Leicestershire County Council

LOCAL PENSION COMMITTEE - 26 NOVEMBER 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

2022 FUND VALUATION ASSUMPTIONS

Purpose of the Report

1. The purpose of the report is to seek the Committee's approval of the Fund's future investment returns assumption for use in the Fund valuation on 31 March 2022. The Committee will also receive a presentation by Hymans Robertson (Appendix A) regarding the approach for other key assumptions.

Background

2. Leicestershire Local Government Pension Scheme is required to complete a Pension Fund Valuation every three years. The most recent valuation took place on the 31 March 2019 and the next valuation will take place on the 31 March 2022.

3. A report was taken to the Committee on the 10 September 2021 that laid out the valuation timeline and a mid-valuation funding position to assess progress since the last valuation. It also provided a guide to the likely outcome at the 2022 valuation.

4. The next stage in the 2022 valuation is to consider the Fund's valuation assumptions. Assumptions are set by the Fund Actuary (Hymans) through discussions with Officers and the Committee.

Assumptions

5. Assumptions are a mixture of those specific to the Fund and those relating to the wider economy. Whilst there is greater discretion over the former, they would not normally be materially different to other LGPS Funds, and they should balance prudence and fairness to employers.

6. Funds are required to use prudent funding assumptions to ensure protection for member benefits. The approach of the Actuary is to adopt a margin of prudence within the future investment return assumption and set all other assumptions as "best estimates".

7. The assumptions directly impact on the past service funding position and future employer contribution rates. Officers and the Committee need to consider the impact that assumptions have on the future sustainability of the

Fund, alongside the financial burden on employers. Whilst the final employer contributions rates are signed off by the Actuary, Officers must be mindful of the risk to the Fund should any employer become unable to pay.

Future Investment Returns

8. At the 2019 valuation there was high level of uncertainty regarding a pending legal challenge, based on age discrimination in Public Sector Schemes favouring older active scheme members. This is known as McCloud. Following the conclusion of the legal process a decision was made by Government to amend Public Sector Schemes to remove the age discrimination. This had the effect that all eligible members with both final salary and career average benefits, would receive the higher of the two benefits for a period between 2014 and 2022.

9. In 2019 the cost for the McCloud remedy was unclear and SAB guidance at the time instructed LGPS funds to consider and reflect in their Funding Strategy Statement, how this risk had been allowed for. Officers and the Actuary decided to adopt a higher level of prudence in the future investment return assumption to allow for McCloud uncertainty. Instead of using 75% likelihood of achieving target investment returns, an additional 5% margin of prudence was included, so 80% likelihood of achieving future investment return was adopted.

10. There is now greater clarity on McCloud costs and the expected impact is likely to be much lower than originally thought. The estimated costs will now be included directly in the estimate of liabilities at the 2022 valuation.

11. To avoid double counting the McCloud impact officers propose to reduce the required likelihood of achieving future investment return from 80% to 75% in the 2022 valuation. By doing so, this increases the future return assumption over the next 20 years from 3.8% per annum to 4.1% per annum, based upon the current Strategic Asset Allocation and economic outlook at 31 March 2021. The consequence is there will be a net improvement to the funding position, although the Fund is taking on a greater level of investment risk but not at a concerning level. The 75% likelihood target for future returns is consistent with the 2019 target once the McCloud margin is removed. This proposed change has been discussed with the Actuary who support this view. This approach is likely to be in line with other funds.

Indicative impact on funding and future employer contribution rates

12. By moving from 80% likelihood of achieving target future investment returns to 75%, it is broadly expected that this, alongside the strong investment performance of the Fund since 2019, the overall funding position will improve and many employers may become 100% funded. However, some employers may still see an increase in contribution rates despite this improvement in past service funding as the cost of future benefit accrual has increased since 2019.

As a well-managed Fund, Officers only want to increase employer contribution rates where necessary.

13. Employer rates are split into two, primary and secondary rates.

- The primary rate covers the cost of future benefit accrual.
- The secondary rate covers the cost of benefits already accrued.

14. Hymans indicate the cost of future benefit accrual has increased which is likely to increase the cost of the primary rate. The likelihood of the average primary rate, 20.4% of pay meeting the cost of future benefit accrual has reduced from 78% at 31 March 2019, to 70% at 31 March 2021. Until we reach March 2022 it not known what the final position will be.

15. Therefore, whilst the overall funding position is likely to improve, reducing employer rates is unlikely. However, any increases to employer rates will be generally lower than in previous Fund valuations.

14. The risk individual employers pose to the Fund will also be considered when employer rates are established, with higher risk employers possibly paying more to reduce their deficit faster, thereby reducing the risk to the Fund.

