection with the actuarial valuations of the 13 funds in the Local Government Pension Scheme Scotland ("LGPS Scotland" or "the scheme").

This is the second formal section 13 report and sets out the Government Actuary's findings following the fund valuations as at 31 March 2020.

Section 13 was applied for the first time to the fund valuations as at 31 March 2017, following a "dry run" which was undertaken as at 31 March 2014.

What are Local Government Pension Scheme Scotland valuations?

The LGPS Scotland is a funded scheme and periodic assessments are needed to ensure the fund has sufficient assets to meet its liabilities. Employer contribution rates may change depending on the results of valuations. Scheme regulations set out when valuations are to be carried out.

Each LGPS Scotland pension fund is required to appoint their own fund actuary, who carries out the fund's valuation. The fund actuary uses a number of assumptions to value the liabilities of the fund. Costs are split between those that relate to the past (the past service cost) and those that relate to the future (the future service cost). The results of the valuation may lead to changes in employer contribution rates for both future and past service costs.

2.1 This report is addressed to Scottish Ministers as the responsible authority for the purposes of subsection (4) of section 13 of the Public Services Pensions Act 2013 ("the Act"). Scottish Ministers appointed GAD to prepare this report. This report sets out the results of our review of the 2020 funding valuations of LGPS Scotland. This report will be of relevance to administering authorities and other employers, actuaries performing valuations for the funds within the LGPS Scotland, the LGPS Scotland Scheme Advisory Board (SAB), HM Treasury (HMT) and the Chartered Institute of Public Finance & Accountancy (CIPFA) as well as other LGPS Scotland stakeholders.

2.2 As at 31 March 2020 there were 13 funds participating in the LGPS Scotland.

2.3 Subsection (4) of section 13 requires the Government Actuary, as the person appointed by Scottish Ministers, to report on whether the four main aims are achieved:

> Compliance: whether the fund's valuation is in accordance with the scheme regulations

> Consistency: whether the fund's valuation has been carried out in a way which is not inconsistent with the other fund valuations within Local Government Pension Scheme Scotland (LGPS Scotland)

> Solvency: whether the rate of employer contributions is set at an appropriate level to ensure the solvency of the pension fund

> Long-term cost efficiency: whether the rate of employer contributions is set at an appropriate level to ensure the long-term cost efficiency of the scheme, so far as relating to the pension fund.

2.4 Section 13, subsection (6) states that if any of the aims of subsection (4) are not achieved

a. the report may recommend remedial steps

b. the scheme manager must—

   i. take such remedial steps as the scheme manager considers appropriate, and

   ii. publish details of those steps and the reasons for taking them

c. the responsible authority may—

   i. require the scheme manager to report on progress in taking remedial steps

   ii. direct the scheme manager to take such remedial steps as the responsible authority considers appropriate.

Identifying if the aims of section 13 are met

2.5 We have looked at a range of metrics to identify exceptions under the solvency and long-term cost efficiency objectives. Each fund is given a colour coded flag under each measure, where:

Key

RED indicates a material issue that may result in the aims of section 13 not being met. In such circumstances remedial action to ensure solvency and/or long-term cost efficiency may be considered.

AMBER indicates a potential material issue that we would expect funds to be aware of. In isolation this would not usually contribute to a recommendation for remedial action in order to ensure solvency and/or long-term cost efficiency.

WHITE is an advisory flag that highlights a general issue but one which does not require an action in isolation. It may have been an amber flag if we had broader concerns.

GREEN indicates that there are no material issues that may contribute to a recommendation for remedial action in order to ensure solvency or long-term cost efficiency.

2.6 The trigger points for these flags are based on a combination of absolute measures and measures relative to the bulk of the funds in scope at a point in time. We have maintained consistency with the approach adopted in 2017, except where noted.

2.7 While they should not represent targets, these measures and flags help us determine whether a more detailed review is required. For example, we would have a concern where multiple measures are triggered amber for a given fund.

2.8 It should be noted that these flags are intended to highlight areas where risk may be present, or further investigation is required. For example, where an amber flag remains following engagement, we believe this relates to an area where some risk remains that administering authorities and pension boards should be aware of. There is no implication that the administering authority was previously unaware of the risk.

2.9 A green or white flag does not necessarily indicate that no risk is present and similarly the fact that we are not specifically suggesting remedial action does not mean that scheme managers should not consider actions.

2.10 The figures shown in the tables in this report are based on publicly available information and/or information provided to GAD.

2.11 Further detail is provided in the solvency and long-term cost efficiency chapters and appendices. In addition, we have considered the overall funding position of the funds within the LGPS Scotland in our funding analysis report published alongside this document.

2.12 Local valuation outputs depend on both the administering authorities' Funding Strategy Statements and the actuary's work on the valuation. We have reported where valuation outcomes raised concerns in relation to the aims of section 13. It is not our role to express an opinion as to whether that conclusion was driven by the actions of authorities or their actuaries, or other stakeholders.

2.13 The following key has been used to identify the actuarial advisers for each fund:

Barnett Waddingham
Hymans Robertson
Mercer

2.14 We note that there are two closed funds in LGPS Scotland: Scottish Homes Pension Fund and Aberdeen City Council Transport Fund. Both have strategies in place to mitigate any solvency risk.

2.15 More generally it is important to note that this report focuses on the funding of future member benefits. The calculation of members' benefits is set out in regulations. Consequently, the benefits paid to members are not dependent on the funding position of any particular fund.

Limitations

2.16 We recognise that the use of data and models has limitations. For instance, the data that we have from valuation submissions and publicly available financial information is likely to be significantly less detailed than that available to funds. Our risk assessment framework enables us to broadly assess scheme risks and decide on our engagement with schemes on an indicative basis.

2.17 Because of the nature of this exercise, generally only post valuation experience allowed for in the valuation disclosures has been taken into account.

Standardised basis

2.18 There are some areas of inconsistency highlighted in Chapter 5, which make meaningful comparison of valuation results set out in local valuations reports difficult.

