

Leicestershire County Council Pension Fund

Pension Committee update on
2022 Valuation assumptions

26 November 2021

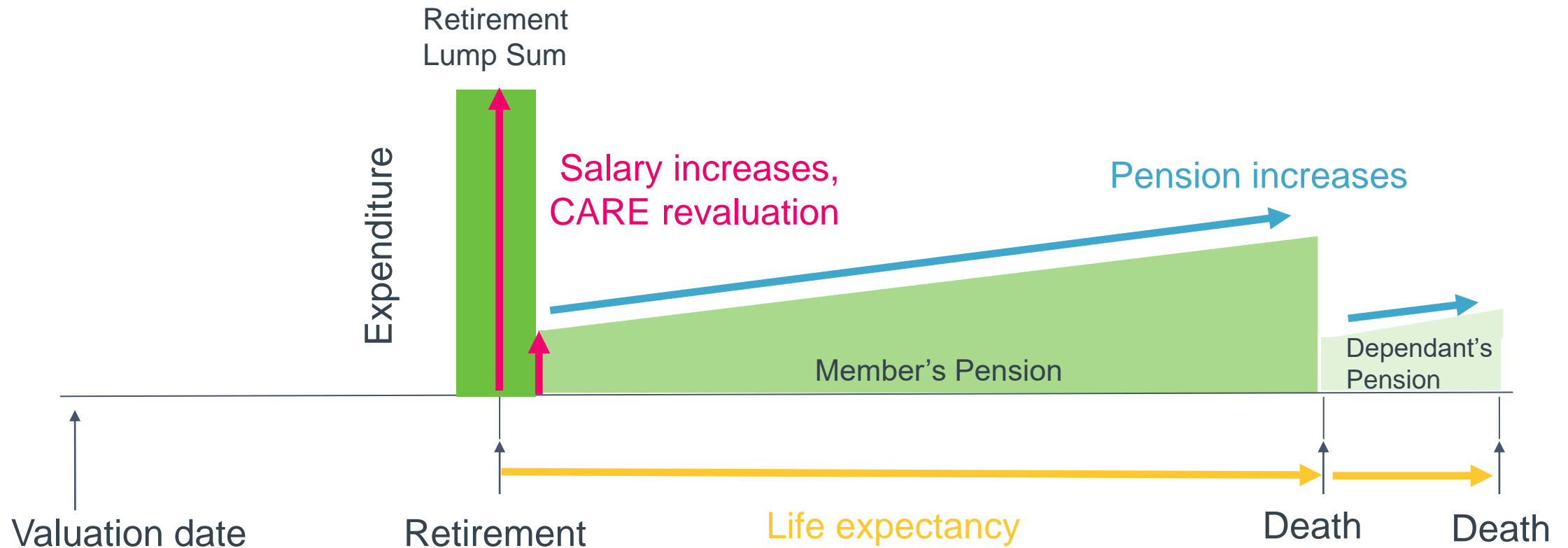


Funding valuation assumptions - overview

- Selection of appropriate assumptions is a key risk management tool
- Set by the Fund actuary through discussions with officers (and Committee)
- Assumptions should be Fund-specific (where appropriate)
- Funds are required to adopt prudent funding assumptions
- Margin of prudence included in the future investment return assumption
 - All other assumptions are 'best estimate'

Key discussion: What level of prudence should the Fund adopt for the 2022 valuation?

Why do we need assumptions? (recap)



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Assumptions made about the future to project future benefit payments

Actuarial assumptions – impact on results

Assumption	Source
Future Investment Returns	Based on Fund's asset portfolio (incl. margin of prudence)
Benefit Increases (CPI)	Consumer Prices Inflation (CPI)
Longevity / Mortality	Tailored to Fund members - ClubVITA analysis
Salary Increases	Typically (CPI) inflation plus a small margin
Other demographics*	Fund specific, based on actual member experience

