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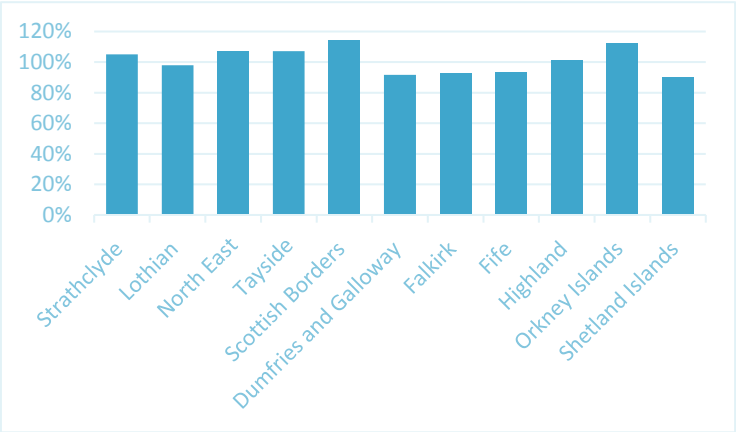
Sixty second summary

Scottish LGPS - 2017 valuation results

At the 2017 valuations Scottish funds saw their funding levels increase from the results reported in 2014, as a result of strong asset performance. Benefits earned up to the valuation date are well funded, but an uncertain outlook for future investment returns presents challenges for employers to meet the ongoing cost of providing LGPS benefits.

Reported funding levels

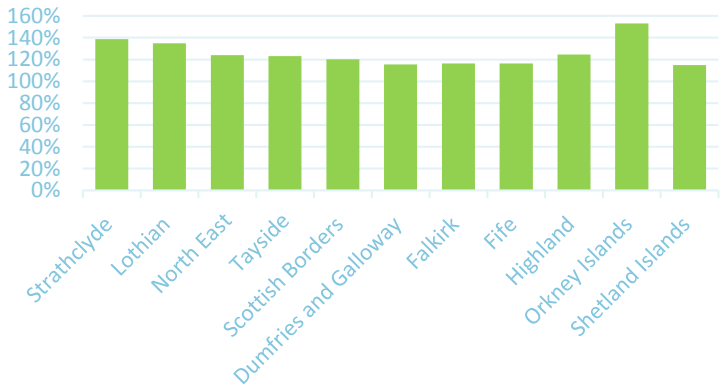


Funds largely experienced positive outcomes as a result of the 2017 triennial valuations.

There is an average increase in reported funding level of around 6% from results reported in 2014. The reported funding level measures a fund's current assets against the assets that the fund targets holding to meet the benefit payments earned. Five funds declared a surplus in 2017, meaning they had more assets than they targeted to hold to meet the payment of benefits accrued up to the valuation date.

Reported funding levels for the 11 main LGPS funds in Scotland as at 31 March 2017 ranged from 90% to 114%.

Funding levels (standardised assumptions)



Many stakeholders find it useful to compare funds not only against their own funding target, but on what we call a 'like-for-like' basis i.e. if each fund had the same target, how would they compare?

We have applied the SCAPE discount rate[1], as used by the Government Actuary's Department in valuing the unfunded public service schemes, to report the funds' liabilities on an equivalent basis. This is a convenient measure for facilitating a comparison between funds but is not a suitable target basis for funding as it does not directly relate to the assets held by LGPS funds.

A surplus on this basis does not imply that the funds have more money than they consider that they need to meet the benefit payments.

[1] The SCAPE discount rate is 2.8% pa net of inflation

Conclusions

The benefits earned before the valuation date are well funded

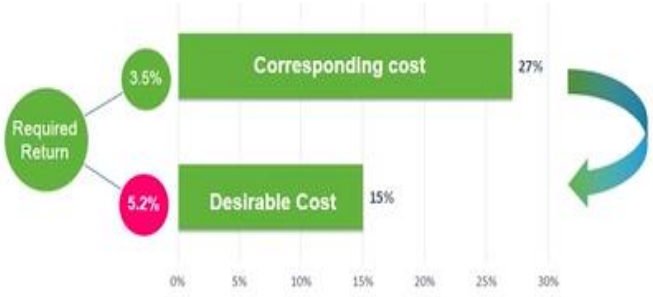
The LGPS is a funded scheme; it aims to hold assets sufficient to enable it to meet all the benefit payments earned. Therefore, a good measure to help paint the picture of how Scotland's LGPS funding has improved over the period is the investment return required to keep past service liabilities fully funded in 2017, against the equivalent figure in 2014.

Scottish funds are holding more assets today per pound of liabilities to be paid in the future than ever before. As a result, the return that funds' investments are required to deliver, to ensure that these past service liabilities are covered, has fallen significantly. As at 31 March 2017, the required return had dropped to **3.3%** p.a. from a required return of **4.5%** p.a. in 2014.

The LGPS is dependent on strong investment returns to deliver affordable new benefits

Although the return required for funds to protect their past service liabilities has fallen, fund members are still accruing future benefits.

To keep the past service benefits funded, the funds could target a low risk return of, say, **3.5%** p.a. which is slightly in excess of the investment return required. However, the corresponding cost of future service benefits to employers, if this return is achieved, is around **27%** of payroll. This is considerably more than most stakeholders would agree is a desirable, affordable and sustainable cost in respect of new future service benefits.



In order to deliver a more affordable future service cost for employers of, say, around **15%** of payroll we estimate that funds would need an investment return of around **5.2%** p.a. There is therefore a significant difference in the return needed from investments in respect of earned and new benefits.

Summary

As at 31 March 2017, Scotland's LGPS is well funded and the investment return required to keep this well-funded position has fallen since the 2014 valuation. However, funding challenges remain.

Past service – the need to protect the strong funding position

- Liabilities are growing relative to the size of employers' payroll so contributions are becoming a less effective way of being able to repay any deficit that could arise in the future.
- We need to protect the strong funding position with suitable investments.

New benefits – managing the cost of the scheme going forward

- Markets remain uncertain and all funds dropped their anticipated returns at the 2017 valuations to reflect this.
- A strong investment return is still needed to ensure future service costs are affordable for employers.