2.19 To address this, we have referred to results restated on two bases:

> A standard basis was established by the SAB in England and Wales and agreed by stakeholders in Scotland as appropriate for this exercise. The

resulting fund liabilities on this basis has been calculated by fund actuaries

> A best estimate basis consistent with market conditions as at 31 March 2020 derived and calculated by GAD

2.20 This use of standardisation does not imply the bases are suitable to be used for funding purposes as we would expect a funding basis to be consistent with the market and prudent. We note that:

> The SAB standard basis is not consistent with current market conditions

> The GAD best estimate basis is based on our views of likely future returns on each broad asset class across the Scheme. Regulations and CIPFA guidance call for prudence to be adopted when setting a funding basis. Our best estimate basis does not include prudence and is based on the average investment strategy for the overall Scheme, so will not be pertinent to any given fund's particular investment strategy. Further, we do not take into account any anticipated changes in investment strategy that may be planned/in train.

2.21 The local valuations and our calculations underlying this report are based on specific assumptions about the future. Some of our solvency measures are stress tests but these are not intended to indicate a worst case scenario.

Future review

2.22 We are grateful to stakeholders for their assistance in preparing this report. We are committed to preparing a section 13 report that makes practical recommendations to advance the aims in the legislation. We will continue to work with stakeholders to advance these aims and expect that our approach to section 13 will continue to evolve to reflect ever changing circumstances and feedback received.

Appendices

2.23 Appendices are contained in a separate document.

Other important information

2.24 The previous section 13 report was published on 16 December 2019 following the valuations as at 31 March 2017 details of which can be found in the Local Government Pension Scheme (Scotland): review of the actuarial valuations of funds as at 31 March 2017.

2.25 GAD has no liability to any person or third party other than Scottish ministers for any act or omission taken, either in whole or in part, on the basis of this report. No decisions should be taken on the basis of this report alone without having received proper advice. GAD is not responsible for any such decisions taken.

2.26 In performing this analysis, we are grateful for helpful discussions with and cooperation from:

- Actuarial advisors
- Fund administrators
- LGPS Scotland Scheme Advisory Board
- the Scottish Public Pensions Agency

2.27 We note that this report is GAD's alone, and the stakeholders above are not responsible for the content.

2.28 GAD would like to acknowledge the commitment shown by the funds and their advisors, which is illustrated through the continued strong funding position of funds since the previous valuation.

2.29 We understand and assume that there is no regulatory authority assumed by or conferred on the Government Actuary in preparing this or any future section 13 report. The appointment to report under section 13 does not give the Government Actuary any statutory power to enforce actions on scheme managers (or others).

2.30 In preparing this report, we are aware that our analysis may be affected by risks arising from the impact of the COVID-19 pandemic. The full impact of the COVID-19 pandemic is not known and will remain uncertain until further evidence has been established. We have not allowed for any additional margins in this analysis, beyond those that might be assumed by third parties and/or markets, to reflect these risks unless otherwise stated.

2.31 This work has been carried out in accordance with the applicable Technical Actuarial Standard: TAS 100 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK.

3 Progress

We made two recommendations in the 2017 section 13 report. We have reported on the progress made against each of these recommendations in the table below:

2017 Recommendation	Progress
1: We recommend SPPA should consider the standard way of presenting relevant disclosures adopted for LGPS England and Wales valuation reports as at 31 March 2019, with a view to making a recommendation on standard way of presenting relevant disclosures for LGPS Scotland to Scottish Ministers in advance of the next valuation.	We are pleased to report that good progress has been made on this recommendation. All funds provided standardised dashboard information, and this has been published in a separate funding analysis report.
2: We recommend that SPPA should develop a basis for standardised calculations, in addition to the funding calculations, to enable cross comparisons of funds, and funds should report results on this standardised basis. The standardised basis would be to allow comparisons only, not to suggest an appropriate funding basis.	Good progress appears to have been made in this area. SPPA agreed with fund actuarial advisors to adopt the standardised assumptions used by LGPS England and Wales funds. All funds provided results on this standardised basis.

4 Compliance

Key Compliance findings

- All reports checked contained a statement of compliance.
- The reports checked contained confirmation of all material requirements of regulation 60.
- We concluded the aims of section 13 were achieved under the heading of Compliance in terms of valuation reporting.

Under section 13(4)(a) of the Act, the Government Actuary must report on whether the actuarial valuations of the funds have been completed in accordance with the scheme regulations.

In this Chapter:

- We set out our approach to reviewing compliance and our conclusions from that review

Summary of compliance outcomes

4.1 Valuation reports materially complied with the regulations.

4.2 There is a great deal of consistency between the actuarial methodologies and the presentation of the actuarial valuation reports for funds that are advised by the same firm of actuarial advisors (see Chapter 5 on Consistency). Accordingly, GAD has selected one fund as a representative example from each of the firms of actuarial advisors and has assessed whether these reports have been completed in accordance with Regulation 60. The statutory instrument governing the publication of actuarial valuations for the LGPS Scotland is Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2018.

4.3 We found that the actuarial valuation reports have been completed in accordance with Regulation 60 and have therefore concluded that the compliance criteria of section 13 have been achieved. We note that this is not a legal opinion.

4.4 We did note that whilst the regulations require a reference to the assumptions on which the Rates and Adjustment Certificate (the certificate setting out employer contributions) was given, this was not always clear. It would be helpful to ensure such information is clearly stated in future. We did not consider this to be material non-compliance.

4.5 In line with the required actuarial standards, we noted that all three valuation reports reviewed contained confirmation that the required Technical Actuarial Standards had been met.

4.6 Our review of compliance is focused on the actuarial valuation reports produced under Regulation 60. We have not, for example, systematically reviewed Funding Strategy Statements prepared under Regulation 56.

4.7 The comments we make in subsequent chapters on consistency, solvency and long-term cost efficiency do not imply that we believe that the valuations are not compliant with the regulations. These comments relate only to whether the valuations appear to achieve the aims of section 13.

5 Consistency

Key Consistency findings

- **Funds have provided consistent "dashboard" information and standardised results which we feel greatly aids stakeholders' understanding. We have published this information in our funding analysis report.**
- **We think it would be helpful for stakeholders to have access to this information as part of the fund valuations and have recommended some changes to further assist users.**
- **We welcome the observed move towards greater consistency in relation to key assumptions. We recognise that different advisors will recommend different assumptions. However, this makes comparability difficult. Stakeholders in the LGPS Scotland would benefit from greater comparability.**
- **We recommend that SPPA engage with funds and other stakeholders to consider the impact of inconsistency. It should continue to consider whether a consistent approach needs to be adopted when assessing the impact of emerging issues.**

Section 13 requires that GAD must report on whether each actuarial valuation has been carried out in a way which is not inconsistent with other valuations. This requires both presentational and evidential consistency and is important to enable readers to make comparisons between different valuation reports.