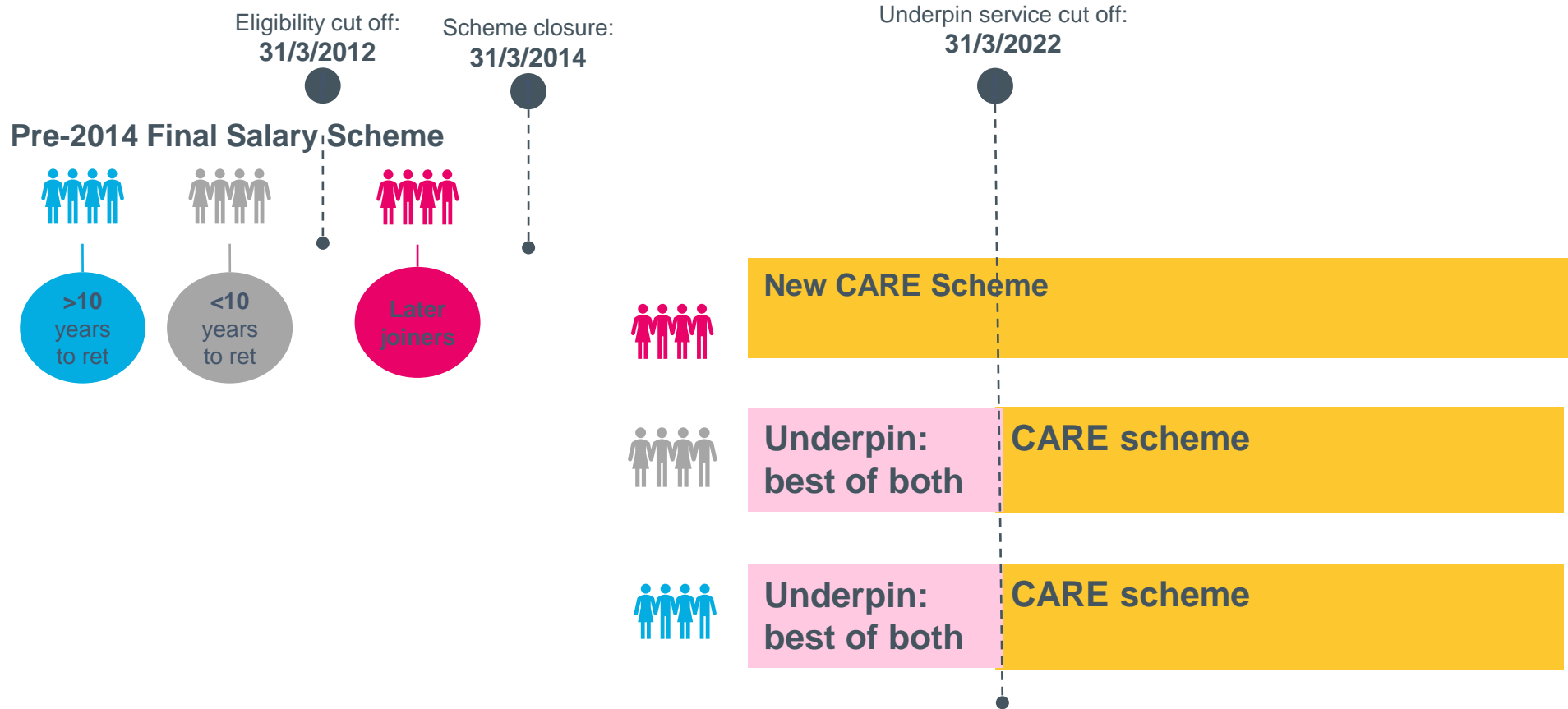


*including commutation, ill-health retirements and withdrawals etc.

All assumptions are long-term to reflect the long-term nature of the future benefit payments

Future investment returns (level of prudence)

'McCloud' underpin



An estimate will be calculated as part of employer liabilities at 2022 valuation

McCloud – 2019 valuation approach (recap)

Page 8 on the Fund’s Funding Strategy Statement says:

“The Fund, in line with the advice in the SAB’s note, has considered how to allow for this risk in the setting of employer contribution rates.

