

Policy Review Group
Pension Managers

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Dear Colleague

GAD's Dry Run – Draft Model Fund

In the covering letter of 27 November accompanying the consultation draft of the Statutory Instrument intended to introduce the first steps in cost sharing mechanisms, paragraphs 17-19 advised that a dry run modelling exercise was being undertaken by GAD. I now enclose for your further consideration during the current consultation period the first draft report which has been produced as a result of this modelling exercise.

The following summarises key findings of the report.

- The accrued going concern liabilities for the scheme as at 31 March 2007 have been estimated at **£144 billion**, ie asset = liabilities
- The going cost of providing benefit is **19.1%** of pensionable pay (SCR – Standard Contribution Rate).
- DMF is **not** equal to an aggregation of all local funds.
- Data provided represents **96%** of the scheme membership.
- The data received from the actuaries was expected to be **cleansed** data although some minor discrepancies were referred to the relevant fund actuaries.
- CRA (Critical Retirement Age) was determined solely by a simple R085 calculation; it doesn't account for complicated calculation of the previous 25 year rule or the effects of transfer-in or added contracts.
- Members reaching age 65 at April 2010 are excluded from the calculation as it is assumed they would retire immediately after the 2010 valuation.

Demography and Benefits

- Average number of male pensioners = 301,000
- Average number of female pensioners = 361,000

- Total number of male pensioners = 435,000
(incl ill-health; deferred; dependent)

- Total number of female pensioners = 627,000
(incl ill-health; deferred; dependent)

- Overall Average Pension per annum
 - Male =£5,771
 - Female =£2,734

DMF – assumptions adopted within the model

- The national asset of the initial FMF = aggregate accrued liabilities on the LGPS at 31 March 2010.
- Accrued liabilities have been valued using a Projected Accrual Benefit.
- FMF will determine the ‘SCR’ for future service cost going forward from April 2010.
- Real rate of return net of price inflation of 3.5%.
- Real rate of return net of earning inflation of 2%.
- Mortality rate: life expectancy for male retiring in 2048 is about 24 ½ years for male and 27 ½ years for female. These figures are higher than assumed for individual fund assumptions at 31 March 2007.
- GMP: calculations are excluded from the DMF, as it is not certain whether it will add any material value and also the GMP data is incomplete and unreliable. Hence for DMF the potential effects of GMP are ignored.

DMF – Output result with application of variants

- The sample scenarios relates to two main variant changes ie longevity and the commutation take-up rate and how a minor change in variant assumption leads to a significant shift in the SCR of the scheme going forward in 2010, as for examples below:
 - Where the mortality rate improves (or longevity increases) say by 1.8% then the assumed (live expectancy for male retiring at 2048 about 24 ½ and female 27 ½ years) would create a liability of £3.3 billion (1.8% x £185b) at 31 March 2010. This will convert into a deficit contribution of 0.1%-0.2% and payroll cost by 0.4%-0.5% leading to increase of 0.3% on SCR going forward. In other words the revised SCR will increase from the original calculation of 19.1% to 19.5%.

- Alternatively where the take of commutations is higher than assumed (60%) will reduce liabilities for the scheme going forward to 2010 however it will make a significant change in the revenue account as it will increase the net expenditure more than expected. For example if the commutation rate is increased by 0.2% above the assumed rate (60%), we would expect a surplus of £0.4 billion (0.2% x £185b) at 31 March 2010. This will convert to a negative surplus spreading adjustment to SCR and if there is no significant change in pay distribution the SCR of scheme going forward will reduce from 19.2% to 19.0%

The initial outcome of the dry run indicates an estimated overall ongoing cost of providing benefit being **19.1%** of pensionable pay. However it should be borne in mind that this figure does not include around 0.3-0.4% administrative costs, nor, more importantly does it take account of certain experience levels which could impact on overall costs and would see an increase in this, possibly optimistic, assessment.

Yours sincerely

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