In this Chapter we:

- **Provide some background on the legislation and importance of consistency**
- **Discuss presentational consistency with a focus on contribution rates**
- **Consider evidential consistency in more detail, looking at liability values, funding assumptions and McCloud treatment**
- **Comment on emerging issues**
- **Conclude and make recommendations.**

Presentational Consistency:

Information may be presented in different ways in different reports, and sometimes information is contained in some reports but not others (e.g. discount rate derived to determine future contribution rates), so readers may have some difficulties in locating the information they wish to compare. We call this presentational inconsistency.

Evidential Consistency:

When the reader has located the relevant information (e.g. funding levels), differences in the underlying methodology and assumptions mean that it is not possible to make a like for like comparison. We call this evidential inconsistency. We believe that local circumstances may merit different assumptions (e.g. financial assumptions are affected by the current and future planned investment strategy, different financial circumstances leading to different levels of prudence adopted) but that wherever possible information should be presented in a way that facilitates comparisons.

Importance of Consistency

5.1 LGPS Scotland is a common pension scheme locally administered by separate Administering Authorities. Section 13 requires valuations to be carried out in a way that is not inconsistent with other LGPS Scotland fund valuations. This is important to enable readers to draw comparisons between the results from two valuation reports. We also believe that there are greater benefits that could be attained by adopting a more consistent funding approach, although we acknowledge that it may be appropriate to allow for local differences.

5.2 Where members are provided with identical benefits it is hard to justify large variations in the cost of these benefits. This is particularly pronounced where one employer is participating in numerous different LGPS Scotland funds and can be required to contribute differing costs. In this situation it is increasingly important to understand what is driving the difference and ensure that this is clear to employers. The greater the difference in cost between different funds, the more significant this issue.

5.3 Furthermore, given the mobility of the workforce it is not unusual for members to transfer between funds. The greater the variation in different funding basis the greater the potential strain. In addition, in relation to bulk transfers protracted discussions on the appropriate transfer basis can result, which are not helped by differences in funding bases.

5.4 We also note that there is a common basis used for various calculations within the LGPS Scotland. Where this basis diverges from funding basis this can be a source of additional strain, which needs to be managed.

Presentational Consistency

5.5 As previously we note a high degree of similarity between reports produced by each consultancy. Therefore, we have taken at random a report produced by each actuarial advisor to assess whether the information disclosed is consistent across all three advisors. However, we recognise that the information disclosed is agreed between administering authorities and their actuaries. The approach adopted by different funds advised by the same advisor might therefore differ. We do not have any specific concerns about these funds, which have been chosen at random and note none of the funds raise any amber or red flags. These funds are:

Tayside Pension Fund (Barnett Waddingham)

Fife Pension Fund (Hymans Robertson)

Aberdeen City Council Transport Fund (Mercer)

Dashboard

5.6 We are pleased to note that all funds provided standard "dashboard" information in their data submission to GAD. However only one fund chose to publish as part of their valuation report. It was agreed previously that GAD would publish this information as part of the 2020 Section 13 review. Going forward we think readers of the valuation reports would benefit if the dashboard was published shortly after the report, with a suggestion that publication should be appended to the report.

5.7 We expect the dashboard to be revised from time to time to reflect recent developments in relation to emerging risks and funding positions. We recommend that SPPA consider the content of the dashboard. Table B1 in Appendix B sets out the proposed dashboard information for 2023 valuation.

Recommendation 1:
SPPA should consider the content and where future standardised information should be published, to enable stakeholders to access and compare funds accordingly.

Contribution rates

5.8 Contribution rates include the following components:

> Primary Contribution Rate

> Secondary Contribution Rate

> Member Contribution Rate

5.9 The analysis below focuses on the employer contributions (the primary and secondary contributions payable by the employer). Total employer contributions expected to be received in the three years covered by the 2020 valuation are set out in the following table:

Table 5.1: Total LGPS Scotland expected employer Contributions

Contribution	2021-22 £bn	2022-23 £bn	2023-24 £bn
Primary contributions	1.35	1.39	1.43
Secondary contributions	-0.24	-0.25	-0.25
Total Employer contributions	1.11	1.14	1.18

The trend in secondary contributions reflects that most funds are in surplus and therefore it may be reasonable for employers to pay less than the primary contribution rate.

The primary contribution rates are easily found in the valuation reports for each fund, and, as they are all expressed as a percentage of pay, are easily comparable. The same is true of member contribution rates.

Secondary contribution rates are more complex. All actuarial advisors provide a detailed breakdown of the secondary contribution rates by employer for each of the next three years in their Rates and Adjustments Certificates.

Secondary Contribution Rates

5.10 Table 5.2 summarises the information about secondary contribution rates that is given in the valuation reports for the different actuarial advisors. These are not directly comparable because they are expressed in a mix of monetary amounts and/or a percentage of pay.

5.11 Employers will budget for secondary contributions in different ways, therefore it is not unreasonable for employers' contributions to allow for such differences in the Rates and Adjustment certificate. The dashboard provides a breakdown of the monetary amounts, therefore enables a like for like comparison of secondary contributions, as well as total contributions.

Tayside Pension Fund expressed the secondary contribution as both a monetary amount and a percentage of pay.

Fife Pension Fund expressed the secondary contribution as a monetary amount only.

Aberdeen City Council Transport Fund expressed the secondary contribution as a combination of a monetary amount and a (negative) percentage of pay.