The Fund has taken the following action:

An additional margin of prudence has been included in the method for setting contribution rates to allow for the uncertainty in the cost of past and future benefits. This margin has been established by targeting a higher likelihood of success for employers – see table 3.3”

80% likelihood measure was adopted at 2019

This was 5% higher than initially proposed to allow for McCloud uncertainty

McCloud – 2022 valuation approach

More clarity now on proposed remedy

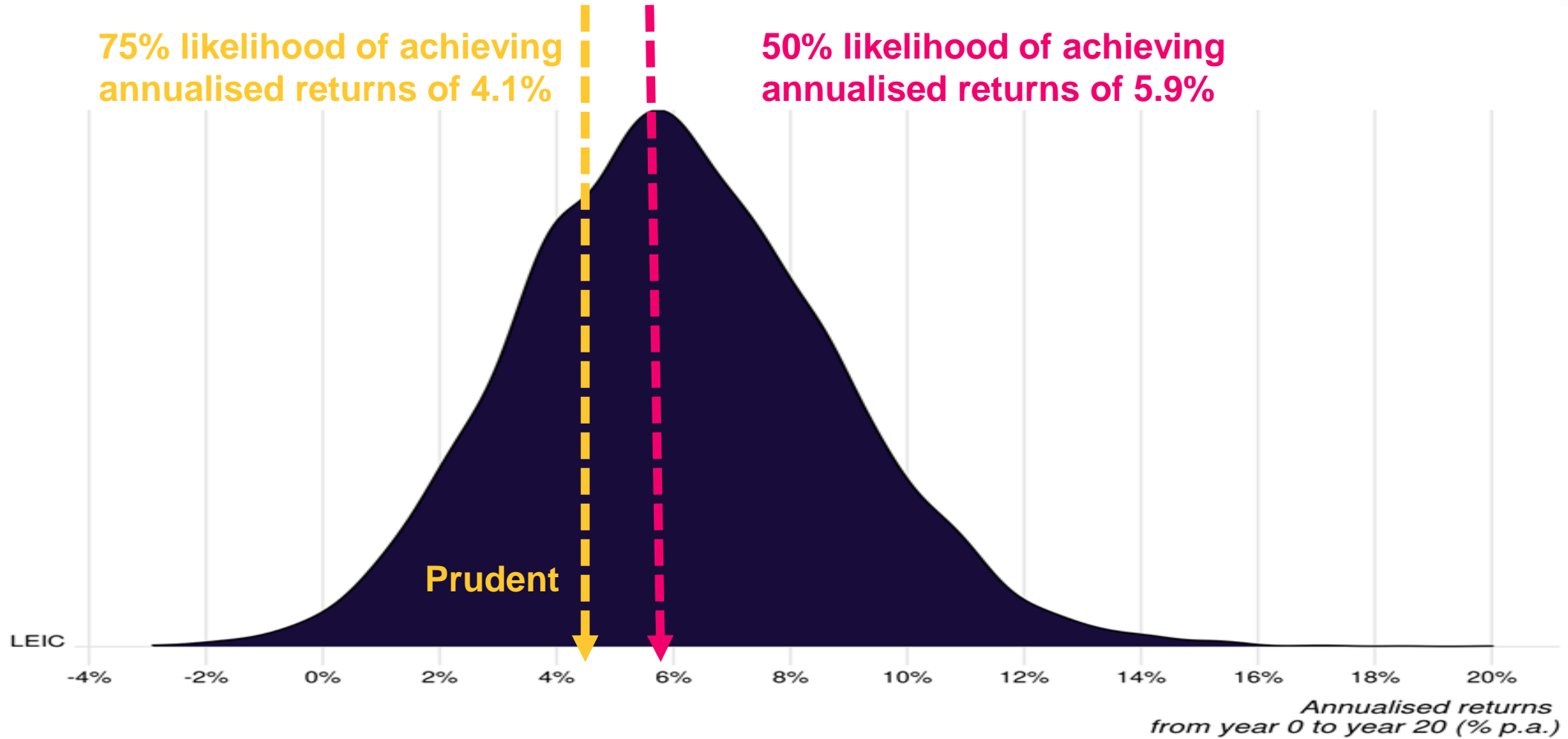
- Unlikely that membership data will be updated to include McCloud for 2022 valuations

