Royal Borough of Kensington and Chelsea Pension Fund

Pension accounting disclosure as at 31 March 2015
Prepared in accordance with IAS26

Barnett Waddingham
Public Sector Consulting

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1. Introduction

We have been instructed by the Royal Borough of Kensington and Chelsea, the administering authority to the Royal Borough of Kensington and Chelsea Pension Fund (the Fund), to undertake pension expense calculations in respect of pension benefits provided by the Local Government Pension Scheme (the LGPS) to members of the Fund as at 31 March 2015.

This report is addressed to the administering authority and its advisers; in particular, this report is likely to be of relevance to the Fund's auditor.

These figures are prepared in accordance with our understanding of IAS26. In calculating the disclosed numbers we have adopted methods and assumptions that are consistent with IAS19.

This advice complies with all Generic Technical Actuarial Standards (TASs) and the Pensions TAS.

The LGPS is a defined benefit statutory scheme administered in accordance with the Local Government Pension Scheme Regulations 2014, is contracted out of the State Second Pension and currently provides benefits based on career average revalued salary and length of service on retirement. Changes to the LGPS came into effect from 1 April 2014, with various protections in place for those members in the scheme before the changes took effect.

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2. Valuation data

Data sources

In completing our calculations for pension accounting purposes we have used the following items of data, which we received from the Royal Borough of Kensington and Chelsea:

- The results of the valuation as at 31 March 2013 which was carried out for funding purposes;

- Estimated whole Fund income and expenditure items for the period to 31 March 2015;

- Estimated Fund returns based on Fund asset statements provided (or estimated where necessary) as at 31 March 2013, 31 March 2014 and 31 December 2014, Fund income and expenditure as noted above, and estimated market returns thereafter for the period to 31 March 2015; and

- Details of any new early retirements for the period to 31 March 2015 that have been paid out on an unreduced basis, which are not anticipated in the normal employer service cost.

Although some of these data items have been estimated, we do not believe that they are likely to have a material effect on the results of this report. Further, we are not aware of any material changes or events since we received the data.

Employer membership statistics

The table below summarises the membership data, as at 31 March 2013.

Member data summary	Number	Salaries/Pensions	Average age
		£000s	
Actives	2,923	82,250	45
Deferred pensioners	4,238	10,333	45
Pensioners	2,558	19,416	70

Assets

The return on the Fund (on a bid value to bid value basis) for the year to 31 March 2015 is estimated to be 16%. The actual return on Fund assets over the year may be different.

The estimated asset allocation for Royal Borough of Kensington and Chelsea Pension Fund as at 31 March 2015 is as follows:

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Employer asset share - bid value	31 Mar 2015		31 Mar 2014	
	£000s	%	£000s	%
UK Equities	34,163	4%	33,964	5%
Overseas Equities	161,155	20%	135,855	20%
Global Equities	378,145	47%	264,916	39%
Private Equity	42,214	5%	33,964	5%
Property	29,931	4%	27,171	4%
Absolute Return Portfolio	93,754	12%	176,612	26%
Cash	62,635	8%	6,793	1%
Total	**801,997**	**100%**	**679,275**	**100%**

We have estimated the bid values where necessary. The final asset allocation of the Fund assets as at 31 March 2015 is likely to be different from that shown due to estimation techniques.

Unfunded benefits

We have excluded any unfunded benefits as these are liabilities of employers rather than the Fund.

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3. Actuarial methods and assumptions

Valuation approach

To assess the value of the Fund's liabilities at 31 March 2015, we have rolled forward the value of Fund's liabilities calculated for the funding valuation as at 31 March 2013, using financial assumptions that comply with IAS19.

The full actuarial valuation involved projecting future cashflows to be paid from the Fund and placing a value on them. These cashflows include pensions currently being paid to members of the Fund as well as pensions (and lump sums) that may be payable in future to members of the Fund or their dependants. These pensions are linked to inflation and will normally be payable on retirement for the life of the member or a dependant following a member's death.

It is not possible to assess the accuracy of the estimated liability as at 31 March 2015 without completing a full valuation. However, we are satisfied that the approach of rolling forward the previous valuation data to 31 March 2015 should not introduce any material distortions in the results provided that the actual experience of the Fund has been broadly in line with the underlying assumptions, and that the structure of the liabilities is substantially the same as at the latest formal valuation. From the information we have received there appears to be no evidence that this approach is inappropriate.

Demographic/Statistical assumptions

We have adopted a set of demographic assumptions that are consistent with those used for the most recent Fund valuation, which was carried out as at 31 March 2013. The post retirement mortality tables adopted are the S1PA tables with a multiplier of 105% for males and 95% for females. These base tables are then projected using the CMI 2012 Model, allowing for a long-term rate of improvement of 1.5% p.a.

The assumed life expectations from age 65 are:

Life expectancy from age 65 (years)	31 Mar 2015	31 Mar 2014
Retiring today		
Males	22.4	22.3
Females	25.7	25.5
Retiring in 20 years		
Males	24.6	24.5
Females	28.0	27.9

We have also made the following assumptions:

- Members will exchange half of their commutable pension for cash at retirement;

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- Members will retire at one retirement age for all tranches of benefit, which will be the pension weighted average tranche retirement age; and

- 5% of active members will take up the option under the new LGPS to pay 50% of contributions for 50% of benefits.

