



**LOCAL PENSION COMMITTEE - 9 SEPTEMBER 2022**

**REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

**PENSION FUND VALUATION - FUNDING STRATEGY STATEMENT**

**Purpose of the Report**

1. The purpose of this report is to inform Committee of the key policy changes in the Leicestershire Local Government Pension Scheme (LGPS) draft Funding Strategy Statement (FSS).

**Background**

2. Each LGPS administering authority has a statutory obligation to have an actuarial valuation carried out every three years and all Funds in England and Wales have a valuation carried out as of 31 March 2022.
3. The major purpose of the actuarial valuation is for the actuary to set employer contribution rates 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). To set these contribution rates the actuary must take account of a large number of factors, most of which are assumptions of what will happen in the future. The draft assumptions for use at the 31 March 2022 valuation were presented to Committee at the 10 June 2022 meeting.
4. In addition to the assumptions that remain under review, Officers must review and update the Fund's Funding Strategy Statement (FSS). The FSS underpins the Fund policies and includes a table detailing the Fund's framework for setting contribution rates for differing employer groups.
5. As part of the valuation process, employers must be made aware of the FSS and any key changes, and a consultation must take place with the employers. A timetable of the valuation process is included in the report.

**Funding Strategy Statement**

6. The Actuary and Fund Officers work collaboratively on the Fund's FSS. Officers have used this opportunity to review the "style and presentation" of the FSS, with the intention of making this easier to navigate for all parties.
7. The new style FSS is made up of two main sections. A core section and appendices. The "core section" covers the following;

- Welcome to the FSS
- Calculation of employer contributions
- Additional contributions that may be payable
- Calculation of assets and liabilities
- Employers joining the Fund
- Bulk transfers of staff
- Employers leaving the Fund
- Statutory reporting

Appendices to the core FSS, generally relate to Leicestershire Fund policies that cover the following;

- Regulatory framework
- Roles and responsibilities
- Risks and controls
- Assumptions
- Pass-through policy
- Academies policy
- Contribution reviews
- Cessation policy

8. Much of the information in the new style draft FSS remains the same as the Fund's previous FSS, but for ease the key changes are highlighted in yellow. These are detailed as follows;

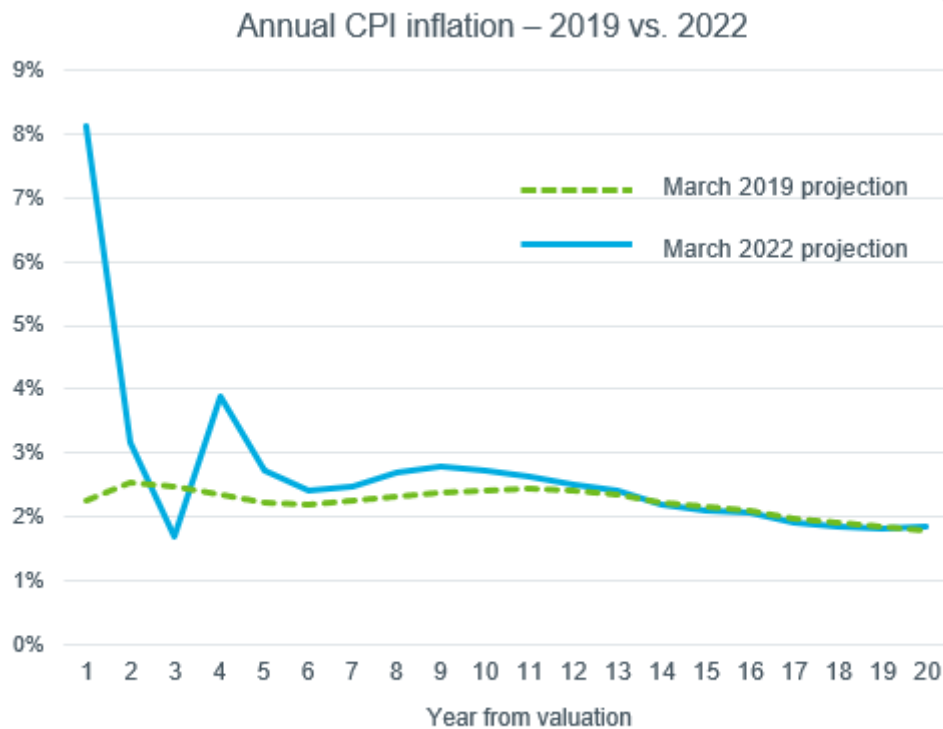
- Contribution reductions (page 4 – Point 2.3). This sets out the Fund's proposal on how to deal with employer rates, especially with the improved funding position since the 2019 valuation, for those well-funded employers in surplus. The concept was taken to Committee on the 26 November 2021 for noting, and further information will follow in the final FSS in early 2023.
- Prepayment of contributions (page 6 – Point 2.9). There is no change to the Fund's current approach for the prepayment of contributions, however this is now more explicit in the FSS.
- Early retirement on ill-health grounds (page 7 – Point 3.2). There is no change to the Fund's current approach to ill health risk mitigation, however this is now more explicit in the FSS.
- Risk and control – For best practice the FSS now includes a link to the Fund's risk register (Appendix C – C1). The risk register will continue to be reviewed by Officers.
- Employer covenant assessment and monitoring (Appendix C – C6). There is no change to the Fund's current approach, however this is now more explicit in the FSS.