Proposed approach is to calculate an estimate within the liabilities at 2022

- Same approach adopted for Scottish valuations in 2020
- On average, the expected impact of McCloud is likely to be less than 1% increase in liabilities.

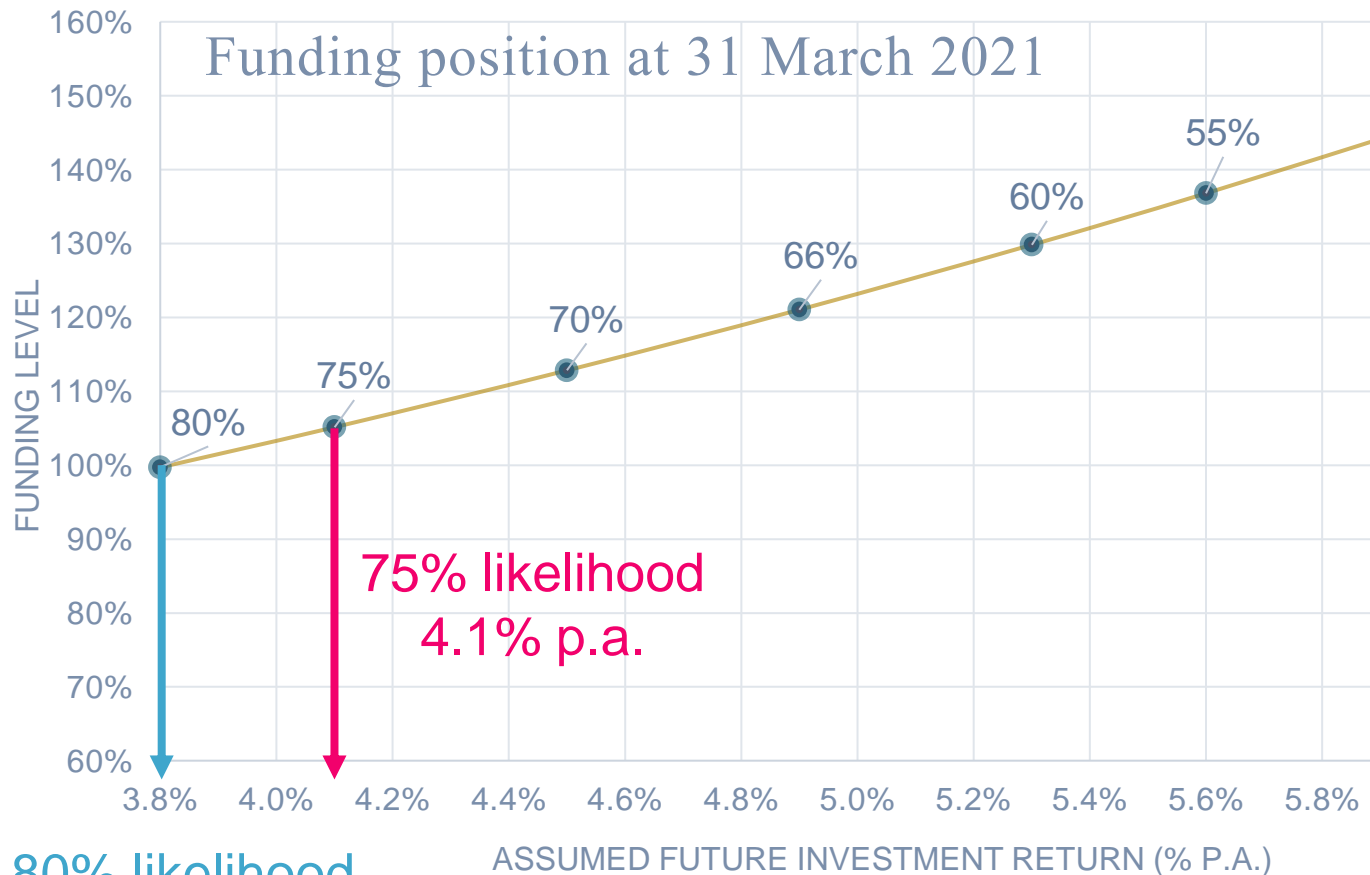
**Estimated McCloud impact will now be included in liabilities
The Fund can remove the additional 5% margin of prudence that was included at 2019**

Future investment return assumption (at 31 March 2021)



Leicestershire future investment returns modelled within our projected asset return model

What is the impact on funding levels? (recap)



80% likelihood
3.8% p.a.