Table 5.2: Secondary Contribution Rates

Fund (Actuarial Advisor)	Secondary Contribution Rates		
	2021/22	2022/23	2023/24
Tayside Pension Fund (Barnett Waddingham)	−5.8% of pensionable pay or −£25,000,000	−5.8% of pensionable pay or −£26,000,000	−5.8% of pensionable pay or −£27,000,000
Fife Pension Fund (Hymans Robertson)	−£3,550,000	−£3,454,000	−£3,339,000
Aberdeen City Council Transport Fund (Mercer)	−43.7% of pensionable pay less £140,000	−43.7% of pensionable pay less £140,000	−43.7% of pensionable pay less £140,000

Table 5.3: Information provided on spreading surplus

Fund	Information provided on spreading surplus
Tayside Pension Fund (Barnett Waddingham)	Limited information in the valuation report (likely to have been provided in accompanying information)
Fife Pension Fund (Hymans Robertson)	Provide time horizon set by employers instead of surplus spreading period. Detail provided in funding strategy statement.
Aberdeen City Council Transport Fund (Mercer)	The surplus at the valuation date was sufficient to offset the primary contribution requirements for the projected future working lifetime of the active membership. Therefore, it was agreed that no employer contributions will be required for the next valuation period.

5.12 We note that whilst comparison of secondary contributions over the next three years is relatively easy, it is harder to understand what funds' objectives are to reducing the surplus over the longer term. We have suggested updating the dashboard to provide additional information in respect of longer-term funding plans (see Appendix B).

Comparison with previous valuation

5.13 Regulations require contribution rates to be split into primary and secondary contribution rates for employers. This makes comparison with the previous valuation easier compared to earlier valuation cycles.

5.14 A comparison of aggregate employer rates is provided in some cases. In other cases, a comparison of primary rates only is provided, see table 5.4.

Table 5.4: Comparison with previous valuation contribution rates

Fund	Comparison provided
Tayside Pension Fund (Barnett Waddingham)	Analysis of the change in primary contribution rates
Fife Pension Fund (Hymans Robertson)	Comparison of primary rate (as % of pay) and secondary rate (as fixed monetary amounts)
Aberdeen City Council Transport Fund (Mercer)	Breakdown of the primary employer contribution rate compared with the previous valuation

5.15 We believe a comparison of current and previous total contributions is helpful to provide the reader with useful context. We suggest that the average three yearly total contributions should be included in an updated dashboard (see Appendix B).

5.16 We note as previously each report contains a section that summarises the changes to the funding position since the 2017 reports, and these are presented in very similar ways, again making for easy comparison.

Evidential Consistency

5.18 We have considered whether the local fund valuations have been carried out in a way which is not inconsistent with each other. We have found that whilst inconsistencies in the methodologies and assumptions adopted remain, these are possibly less pronounced than observed in 2017.

5.19 Primary contribution rates range between 21% and 44% for all funds and between 21% and 27% for the open funds in 2020. This range is a function of differences in age profile as well as different assumptions adopted. It is a considerably narrower range than that emerging following the 2017 valuations (between 18% and 59% for all funds, 18% and 32% for open funds), which might imply an improvement in evidential consistency.

5.20 The value assigned to liabilities in each actuarial valuation report has been calculated on assumptions set locally. Differing levels of prudence are to be expected and may be reflective of local variations in risk appetite, but care needs be taken when comparing results.

5.21 The government is committed to remedy age discrimination that arose when the LGPS Scotland was reformed in 2015. This is commonly referred to as McCloud remedy. Whilst the detail of that remedy has not yet been finalised, we were pleased to see that SPPA provided guidance on how they expected funds to allow for McCloud prior to completion of the 2020 valuations. We note that the sample funds reviewed appear to have adopted a consistent approach in line with that guidance.

Reported liabilities

5.22 Chart 5.1 below shows the difference in ranking of funds on the local basis and that on the SAB standard basis. This presentation allows a clear ranking, and easy comparison, of funding levels. The change in rank for a fund between the left and right sides of the table is due to the relative gap between the local valuation basis and the standard basis, compared to the other funds. The level of prudence adopted in setting assumptions as well as local differences are the main reasons for the range of differences between the local basis and the standard basis.

5.23 The difference between local and standardised basis funding levels varies from fund to fund, as this reflects different levels of prudence and asset strategies. We note that there is a degree of similarity in ranking for most funds and hence flat lines between the two bases. It is important to note that some differences might be expected between the closed funds (Aberdeen City Council Transport Fund and Scottish Homes Pension Fund) and the other funds as they are closed to new entrants and hence have a different risk profile.

5.24 The liability value on the local basis is higher than that calculated on the SAB standard basis for all funds. However, the differences ranged from +9% to +28% in relation to the open funds. As noted in paragraph 2.20, the SAB standard basis is not useful for assessing liabilities for funding purposes. However, this analysis illustrates the range of difference in liability values, and it is not clear the extent to which these are local differences which makes valuation reports difficult to compare directly.

Chart 5.1 Comparison of funding level on local and standardised basis

2020 LOCAL BASES		STANDARD BASIS	
118%	Orkney Islands Council Pension Fund	Aberdeen City Council Transport Fund	205%
118%	Scottish Homes Pension Fund	Scottish Homes Pension Fund	189%
114%	Aberdeen City Council Transport Fund	Orkney Islands Council Pension Fund	146%
110%	Scottish Borders Pension Fund	Strathclyde Pension Fund	134%
109%	Tayside Pension Fund	Lothian Pension Fund	132%
106%	Strathclyde Pension Fund	Tayside Pension Fund	127%
106%	Lothian Pension Fund	North East Scotland Pension Fund	125%
103%	North East Scotland Pension Fund	Scottish Borders Pension Fund	119%
100%	The Highland Council Pension Fund	The Highland Council Pension Fund	117%
97%	Fife Pension Fund	Fife Pension Fund	115%
94%	Falkirk Council Pension Fund	Falkirk Council Pension Fund	110%
92%	Shetland Islands Council Pension Fund	Shetland Islands Council Pension Fund	104%
92%	Dumfries and Galloway Council Pension Fund	Dumfries and Galloway Council Pension Fund	103%

Assumptions

5.25 We compared the following key assumptions that need to be made for the actuarial valuations for all funds to consider whether variations in those assumptions are justified in terms of local conditions.

Discount Rate

5.26 The discount rate is the most significant assumption in terms of impact on the valuation results. We have therefore focused on the derivation of this assumption in this section. It is expected that different advisors will have different views on expected future investment returns, from which discount rates are derived.