Financial assumptions

The financial assumptions used to calculate the results in Section 4 and the Appendices are as follows:

Assumptions as at	31 Mar 2015		31 Mar 2014		31 Mar 2013	
	% p.a.	Real	% p.a.	Real	% p.a.	Real
RPI increases	3.2%	-	3.6%	-	3.4%	-
CPI increases	2.4%	-0.8%	2.8%	-0.8%	2.6%	-0.8%
Salary increases	4.2%	1.0%	4.6%	1.0%	4.8%	1.4%
Pension increases	2.4%	-0.8%	2.8%	-0.8%	2.6%	-0.8%
Discount rate	3.3%	0.1%	4.5%	0.9%	4.6%	1.2%

These assumptions are set with reference to market conditions at 31 March 2015.

Our estimate of the duration of the Fund's liabilities is 19 years.

The discount rate is the annualised yield at the 19 year point on the Merrill Lynch AA-rated corporate bond yield curve which has been chosen to meet the requirements of IAS19 and with consideration of the duration of the Fund's liabilities. This is consistent with the approach used at the last accounting date.

The Retail Prices Index (RPI) increase assumption is set based on the difference between conventional gilt yields and index-linked gilt yields at the accounting date using data published by the Bank of England (BoE), specifically the 19 year point on the BoE market implied inflation curve. The RPI assumption is therefore 3.2% p.a. This is consistent with the approach used at the last accounting date.

As future pension increases are expected to be based on the Consumer Prices Index (CPI) rather than RPI, we have made a further assumption about CPI which is that it will be 0.8% p.a. below RPI i.e. 2.4% p.a. We believe that this is a reasonable estimate for the future differences in the indices, based on the different calculation methods.

Salaries are then assumed to increase at 1.8% p.a. above CPI in addition to a promotional scale. However, we have allowed for a short-term overlay from 31 March 2013 to 31 March 2016 for salaries to rise at 1.0% p.a.

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4. Results and disclosures

We estimate that the net liability as at 31 March 2015 is a liability of £264,152,000.

The results of our calculations for the year ended 31 March 2015 are set out in the appendices below:

- Appendix 1 sets out the Statement of financial position as at 31 March 2015;

- Appendix 2 details a reconciliation of assets and liabilities during the year; and

- Appendix 3 shows a sensitivity analysis on the major assumptions.

The figures presented in this report are prepared only for the purposes of IAS19. In particular, they are not relevant for calculations undertaken for funding purposes or for other statutory purposes under UK pensions legislation.

We would be pleased to answer any questions arising from this report.

Graeme Muir FFA
Partner

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Appendix 1 Statement of financial position as at 31 March 2015

Net pension asset as at	31 Mar 2015 £000s	31 Mar 2014 £000s	31 Mar 2013 £000s
Present value of the defined benefit obligation	1,066,149	887,960	897,050
Fair value of Fund assets (bid value)	801,997	679,275	633,200
Net liability in balance sheet	**264,152**	**208,685**	**263,850**

*Present value of funded obligation consists of £952,402,000 in respect of vested obligation and £113,747,000 in respect of non-vested obligation.

Appendix 2 Asset and benefit obligation reconciliation for the year to 31 March 2015

Reconciliation of opening & closing balances of the present value of the defined benefit obligation	Year to 31 Mar 2015 £000s	Year to 31 Mar 2014 £000s
Opening defined benefit obligation	**887,960**	**897,050**
Current service cost	20,629	21,633
Interest cost	39,538	40,778
Change in financial assumptions	136,902	28,881
Change in demographic assumptions	-	32,417
Experience loss/(gain) on defined benefit obligation	-	(111,445)
Liabilities assumed / (extinguished) on settlements	-	-
Estimated benefits paid net of transfers in	(25,701)	(27,559)
Past service costs, including curtailments	608	636
Contributions by Scheme participants	6,213	5,569
Unfunded pension payments	-	-
Closing defined benefit obligation	**1,066,149**	**887,960**

Reconciliation of opening & closing balances of the fair value of Fund assets	Year to 31 Mar 2015 £000s	Year to 31 Mar 2014 £000s
Opening fair value of Fund assets	**679,275**	**633,200**
Interest on assets	30,522	29,176
Return on assets less interest	94,721	14,885
Other actuarial gains/(losses)	-	308
Administration expenses	(473)	(419)
Contributions by employer including unfunded	17,440	24,115
Contributions by Scheme participants	6,213	5,569
Estimated benefits paid plus unfunded net of transfers in	(25,701)	(27,559)
Settlement prices received / (paid)	-	-
Closing Fair value of Fund assets	**801,997**	**679,275**

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Appendix 3 Sensitivity Analysis

Sensitivity analysis	£000s	£000s	£000s
Adjustment to discount rate	+0.5%	0.0%	-0.5%
Present value of total obligation	971,501	1,066,149	1,170,546
Adjustment to long term salary increase	+0.25%	0.0%	-0.25%
Present value of total obligation	1,072,434	1,066,149	1,059,965
Adjustment to pension increases and deferred revaluation	+0.25%	0.0%	-0.25%
Present value of total obligation	1,111,111	1,066,149	1,023,320
Adjustment to mortality age rating assumption	+1 Year	None	- 1 Year
Present value of total obligation	1,028,644	1,066,149	1,104,002

For the adjustment to the mortality age rating assumption, we are essentially assuming a member has the mortality of someone a year older or a year younger, for example, under +1 Year we assumed that a 40 year old actually has the mortality of a 41 year old.

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