75% likelihood
4.1% p.a.

Likelihood of achieving returns	80%
Future return assumption*	3.8% p.a.
Funding level	100%
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Likelihood of achieving returns	75%
Future return assumption*	4.1% p.a.
Funding level	105%

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*annualised return over next 20 years

Level of prudence should be a principles-based decision

How important is it to be 100% funded?

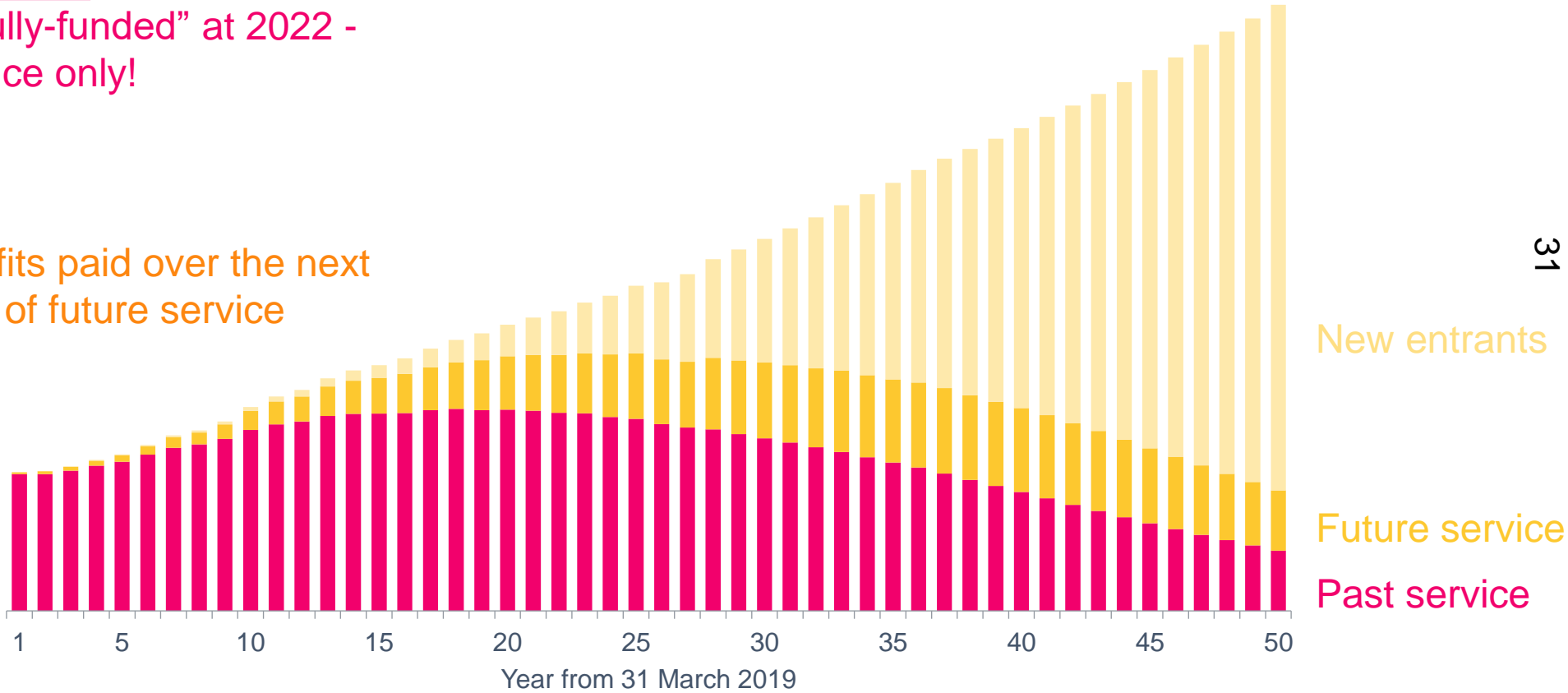
Past service funding position:

Many employers will be “fully-funded” at 2022 - but this refers to past service only!

Future service

Around 2/3rds of the benefits paid over the next 50 years will be in respect of future service

Projected benefit payments from 2019 valuation



Cost of future benefits is more important than past service funding position

Future investment returns assumption - summary

Proposed assumption

At 2019 the Fund adopted an 80% likelihood measure for future investment returns being achieved. This included a 5% margin to allow for the potential costs of the McCloud judgement.

At 2022 the estimated impact of McCloud will be included in liabilities, therefore the **Fund proposes to remove the additional 5% McCloud margin.**

Impact of the proposed assumption

Employer funding levels will increase by around 5%

We may expect to see relatively stable rates for many employers
- some rates may still increase as the cost of future accrual has risen

Propose to adopt a 75% likelihood target for achieving future investment returns at the 2022 valuation

What lies ahead? Key decisions and dates

Autumn/Winter 2021

Pre-valuation work:

- Planning
- Data cleansing
- Contribution modelling (precepting employers)
- Employer risk profiling
- **Reviewing assumptions (today)**
- Review of funding and investment strategy