5.27 The discount rate is used to value past service liabilities. A way of measuring the level of prudence included is to consider the implied asset outperformance within the discount rate (see Appendix B for more details). Note this applies to all assets, not just "return seeking" assets. The range of implied asset outperformance by actuarial advisor is set out in Chart 5.2 below.

Chart 5.2 Implied asset outperformance range (open funds)

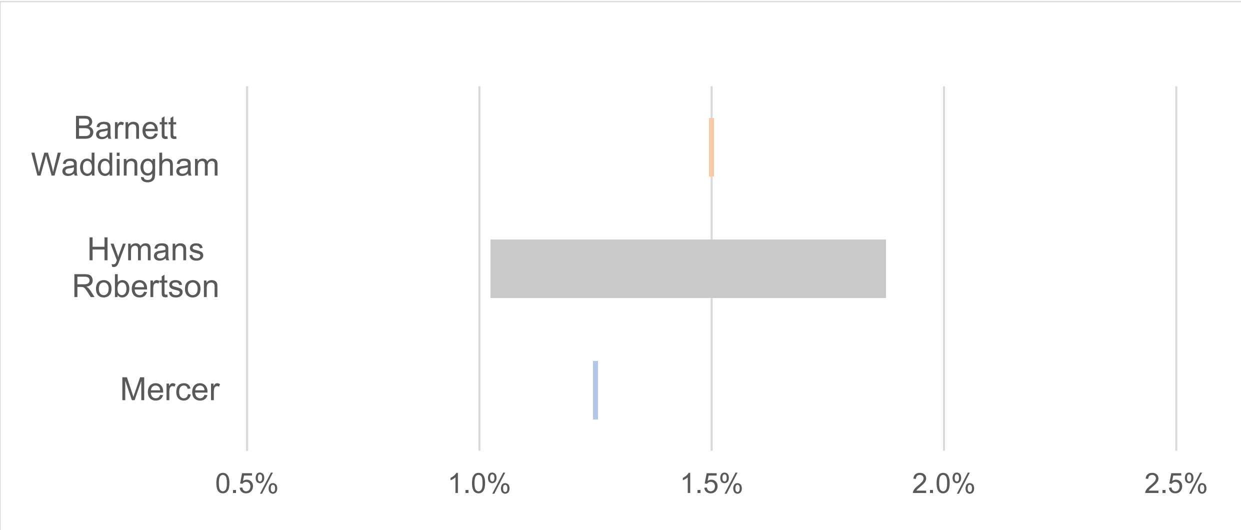


Chart 5.2 illustrates one aspect of the difference in assumptions applied by the three actuarial advisors (with the closed funds – Scottish Homes Pension Fund and Aberdeen City Council Transport Fund – excluded)

Barnett Waddingham and Mercer only advised one open fund each.

We note the spread of assumptions is smaller in 2020, with a greater overlap between advisors.

5.28 The implied asset outperformance in chart 5.2 relates to the discount rate for past service liabilities only.

5.29 Mercer's approach allows for the fact that contributions made after the valuation date will receive a future investment return that is not directly linked to market conditions at the valuation date. This resulted in a higher discount rate assumption for setting future contribution rates than used to value past service liabilities.

5.30 Hymans Robertson use stochastic techniques leading to a probability of success ("meeting the funding target by the funding time horizon") over a projection period (such as, for example, twenty years) to help set their contribution rates. Whilst GAD have no concerns about the appropriateness of the approach used, we would encourage Hymans Robertson to provide further information on how future contributions are set. We have suggested additional information should be provided in future dashboards (see Appendix B).

5.31 We also note that to avoid long-term funding strategies being unduly impacted by the short-term conditions that were in place as at 31 March 2020, Hymans Robertson have chosen to use assumptions at different dates to determine future contribution rates. To ensure consistency between future assumptions and known experience to date a quarter end was chosen (where there is greater certainty on asset values). We understand for practical reasons and previous longstanding fixed engagements planned with funds, different dates have been used for the setting future contribution rates for different funds (either 31 March 2020, 30 June 2020 or 30 September 2020). Whilst we agree that it is not inappropriate to allow for known future conditions GAD did not find it easy to understand the process adopted on reading the valuation report. However, we understand that further information was available in Hymans Robertson's valuation toolkit document and the relevant Funding strategy statement. We feel that additional explanation of their approach within their valuation reports would be helpful.

5.32 We would expect some fund-by-fund variation due to asset strategy and different levels of risk appetite, hence we do not consider the fact that funds adopt different discount rates to be a particular cause for concern. Future asset returns are highly uncertain, and hence there is a wide range of reasonable assumptions that may be adopted.

5.33 To aid comparison, we propose that the discount rate used for contribution rate setting (which may be different to the rate used for assessing past service liabilities) be disclosed in the dashboard (see Appendix B).

Other assumptions

5.34 We have compared the following assumptions used by funds advised by different actuarial advisors:

> Future mortality improvements

> Inflationary and economic salary increases

> Commutation assumptions

5.35 We expect assumptions to vary between funds. To aid transparency, this variation should be justified in relation to local circumstances.

Emerging Issues

5.36 A number of issues affecting the LGPS Scotland are emerging. These issues require consideration from the funds and their advisors. We encourage dialogue with a view to treating these issues consistently in the 2023 valuation and beyond.

Climate risk

5.37 Climate risk will be a focus in future section 13 reports. GAD will facilitate dialogue and engagement with SPPA, actuarial advisors and the SAB prior to publication of the 2023 valuations to ensure a consistent approach is adopted.

Allowance for COVID-19 and the high inflationary environment

5.38 As evidence emerges on the impact on mortality following the COVID-19 pandemic and anticipated high inflationary environment, we encourage dialogue to ensure a consistent approach is adopted in allowing for this.

5.39 In respect of COVID-19, we note that different funds have allowed for the immediate asset shock in early 2020 in different ways. Whilst we acknowledge that funds have advised their own clients in relation to COVID-19 we encourage dialogue across funds to ensure a consistent approach is adopted.

Recommendation 2:
SPPA should engage with funds and other stakeholders to consider the impact of inconsistency. It should continue to consider whether a consistent approach needs to be adopted when assessing the impact of emerging issues.