15. Whilst Officers must manage the overall Fund risk and take a prudent approach, there is an acceptance where employers are significantly above 100% funded there should be an easing on these employers' rate. Until the indicative rates are calculated and individual employer risks are known, the final methodology cannot be finalised, but Officers and Hymans are working on a framework that provides prudence for the Fund but also provides fairness to employers. Officers will provide further information to Committee during the valuation process.

The table below shows an indicative framework, noting that the specific detail remains under discussion between Officers and the Actuary. The final detail will be included in the Funding Strategy Statement towards the end of 2022.

Employer Funding Level	Action
Less than 100%	Employer funding plan continues to target being 100% funded in the future – i.e. the employer pays the new primary and new secondary rates in full
100% to 110%	Employer pays the new primary rate - meeting the cost of future benefits accruing. No secondary rate applies.
110% to 120%	Employer pays the lower of the new primary rate (for future benefit accrual) or their total rate currently in payment.
120% plus	Employer can benefit from contribution rate reductions – i.e. the

	total contribution rate proposed may be less than the total rate currently in payment.

It is important to note; there may be some employers where the above approach is not appropriate, e.g. where there are additional risk factors to consider. Officers are keen that any return of the surplus must be managed and not run down too quickly.

Other assumptions

16. There are other key assumptions used at the valuation. These are;

- Pensions Increases / career average revaluation – driven by CPI
- Salary increases – influences final salary scheme benefits
- Longevity/mortality – life expectancy for pensioners
- Other demographics – fund specific based on actual member experience e.g. commutation, ill health retirements etc

The CPI assumption will be set by the Actuary and this will be based on market conditions and the future economic outlook at the valuation date. Typically, this assumption will be the same across all funds advised by the Actuary. The Fund uses Club Vita analytics to inform the best estimate for the longevity/mortality assumption. These assumptions will be individually tailored to the Fund's membership and the short and longer terms of COVID will be considered as part of this process.

17. It is too early to state what these assumptions will be, but it is only salary increases that need to be set by Committee. The impact of salary increase is declining as fewer active members retain pre-2014 service which is linked to the member's final salary. Since 1 April 2014 service is linked to career average earning (CARE). A review of the current active membership shows 43% still have pre-2014 service, with the remaining 57% having only CARE service. As time increases, fewer and fewer members will still have the final salary link. A future report will be presented to the Committee in June 2022 detailing these assumptions.

Timeline for the 31 March 2022 Valuation

18. As detailed in the September Committee report, the following table provides a guide to the estimated timeline for the 31 March 2022 valuation. For the 2022 valuation, Officers intend to split the employers into two working groups. This is simply designed to assist administration. It allows the Pension Section to deal with one group of employers first (the stabilised employers), then moving onto all the other employers. The stabilised employers tend to be the larger tax raising employers, e.g. Leicestershire County Council, Leicester City, the Borough and District Councils, Police and Fire authorities.

Date	Topic	Action or Awareness
August/September 2021	Mid-valuation funding update	Board/Committee - **done**
September 2021	Provide Hymans with stabilised employer data	Pension Section - **done**
September/October 2021	Calculate indicative stabilised employer rates	Hymans - **ongoing**
November 2021	Agree principles for the 2022 assumptions	Committee
March 2022	Results of the stabilised employer modelling	Committee
April 2022	Provide the stabilised employers with their indictive rates. 1 April 2023 to 31 March 2026	Pension Section/Stabilised employers
June 2022	Approve final valuation assumptions	Committee
August 2022	Provide Hymans with all Fund data	Pension Section
August/September 2022	Review selected employer's financial health	Pension Section
August/September 2022	Calculate Fund results	Hymans
September/October 2022	Whole Fund valuation results	Committee/Board
October/November 2022	Provide the other employers with their indicative rates. 1 April 2023 to 31 March 2026	Pension Section/Fund employers
December 2022	Changes to Fund Funding Strategy Statement and Investment Strategy Statement	Pension Section/Fund employers
February 2023	Funding Strategy Statement and Investment Strategy Statement finalised	Committee/Board
March 2023	Final valuation report produced with final employer rates	Hymans
April 2023 to March 2026	Employer rates implemented	Pension Section/Fund employers

Recommendation

It is recommended that;

a. the assumption regarding likelihood of meeting future investments returns be set at 75% and approved for use in the 2022 valuation of the Fund

b. the Committee note the remaining assumptions

Equal Opportunities Implications

None specific

Appendix

Appendix A – Hymans slides on the 2022 assumptions

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