September 2022

Initial whole fund results issued

December 2022 - January 2023

Changes to employer funding strategies
Funding Strategy Statement consultation

1 April 2023

New employer contributions start to be paid

March 2022

Results of modelling for precepting employers

June 2022

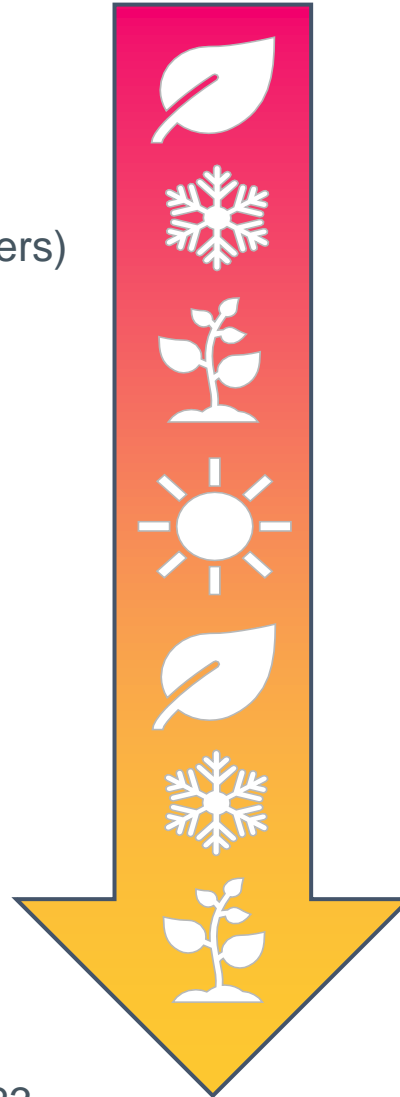
Final valuation assumptions including further analysis brought to committee

October/November 2022

Initial employer results finalised and issued

March 2023

Final valuation report signed
Funding Strategy Statement finalised



Appendix: other assumptions

Inflation

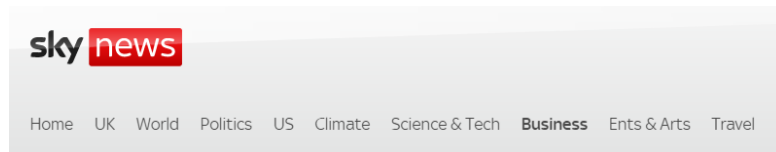


Higher future inflation?



Money Markets Project Syndicate B2B Retail

UK inflation could soar above 4% this year, thinktank warns



COVID-19: 'Cost inflation hits record high' for services firms but recovery 'in full swing'

Bloomberg

Economics

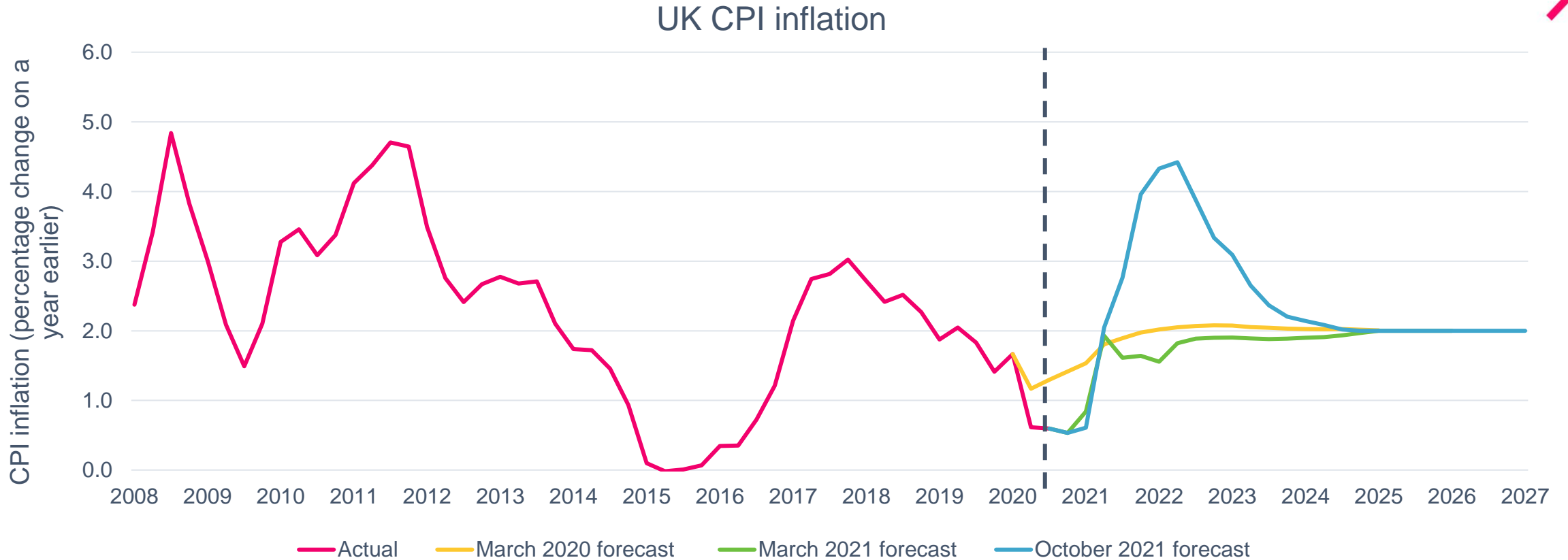
Business Worries About U.K. Inflation Reach Highest Level in a Decade



Bank governor warns against overreaction to higher inflation

Higher inflation would increase pension costs, but no certainty if it will be a long-term trend or short-term blip

Concerns about inflation



The approach at 2022 will allow for shorter term market conditions and longer term expectations

Inflation assumption summary

Pension increases (CPI)

At 2022 the Pension increase (CPI) assumption will be set by considering the median outcome (i.e. the 'best estimate') from our inflation model over the next 20 years.