Conclusion

Objectives for improving consistency

Even allowing for the improvements made, we remain convinced of the advantages of achieving still greater consistency. We have therefore recommended that SPPA considers further if a consistency of approach between advisory firms, particularly for emerging issues of climate risk, COVID-19 and impact of high inflationary environment would be appropriate.

To help stakeholders we have also recommended that the SPPA consider whether it is appropriate to update the dashboard information and recommend that the dashboards should be published as part of future valuation reports.

Improvements since 2017

We were pleased to note that generally there appeared to have been a move towards more consistent assumptions.

Previously we set out a possible standard dashboard information to facilitate the SPPA's consultation with stakeholders and are pleased to note that all funds have provided that information in their data submissions to GAD. We have collated this information in the funding analysis report. We feel that this has helped in understanding the funds' approaches. However, we think this should be reviewed in light of development in relation to emerging risks and funding positions. We think it would be helpful for re-consider the content of the dashboard and consider including as part of fund's valuation report to enable stakeholders to have easier access to helpful standardised information. We are working with the SPPA to see how this can best be achieved.

Examples of where the criterion may not have been achieved include:

- Opportunities to provide further explanations of standardised information and explanation of approaches adopted to enable stakeholders to make sensible comparisons.

These differences contribute, alongside genuine local variations, to differences between funding levels and recommended contribution rates on local bases which a reader may find it difficult to interpret without undertaking further analysis.

6 Solvency

Key solvency findings

- Funding levels have mostly improved on local bases since 2017 despite a significant fall in assets in March 2020. On average the funds of the LGPS Scotland are 104% funded on their local funding bases.
- Generally, we expect funds will grow over time and there is a risk that the funding available to local authorities may not keep pace. We consider this a general risk that funds are growing relative to the size of the local authority employers, so future volatility can have a more profound effect.
- All open funds had green or white flags on all solvency measures. Where otherwise an amber flag might have been raised for the asset stress metric, we considered this a white flag given assets had already been subject to a stress following COVID-19 which had since rebounded.

Under section 13(4)(c) of the Act, the Government Actuary must report on whether the rate of employer contributions to the pension fund is set at an appropriate level to ensure the solvency of the pension fund.

In this Chapter:

- **We provide a definition of solvency**
- **We provide some background on solvency issues, and some of the measures and flags we have used in considering them.**

Definition of solvency

In line with the definition in CIPFA's Funding Strategy Statement Guidance, which we adopt for the purposes of section 13, we consider that the rate of employer contributions has been set at an appropriate level, to ensure the solvency of the pension fund, if

- **the rate of employer contributions is set to target a funding level for the whole fund (assets divided by liabilities) of 100% over an appropriate time period and using appropriate actuarial assumptions**

and either:

- **employers collectively have the financial capacity to increase employer contributions, and/or the fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%**

  or

- **there is an appropriate plan in place should there be, or there is expected in future to be, no or a limited number of fund employers and/or a material reduction in the capacity of fund employers to increase contributions as might be needed.**

Summary of solvency outcomes

6.1 The aggregate funding level of open funds on a prudent local bases has improved from 102% at 2017 to 104% at 2020, despite an asset fall immediately prior to the valuation date.

6.2 The funds were fully funded on GAD's best estimate basis, where the aggregate funding levels for the open funds was 129%. GAD's best estimate basis is the set of assumptions derived by GAD without allowance for prudence, hence with a 50:50 likelihood of the actual experience being higher or lower than the assumption being adopted, in our opinion. Where the funding level on such a basis is higher than 100%, we expect there is a greater than 50% likelihood that existing assets would be sufficient to cover benefits in respect of accrued service when they fall due.

6.3 The table below sets out the results of the solvency measures we have used for each of the individual open funds. More details on the metric are also provided in Appendix C.

Table 6.1 Solvency measures results (open funds)

Pension Fund	Open fund	Relative to average SAB Funding Level	Non-statutory members	Asset shock	
				Deficit or surplus post asset shock	Impact on contribution rate
Dumfries and Galloway Council Pension Fund	Yes	-24%	5%	Deficit	5.3%
Falkirk Council Pension Fund	Yes	-17%	6%	*Surplus*	*3.9%*
Fife Pension Fund	Yes	-12%	6%	*Surplus*	*5.1%*
Lothian Pension Fund	Yes	5%	10%	*Surplus*	*5.5%*
North East Scotland Pension Fund	Yes	-3%	6%	*Surplus*	*5.4%*
Orkney Islands Council Pension Fund	Yes	18%	0%	*Surplus*	*6.2%*
Scottish Borders Pension Fund	Yes	-9%	0%	*Surplus*	*6.6%*
Shetland Islands Council Pension Fund	Yes	-24%	10%	Deficit	4.8%
Strathclyde Pension Fund	Yes	6%	6%	*Surplus*	*6.1%*
Tayside Pension Fund	Yes	-1%	6%	*Surplus*	*5.6%*
The Highland Council Pension Fund	Yes	-11%	8%	*Surplus*	*5.3%*

SAB Funding Level

6.4 The SAB basis is a useful measure to compare the relative funding position of each fund. However, it is important to note that it is not a market related basis and is not directly appropriate for funding purposes.

6.5 The relative funding positions quoted are relative to the aggregate funding level (of open funds) of 128% on the SAB basis. The purpose of the SAB basis is for comparison purposes, therefore where a fund's SAB funding level is below the average the fund may still be fully funded or in surplus on a prudent local basis.

Non statutory members

6.6 We have been provided with the proportion of members within the fund who are/were employed by an employer without tax raising powers or statutory backing. Such employers might be considered to have a weaker covenant than taxpayer backed employers and hence have a higher risk of default.

6.7 We note that all open funds in LGPS Scotland have 10% or less non-statutory backed members, which is lower than the amber flag threshold of 25% and hence results in all green flags.

Asset Shock

6.8 The measure considers the funding position and the impact on contributions if there is a sustained reduction in the value of return seeking assets. For example, a market correction in which asset values do not immediately recover and losses are not absorbed by changes in assumptions.

6.9 We model the additional contributions that would be required to meet any emerging deficit. This is different to considering the total contributions required following the shock – i.e. we are looking at where there is a risk of large changes to the contribution rate, rather than a risk of the total contribution rate exceeding some threshold.

