



LOCAL PENSION COMMITTEE - 10 JUNE 2022

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PENSION FUND VALUATION 2022

Purpose of the Report

1. The purpose of this report is to request that the Committee approve the proposed assumptions used in the Leicestershire Local Government Pension Scheme (LGPS) valuation.

Background

2. Every three years each LGPS administering authority has a statutory obligation to have an actuarial valuation (Valuation) of the pension scheme. The Leicestershire Pension Fund's (Fund) assets and liabilities are assessed on the 31 March 2022 and the overall funding position calculated.
3. The main aim of the Valuation is to set contribution rates for each employer for a three year period that commences one year after the valuation date (i.e. for the period 1 April 2023 to 31 March 2026). In order to set the contribution rates, the Fund Actuary Hymans Robertson, must take account of a number of factors, most of which are the assumptions, on what is likely to happen in the future. These assumptions do not impact onto the ultimate cost of paying benefits they simply calculate the liability derived from these benefits, which in turn impacts the level of contributions set.
4. There is a requirement within the LGPS Regulations that there is an element of prudence built into the actuarial assumptions and that the actuary sets contributions in line with these prudent assumptions while maintaining contribution stability for employers, where possible.

Assumptions

5. The assumptions required for the valuation are grouped by;
 1. Longevity
 2. Investment return and discount rate
 3. Benefit revaluation and pensions increases
 4. Salary increases
 5. Others

Further details on slide 10 of Hymans' report Appendix B

6. Longevity, the investment return (and discount rate) and benefit revaluation (and pension increases) generally have the greatest influence on employer contribution rates.

Longevity

7. The data used by Club Vita is Leicestershire Fund specific, using Fund members' individual data points, including postcode analysis. This allows Hymans Robertson to calculate the longevity likelihoods by member (and employer) area within the Leicestershire Fund and benchmark this to the national average.
8. Longevity assumptions are based upon modelling performed by Club Vita. The assumption is broken into two components:
 1. Baseline
 2. Future improvements.

Further details on slide 23 of Hymans' report Appendix B

9. Baseline longevity reflects current observed mortality (nationally, within the LGPS and within the Leicestershire Fund) and is informed by Club Vita analytics on the Leicestershire Fund members.

Further details on slide 24 of Hymans' report Appendix B

10. Future improvements reflect the expected improvement in life expectancy into the future. The Actuary uses an industry wide longevity CMI (continuous mortality investigation) model and uses Club Vita analysis to help to set the parameters of the model.
11. Given that both 2020 and 2021 experience has been affected by Covid 19 no weight is placed on data from these years. There remains uncertainty on the long-term impact of Covid 19 so the position will continue to be monitored closely for future valuations.
12. However, after excluding uncertainty for Covid 19, Club Vita analysis suggests a reasonable long-term trend of 1.5% annual improvements in longevity. The strength of this recommendation has increased since the previous valuation, where the annual improvement in longevity was 1.25% p.a.. Hymans have suggested the Fund increase this for the 2022 valuation to 1.5%.
13. In isolation, the proposed changes to the longevity (future improvements) assumption will increase assumed life expectancy by around 0.5 years for females currently aged 45 (and around +0.2 years for males).

Further details on slide 27 of Hymans' report Appendix B

14. Longevity results in the Leicestershire Fund are slightly higher than the national average.
15. A presentation from Club Vita forms part of the report and the slides are attached as Appendix A.

Investment return and discount rate

16. Investment returns are based on two separate assumptions. The first assumption is the Fund's future investment returns for the next 20 years. This is derived in a similar way to the comPASS modelling with multiple economic projections being created. These projections are used to calculate the expected performance of each of the asset classes the Fund holds. This range of expected returns over the 20 year period is applied to the holdings in the Fund's asset allocation strategy.

Further details on slide 15 of Hymans' report Appendix B

17. At the November 2021 Committee Meeting, Committee approved a 75% prudence level on the likelihood of the Fund's investment strategy achieving returns over a given period. Using the Hymans economic scenario model, and aiming to meet a 75% success rate, produces a 4.4% p.a. assumed investment return (over years 0-20).

Further details on slide 16 of Hymans' report Appendix B

18. In isolation, adopting a 4.4% p.a. future investment return assumption for calculating funding levels will improve past service funding positions which will lead to lower Secondary rates for employers. This should help to offset the increased cost of future accrual (largely driven by higher inflation).
19. Beyond a 20-year time horizon uncertainty increases greatly, hence a different approach is taken. A single assumption about future investment returns is set, known as the discount rate. The resulting discount rate is based on the underlying economic conditions in year 20 of each scenario modelled, allowing for the Fund's agreed level of prudence (75%).

Further details on slide 15 & 17 of Hymans' report Appendix B

Benefit revaluation and pension increases

20. Hymans model various inflation outcomes within its economic projections. While raising inflation is a risk, this is generally mitigated by the higher inflation on the assets that should provide higher returns.
21. At the 2022 valuation benefit projections are in line with the long-term consumer price index projections within this model.
22. There is no change in approach at the 2022 valuation, but Hymans have used updated modelling calibrations to reflect the current market outlook in the short to medium term.
23. The Hymans model allows for observed market information and short terms trends to reflect current market conditions at 2022, but generally the longer end of the 20-year model remains broadly the same as at the 2019 valuation, i.e., longer term projections are broadly in line with the Bank of England target of 2%.