This long term assumption is less impacted by shorter term market conditions or demand-driven influences within the markets (as illustrated recently with the market's lack of reaction to the Government's announcements on RPI reform).

Salary increases

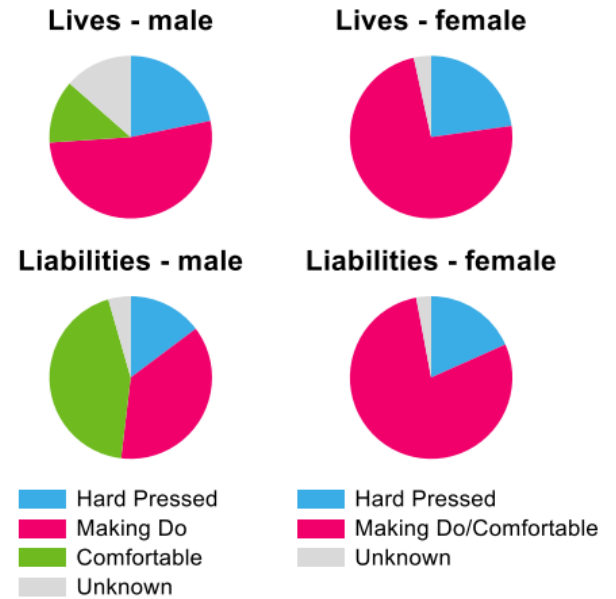
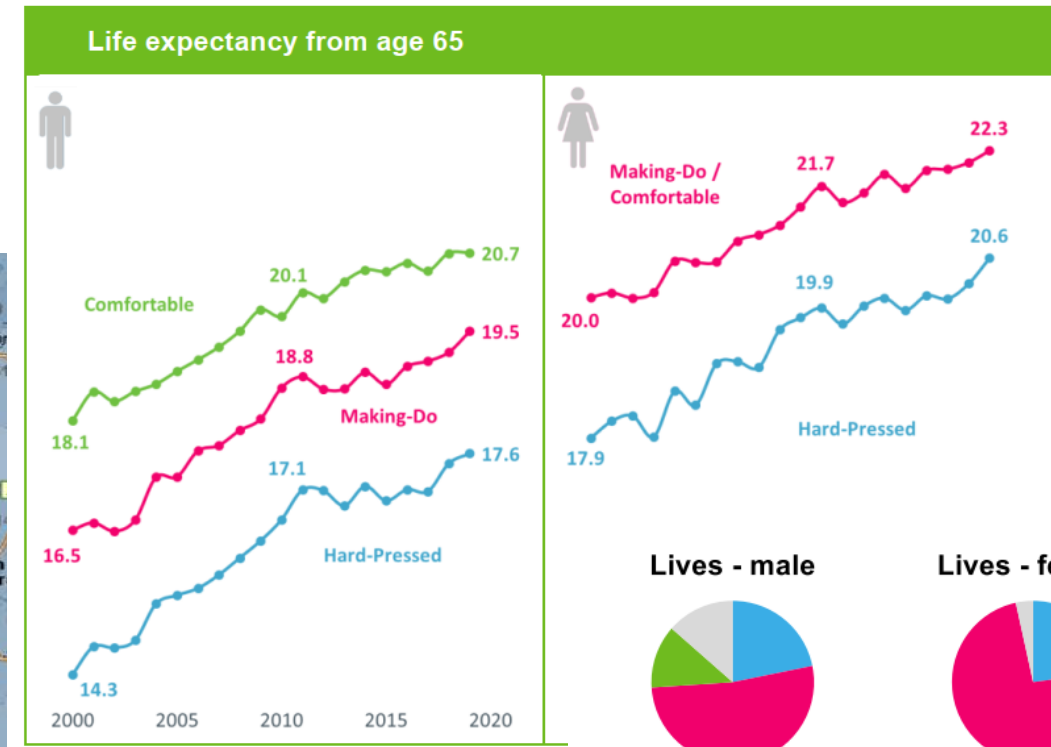
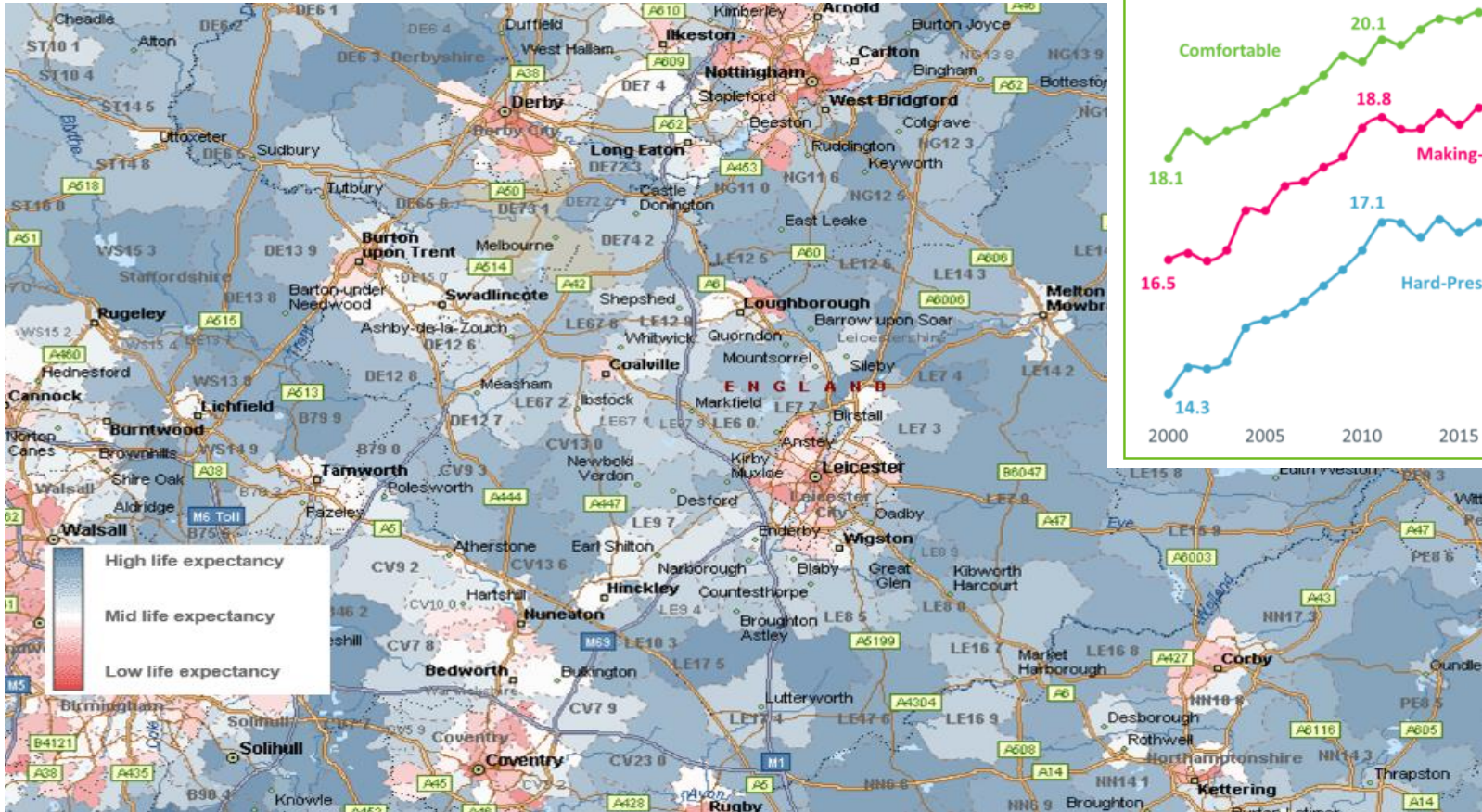
At 2022 the salary increase assumption will continue to be set with reference to CPI (plus a small margin). This assumption is becoming less significant as the proportion of final salary linked benefits continues to reduce.