- Climate risk and Taskforce on Climate-Related Financial Disclosure (TCFD) reporting (Appendix C – C7). This makes the Fund’s approach more explicit in the FSS.
- The Fund has updated the assumptions applied at cessation following an employer’s exit from the Fund (Appendix D – D5). This is a proposed change and moves away from a gilts-based cessation for employer’s exiting the Fund with no guarantor. Further information will be brought to Committee on this.

### **Assumption - Inflation**

9. As detailed in the valuation report to Committee on the 10 June 2022, because of the ongoing economic situation, inflation continues to be closely monitored by the Fund Actuary and Officers.
10. Current inflation is significantly above the Bank of England target (2% pa) and the assumption proposed for the 2022 valuation of 2.7% pa. A high 2023 pension increase of around 10% is likely, based on the expected September 2022 Consumer Price Index (CPI) inflation. However, prevailing expectations are that inflation pressures will be relatively short-term (1-2 years) and move back towards the Bank’s target in the longer-term (3 years +). In the contribution modelling carried out by the Fund’s actuary to set employer rates, the inflation assumption used reflects this pattern and allows for the short-term spike in the early years.
11. The CPI inflation assumption quoted in the FSS (and as proposed at June 2022 committee) of 2.7% pa is an average of the short-term high levels and lower longer-term reversion to around 2% pa, over the approximate average period of the Fund’s liabilities (see chart below). There remains uncertainty around both the level of future short-term inflation and how long the current period of higher inflation will last. However, whilst higher inflation pushes up the value of the Fund’s liabilities, the Fund is currently invested in many asset classes that would be expected to provide a good level of protection against sustained periods of higher inflation, e.g. growth assets such as equities are generally expected to perform better in an inflationary environment to provide similar levels of ‘real’ returns.
12. The vast majority of employers in the Fund are open employers with a long-term commitment to the LGPS. This means that the Fund (and the Actuary) can take a longer-term view on risks such as high short-term inflation. This is similar to the long-term approach the Fund was able to take during the pandemic when asset values fell by over 10% (which would have a similar impact on funding). The Fund carried out in-depth asset liability modelling for the stabilised group of employers in quarter one 2022. The funding strategy was ‘stress tested’ for various risks, including climate transition risks, asset shocks and high inflation. The results evidenced that the current funding strategy is resilient to these risks at an acceptable level of prudence.

13. Employers planning on exiting the Fund soon (such as admission bodies with contract end dates) may be more concerned about the impact of short-term inflation on their funding position after the valuation date. Officers and the Fund Actuary will be considering the future funding implications for this group closely at the valuation and will seek to engage early with affected employers. The wider impact to the Fund of this group is mitigated by
- (i) the majority of short-term employers now participate on a passthrough basis with their pensions risk exposure retained by secure, longer-term employers, and
  - (ii) many of the admission bodies (non-passthrough) are expected to be well funded at the 2022 valuation.
14. The Fund will continue to monitor actual and future expected inflation (and how the Fund's assets have performed in 'real' terms) as more information emerges. Officers plan to bring additional detail to the November Committee on the impact of inflation on future cashflows (and fund liquidity) once the 2023 pension increase order (which is based on September CPI) is known.



*Chart shows median expected annual CPI inflation from the Fund actuary's ESS (Economic Scenario Service) model.*

## Timeline

15. The latest valuation timeline is detailed as follows.

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

	Start a consultation with employers on the Funding Strategy Statement and Investment Strategy Statement (subject to possible amendments for the climate strategy)	
January 2023	Changes to Funding Strategy Statement and Investment Strategy Statement	Pension Section/Fund employers
February/March 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

16. The full draft Funding Strategy Statement (FSS) and Investment Strategy Statement (ISS) will be reviewed and presented to Committee in November 2022. This aligns with development of the Net Zero Climate Strategy.
17. Officers 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.
18. The final assumptions will be taken to Committee in March 2023 alongside the final FSS and ISS after completion of the employer consultation.

### **Recommendation**

It is recommended that the Committee notes

- i. The work undertaken by Fund officers and the Fund's Actuary on proposed changes to the Funding Strategy Statement.
- ii. That the draft Funding Strategy Statement and draft Investment Strategy Statement will be presented in November prior to proposed engagement with scheme employers.

### **Equality and Human Rights Implications**

None

**Appendix**

Appendix A – Fund’s Draft Funding Strategy Statement

**Officers to Contact**

Mr D Keegan, Assistant Director Strategic Finance and Property  
Tel: 0116 305 7668 Email: [Declan.Keegan@leics.gov.uk](mailto:Declan.Keegan@leics.gov.uk)

Mr I Howe, Pensions Manager  
Tel: 0116 305 6945 Email: [lan.howe@leics.gov.uk](mailto:lan.howe@leics.gov.uk)

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