6.10 Funds with a high level of return seeking assets are more exposed to asset shocks and more likely to trigger this flag.

6.11 Where a fund remains in deficit on a best estimate basis after an asset shock, we consider the additional contributions that would be required to meet the emerging deficit as a percentage of payroll relative to our thresholds. In the case of the Dumfries and Galloway pension fund the additional contribution required as a percentage of pensionable payroll was 5.3%. This is slightly above the amber threshold adopted for the 2017 exercise. However, we do not think an amber flag is appropriate given the general market conditions as at 31 March 2020 and the lack of other concerns in relation to this fund. Therefore, under a qualitative analysis we have noted a white flag for the asset shock for this fund.

6.12 Where funds remain in surplus after the asset shock we do not raise any flags. We have shown in the table above the equivalent level of contributions as a percentage of payroll that would equate to the removing such a shock for information only.

6.13 Overall, we raised one white flag on the asset shock, whereas no asset shock flags were raised in the 2017 report.

Volatility in contributions

6.14 Funds are expected to grow in size over time as measured by the value of either their assets or liabilities. There is a risk that the funding available to local authorities may not be able to keep pace.

6.15 Having reviewed the structure of funds in Scotland compared to England and Wales we would similarly expect LGPS Scotland to grow in size over time.

6.16 We discussed with SPPA the recent increases in local authority budgets, as set out in Scottish Local Government Financial Statistics, and after allowance for COVID-19 the increase did not appear to be too dissimilar to that in England and Wales.

6.17 Therefore, the general risk comment from England and Wales is relevant to LGPS Scotland. A key message is that this reflects the increased risk to the whole of the LGPS Scotland. If a shock were to occur, that shock would be more significant than before, if the fund has grown relative to the size of the local authority. Therefore, the ability of the employer to meet the increased contributions that could result will be diminished.

6.18 The potential for future variation in employer contributions and funding is discussed further in the Asset Liability Modelling (ALM) section of the LGPS England and Wales 2019 Section 13 report. The ALM was taken to illustrate:

> potential variability of future employer contribution rates

> Impact on scheme funding levels if there are constraints on employers' and local authorities' pension contributions.

6.19 Our understanding is that actuarial advisors do advise funds in relation to this risk. We would encourage them to continue their engagement both in general, and in relation to emerging risks such as climate change.

General risk comment

Funds in LGPS Scotland, like those in LGPS England and Wales, are expected to grow over time. The amount of funding available to local authorities may not keep pace. The growth of funds relative to the size of local authority employers creates a general risk, where future volatility of the relatively larger funds could have a more profound effect on the local authority employers. This could be a risk if, for example, there was to be a severe and prolonged shock to return seeking asset classes.

We would expect that administering authorities are aware of this risk in relation to solvency. We do not anticipate a specific action now but recommend administering authorities continue to monitor this risk over time. Administering authorities may wish to discuss the potential volatility of future contributions with employers in relation to overall affordability.

Management of Risks

6.20 More generally we note that funds will be exposed to different risks over future valuations. Some of the risks which funds should consider when making investment decisions are listed below:

> Investment risk, including equity returns

> Volatility of contributions

6.21 GAD does not comment on the investment strategy that LGPS Scotland funds should adopt or the types of investments which the LGPS Scotland funds should invest in. Nevertheless, when choosing an investment strategy, we would expect funds to consider the ongoing cost of the benefits and their capacity to increase contributions if required.

Closed Funds

6.22 Scottish Homes Pension Fund has no remaining active members. The liabilities are guaranteed by the Scottish Government. We therefore consider it is not subject to any solvency risk.

6.23 We understand that Aberdeen City Council Transport Fund will merge with North East Scotland Pension Fund prior to the end of March 2023, which will be backdated to March 2022. We believe that this will mitigate the risks associated with the closed maturing fund and will be a positive development.

7 Long-term cost efficiency

Key long-term cost efficiency findings

- All open funds had green flags on all long-term cost efficiency measures.
- We have no concerns around the approaches funds are adopting to spread surpluses.

Under section 13(4)(c) of the Act, the Government Actuary must report on whether the rate of employer contributions to the pension fund is set at an appropriate level to ensure the long-term cost efficiency of the scheme, so far as relating to the pension fund.

In this Chapter:

- We provide a definition of long-term cost efficiency
- We provide some background on long-term cost efficiency issues, and the measures and flags we have used in considering them
- We set out some further considerations we have in relation to funds in surplus.

Definition of long-term cost efficiency

In line with the definition in CIPFA's Funding Strategy Statement Guidance, which we adopt for the purposes of section 13, we consider that the rate of employer contributions has been set at an appropriate level to ensure long term cost efficiency if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

Summary of long-term cost efficiency outcomes

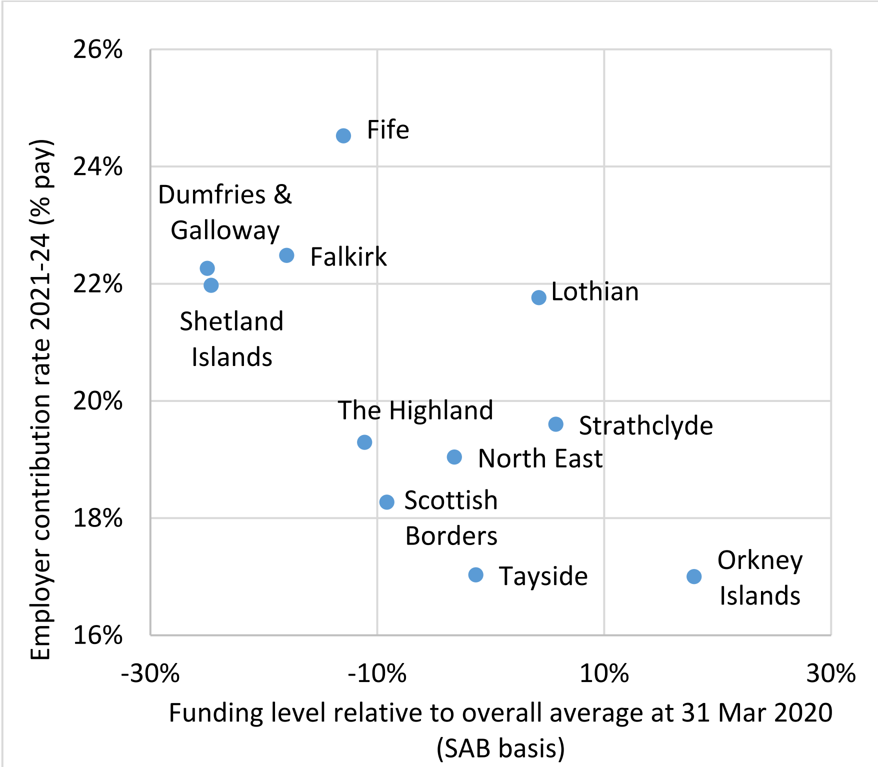
7.1 Long-term cost efficiency (LTCE) relates to not deferring payments and/or returns of surplus too far into the future so that they affect future generations of taxpayers disproportionately. This should be balanced with funds considering whether surplus should be paid immediately.