24. The median (average) CPI over the first 20 years within the model is 2.7% p.a. which is slightly higher than the Bank of England target of 2%, due to the short-term higher inflation increasing the long-term estimate.
25. Given the current economic situation, inflation will continue to be closely monitored by the Fund Actuary and Officers over the coming months.

Further details on slide 18 & 21 of Hymans' report Appendix B

Salary increases

26. Salary increases are becoming less significant as more people have only career average benefits (CARE) service since April 2014. At the 2019 valuation 62% of active members had pre-April 2014 service, linked to final salary, and this has dropped to 40.4% at 2022.
27. Consumer Price Index (CPI) is measured over a 20-year average as noted in paragraph 24, not CPI now.
28. At the 2019 valuation there was an allowance for short-term pay restraint, but this has been removed for the 2022 valuation.
29. The salary increases assumption for the 2022 valuation is CPI of 2.7% plus 0.5% plus a promotional element to account for people moving through the scale points within their pay grade.

Further details on slide 19 of Hymans' report Appendix B

Other assumptions

30. There are several other demographic assumptions that are listed on page 29 to 31 of Hymans report.

These are;

- Withdrawals from the scheme (excluding ill -health)
- Ill health retirements
- Promotional salary scale
- Deaths in service
- 50/50 scheme take up
- Retirement age
- Cash commutation
- Proportion leaving a dependant.

These assumptions have been modelled using the Leicestershire Fund data and based on the Club Vita analysis.

Funding Strategy Statement and Investment Strategy Statement

31. The key policy changes in the Fund's draft Funding Strategy Statement (FSS) will be reviewed by Officers and will be presented to Committee in September 2022.
32. The full draft Funding Strategy Statement (FSS) and Investment Strategy Statement (ISS) will be reviewed and presented to Committee in November 2022. This is reliant on completion of the Climate Strategy.
33. The Fund will propose to start a consultation with employers on the FSS and ISS after Committee in November 2022. To assist administration, this will commence at the same time employers receive their indicative employer rates.
34. The final assumptions will be taken to Committee in February 2023 alongside the final FSS and ISS after completion of the employer consultation.

Timeline

35. The Valuation timeline has been expanded and accounts for the minor changes as agreed with the Fund Actuary, to primarily account for the FSS and ISS. The revised timeline is detailed below.

Date	Topic	Action or Awareness
August/September 2021	Mid-valuation funding update	Board/Committee – complete
September 2021	Provide Hymans Robertson with stabilised employer data	Pension Section - complete
September/October 2021	Calculate indicative stabilised employer rates	Hymans Robertson – complete
November 2021	Agree principles for the 2022 assumptions	Committee - complete
March 2022	Results of the stabilised employer modelling	Committee – complete
April 2022	Provide the stabilised employers with their indicative rates. 1 April 2023 to 31 March 2026	Pension Section/Stabilised employers – complete
June 2022	Detail proposed valuation assumptions	Committee – current stage
August 2022	Provide Hymans with all Fund data	Pension Section
August/September 2022	Review selected employer's financial health	Pension Section
September 2022	Review proposed key policy changes to the Funding Strategy Statement	Committee
September/October 2022	Calculate Whole Fund results	Hymans Robertson
October/November 2022	Whole Fund valuation results	Board/Committee
November 2022	Investment Strategy Statement Draft Funding strategy statement (full)	Committee

November 2022 (through to the 31 December 2022)	Provide the other employers with their indicative rates. 1 April 2023 to 31 March 2026. Start a consultation with employers on the Funding Strategy Statement and Investment Strategy Statement (subject to possible amendments for the climate strategy)	Pension Section/Fund employers
January 2023	Changes to Funding Strategy Statement and Investment Strategy Statement	Pension Section/Fund employers
February 2023	Final assumptions and Funding Strategy Statement and Investment Strategy Statement finalised	Committee/Board
March 2023	Final valuation report produced with final employer rates	Hymans Robertson
April 2023 to March 2026	Employer rates implemented	Pension Section/Fund employers

Recommendation

It is recommended that the Committee;

- a. Approves the approach to the Fund valuation;
- b. Approves the following assumptions, noting these could change between now and February 2023.

Assumption	Approach
Longevity	A long-term trend of 1.5% annual improvements
Investment Return	4.4% p.a. assumed investment return over 0 to 20 years aiming to meet a 75% success rate, using Hymans latest economic scenario model
Discount Rate	Beyond 20 years, use the Fund's agreed level of prudence of 75%
Benefit Revaluation and Pensions Increase	The median (average) CPI over the first 20 years of 2.7% p.a.
Salary Increases	0.5% above 2.7% CPI inflation
Others	Model using the Leicestershire Fund data and based on the Club Vita analysis

- c. That the Director of Corporate Resources, following consultation with the Chair of the Local Pension Committee, be authorised to make any amendments to the assumptions set out in b., noting any changes will be reported to Committee.

Equality and Human Rights Implications

None

Appendices

Appendix A – Club Vita Longevity Update

Appendix B – Hymans Robertson Assumptions Paper

Background Papers

[25 March 2022 - Local Pension Committee – 2022 Fund Valuation – Results of the Stabilised Employer Modelling](#)

[26 November 2021 –Local Pension Committee 2022 Fund Valuation Assumption](#)

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