

# Public Sector Pensions Briefing Note

## Local Government Pension Scheme: FRS17 Projections

December 06

FRS17 valuations are market-based. As LGPS funds are predominantly invested in growth assets (in the expectation that these will, on average, deliver higher returns and hence a lower cost to employers, than investing in assets which more closely match the liabilities), asset values can fluctuate significantly from year to year. Further, the value of the liabilities, and the cost of future service benefits, (the service cost figure which is charged to operating profit), are driven by corporate bond yields and expectations of inflation on the accounting date. The assets and the liabilities will not necessarily move in the same direction and the net pension liability is highly volatile in absolute terms.

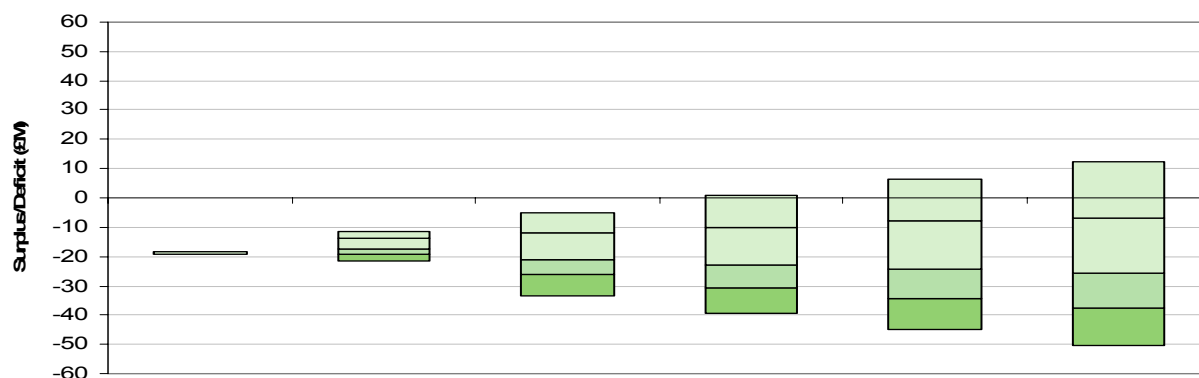
Local authority employers are, to a large extent, protected against the effect of fluctuations in the FRS17 figures. However, this is not the case for corporate bodies participating in the LGPS. This can indirectly affect the local authority where services are outsourced to other bodies, even those partially or wholly owned by the local authority. Some LGPS employers have indicated a desire to better understand how, and to what extent the accounting measures vary from year to year. Further, they wish to know whether the current year's disclosures are "typical" or whether they represent the more extreme outcomes.

### HOW CAN WE HELP?

We can model the range of possible outcomes for both the balance sheet position and revenue account figures (both the service cost and the net income charge/credit). We can then help employers understand how variable the results might be. As an example, the chart below illustrates the range of possible outcomes for the balance sheet position (the net pension asset/liability) from 2006 to 2010 for a sample LGPS employer.

The coloured segments represent outcomes with different probabilities of occurring. There is a 1% chance of an outcome below the bottom of the dark green band; a 5% chance of being below the medium green band; a 16% chance of being below the light green band and a 50% chance of being below the line in the middle of the light green band. There is a 16% chance of being above the top of the light green band. The levels associated with even more beneficial outcomes are shown in the table below, but not in the chart so as not to draw attention to surpluses that may represent irrecoverable levels.

## FRS17 PROJECTIONS



Year ending 31 July	2005 Actual	2006 Projected	2007 Projected	2008 Projected	2009 Projected	2010 Projected
Top 1%	-19.1	-7.8	5.8	16.9	28.4	40.3
Top 5%	-19.1	-9.6	0.1	8.2	17.1	25.3
Top 16%	-19.1	-11.4	-4.8	0.8	6.3	12.4
Median	-19.1	-13.6	-12.0	-10.1	-8.0	-6.8
Bottom 16%	-19.1	-17.2	-20.9	-22.8	-24.5	-25.6
Bottom 5%	-19.1	-19.3	-26.2	-30.8	-34.4	-37.4
Bottom 1%	-19.1	-21.6	-33.5	-39.3	-44.8	-50.4

### NET PENSION ASSET/LIABILITY

What the chart shows is that for this particular employer the central expectation is that the balance sheet position will improve, viz. at the median level, the Net Pension Asset is estimated to improve from a deficit of c£19m in 2005 to a deficit of c£7m at 2010. At the more extreme levels, there is a 1% chance that there could be a surplus of more than £40m in 2010, but also a risk that the deficit could increase considerably: there is a 1 in 100 chance that the Net Pension Asset in 2010 could be a deficit of more than c£50m. Overall, in 2 out of 3 outcomes, the Net Pension Asset lies in the range -£26M to +£12M at the end of the period.

The range of results arises because of the uncertainty of future market conditions, particularly the return achieved on fund assets and the assumptions used to place a value on the liabilities, which are largely prescribed by FRS17.

### WHAT NEXT?

The extent of the uncertainty associated with the future FRS17 position is likely to alarm many employers, particularly those in the private sector. The purpose of the modelling is to inform and to give employers the opportunity to consider whether they wish to try and address (and limit) this volatility. .

We would be delighted to work with administering authorities and their employers in understanding these risks and developing solutions for mitigating these risks if appropriate and are developing a proposal as an add-on to our standard FRS17 reports to include the above modelling. If any employers would be interested in this modelling they should let us know in advance of commissioning an FRS17 report. We are happy to work directly with employers if that would be more helpful (both for the employers themselves and for our administering authority clients).

For further information, or to discuss any matter raised by the Briefing Note, please speak to your usual contact at Hymans Robertson LLP.

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