7.2 No funds are flagged under LTCE in the 2020 review, which is the same position as in 2017, as all 11 open funds have green flags on all measures.

7.3 There have been amendments to the surplus retention metric, to reflect the change in funding environment, and we have also introduced the repayment shortfall metric, in line with LGPS England and Wales.

7.4 Chart 7.1 plots the SAB funding level relative to the average (normalised to the SAB basis) against employer total contributions (expressed as a percentage of pensionable earnings). Any funds located on the bottom left of the chart would be those receiving lower total employer contributions compared to other funds and which are relatively weakly funded on a standardised basis. For the 2020 Scotland Section 13, we did not identify any funds as being in the bottom left quadrant. This was also the case for the 2017.

Chart 7.1 SAB relative funding level vs Employer contribution rate (Open funds)



7.5 Table 7.1 sets out the results for the measures we use to assess long-term cost efficiency for open funds. Further details are in Appendix D.

Table 7.1 – Results of LTCE measures

Pension fund	Maturity	Deficit period	Required return	Repayment shortfall	Surplus retention	Return scope	Deficit recovery plan
Dumfries and Galloway Council Pension Fund	7.4	Surplus	3.8%	Surplus	4.1%	0.7%	Green
Falkirk Council Pension Fund	6.5	Surplus	3.3%	Surplus	5.2%	0.6%	Green
Fife Pension Fund	6.3	Surplus	2.8%	Surplus	6.7%	1.8%	Green
Lothian Pension Fund	6.8	Surplus	2.3%	Surplus	4.5%	1.9%	Green
North East Scotland Pension Fund	6.4	Surplus	2.8%	Surplus	3.4%	1.8%	Green
Orkney Islands Council Pension Fund	5.6	Surplus	2.9%	Surplus	-1.5%	2.0%	Green
Scottish Borders Pension Fund	7.0	Surplus	3.6%	Surplus	-0.2%	1.5%	Green
Shetland Islands Council Pension Fund	6.2	Surplus	3.6%	Surplus	5.1%	1.4%	Green
Strathclyde Pension Fund	6.2	Surplus	2.6%	Surplus	2.5%	2.3%	Green
Tayside Pension Fund	6.7	Surplus	3.4%	Surplus	-0.9%	1.7%	Green
The Highland Council Pension Fund	6.7	Surplus	3.5%	Surplus	1.0%	1.0%	Green

Surplus retention

7.6 Given the strong funding position of funds in LGPS Scotland we note that most funds are in surplus on their local funding basis. In addition, all funds are in surplus on a GAD's best estimate basis. Therefore, our focus in respect of LTCE has been on allowance for surplus spreading.

7.7 Where funds are in surplus it may be appropriate for the surplus to be used to reduce future contributions. However, given the nature of pension funds and the potential volatility of the future assets, it is appropriate to ensure that any surplus is spread over a reasonable time frame.

7.8 This surplus retention metric effectively requires total employer contribution rates to not be less than the best estimate standard contribution rate. Where this is not the case, we consider whether the implied surplus spreading on GAD's best estimate basis is not too short. This additional consideration was introduced as part of the 2020 section 13 review.

7.9 In 2020 some funds were paying less than the best estimate standard contribution rate due to the high levels of surplus. We are comfortable that, on the refined metric, funds were not reducing any surplus too quickly and hence it was not appropriate to flag funds under the surplus retention metric.

Deficit Reconciliation

7.10 Where a fund is in deficit administering authorities should avoid continually extending the deficit recovery period end point at each and subsequent actuarial valuations as this will not meet the LTCE requirements. Over time and given stable and better than expected market conditions, administering authorities should aim to, where possible and appropriate:

> Maintain the levels of contributions and/or

> Reduce deficit recovery periods by maintaining the end point of the recovery period.

7.11 We believe it is appropriate for funds to consider their plans for the duration of the deficit recovery period, so that future contributions are recognised and these form part of employers' budgeting process.

7.12 We would not normally expect to see employer contribution rates decreasing (reducing the burden on current taxpayers) at the same time as the deficit recovery end point is being extended further into the future (increasing the burden on future taxpayers). This expectation considers the desire for intergenerational fairness which is required for LTCE.

7.13 We appreciate there may be circumstances where new deficit may emerge between valuations, as a result of the fund's experience, where it may be appropriate to extend the recovery period. For example, if a fund within the last three years of its deficit recovery period experienced a material reduction in its funding level, it may not be appropriate in the context of fairness between current and future generations of taxpayers to repay that new deficit within three years.

7.14 We consider that reconciliation of the deficit recovery plan is an essential component for all funds to demonstrate they meet LTCE requirements.

7.15 We note that all funds in deficit have increased their contributions, therefore we have not raised any flags on this metric.

Dashboard suggestions for recovery plans

7.16 To ensure that we can compare future recovery and surplus plans; we propose that the following additional information is added to the dashboard for each fund (this is covered in recommendation 1, and further detail is set out in Appendix B).

> Three-year average of total expected employer contributions, expressed as a percentage of pensionable pay (current and previous valuation)

> The latest employer deficit recovery period end point at current and previous valuation, where this method is used by the fund's actuarial advisor

> The earliest employer surplus spreading period at current and previous valuation, where this method is used by the fund's actuarial advisor

> The time horizon end point and funding plan's likelihood of success, where this method is used by the fund's actuarial advisor