The McCloud underpin has created an additional period (between 2014-2022) where a final-salary link potentially remains. However, analysis supports that this underpin is unlikely to 'bite' in the majority of cases.

Further analysis and proposed assumptions will be brought to Committee in 2022

Longevity and other demographic assumptions

Club VITA analytics



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Assumptions tailored specifically to Leicestershire Fund members

COVID-19 – long term impact on longevity

Lower longevity improvements

Global recession

Weaker economies impact future public sector spending in health care etc.

Impaired long-term health

The long term health of those who were infected with Covid-19 but survived the virus might be damaged.

Existing patient deterioration

Deterioration of patients with non-coronavirus conditions due to delays in treatment (e.g. cancer).

New virus strains emerging

Risk of different strains of the virus emerging in future.

Higher longevity improvements

Survivorship bias

The average health of the surviving population could be higher in the years following the outbreak.

Change in social behaviour

Changes in behaviour (e.g. increased handwashing) may reduce prevalence of flu etc in future.

Reduction in air pollution

Change in social behaviour may result in the reductions to air pollution persisting.

Reduction in smoking

Disease may have encouraged existing smokers to stop.

What could the longer term impact of the pandemic on longevity mean for funding pensions?

Longer term impact on pension funding?



Bump in the road



-0.9% LIABILITIES | -1 MONTH DURATION



Innovation in adversity



+2.1% LIABILITIES | +4 MONTHS DURATION



Long road to recovery



-2.5% LIABILITIES | -3 MONTHS DURATION

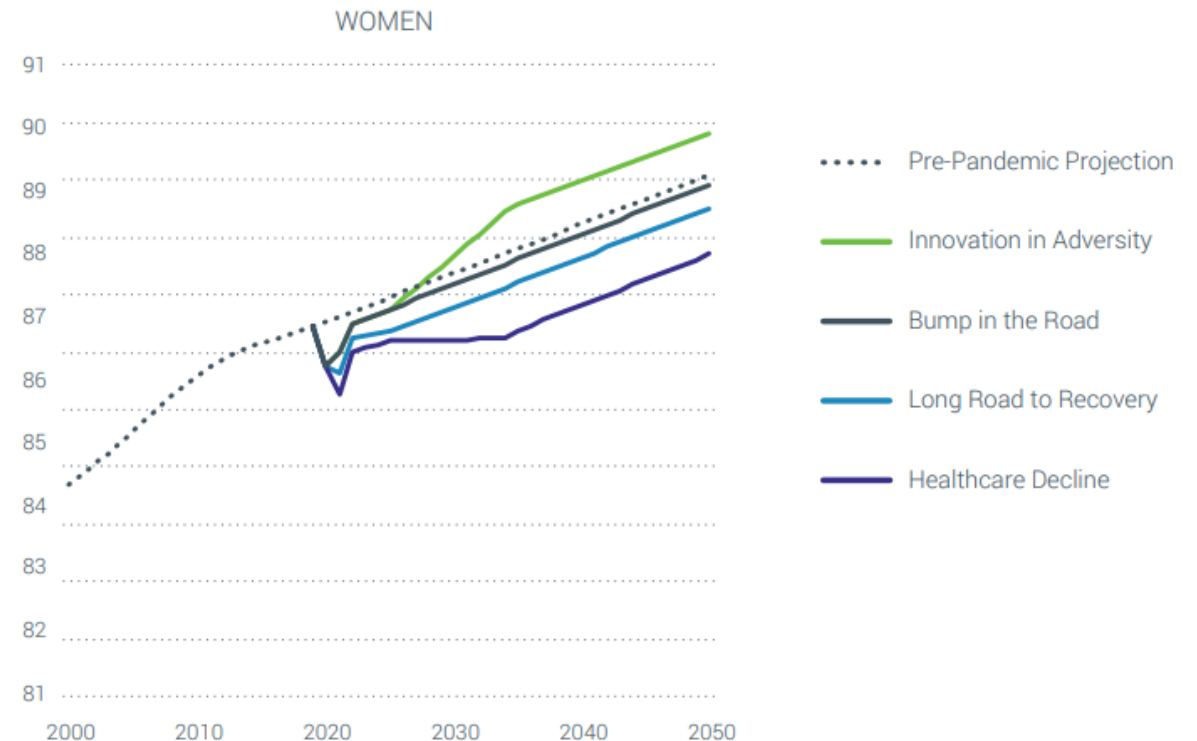


Healthcare decline



-5.3% LIABILITIES | -7 MONTHS DURATION

Life expectancy from age 65



Longevity analysis will be carried out as part of the 2022 valuation

Other demographic assumptions

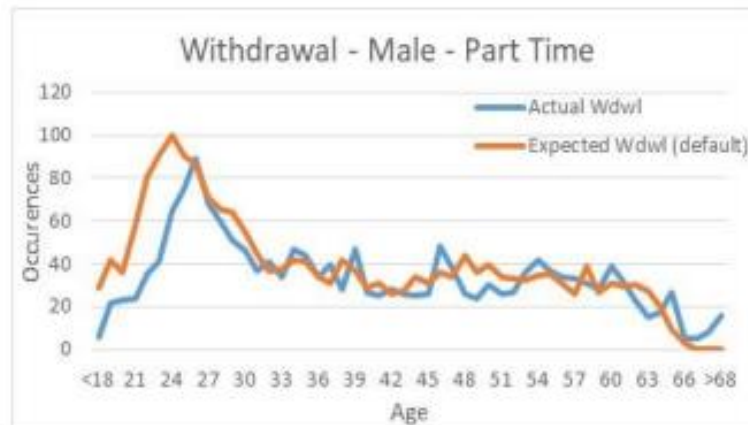
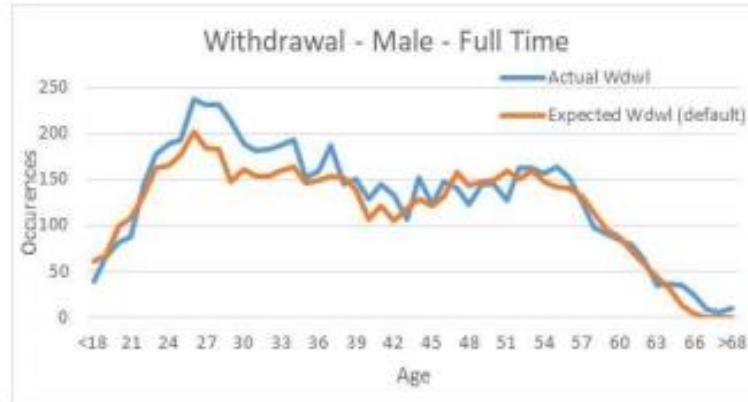
Commutation

Tier 1 Ill-health

Proportions married

Withdrawal

Tier 2 Ill-health...etc



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Fund specific demographic analysis will be carried as part of the 2022 valuation

Summary of assumptions

Actuarial assumptions - summary

Assumption	Approach at 2022 valuation
Future Investment Returns	Proposed: 75% likelihood of returns being achieved based on the Fund's portfolio and markets at 31 March 2022.
Benefit Increases (CPI)	Median inflation outcome from inflation model (over next 20 years). Assumption will be based on modelling at 31 March 2022.
Longevity / Mortality	Tailored to Fund members using ClubVITA analysis. Impact of COVID will be considered within future longevity assumption.
Salary Increases	CPI inflation plus a margin – officers will consult with major employers and the actuary to propose appropriate long-term assumption.
Other demographics	Officers and the actuary will review assumptions based on member data and adjust if necessary.

High



Low

Assumptions will be finalised after 31 March 2022 and brought to June 2022 committee for approval

Employer contribution framework (draft)

Indicative employer contribution framework

Funding level	Approach
Less than 100%	Employer funding plan continues to target being 100% funded in the future – i.e. the employer pays the new Primary and 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 <u>lower</u> of the new Primary Rate (for future benefit accrual) or their total rate currently in payment.
120% plus	Employer is allowed to benefit from contribution rate reductions - i.e. the total contribution rate proposed may be less than the total rate currently in payment.

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Final details to be included in draft Funding Strategy Statement brought to Committee in 2022

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