Leicestershire County Council

LOCAL PENSION COMMITTEE – 29 NOVEMBER 2024

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

2025 VALUATION PRINCIPLES

Purpose of the Report

1. The purpose of the report is to seek Committee's approval of the funding principles for the Leicestershire County Council Pension Fund (the Fund) 31 March 2025 valuation.

Background

2. The Fund's funding level has improved since the 2022 formal funding valuation. The estimated funding position of the Fund is around 150% as at 30 June 2024 (compared with 105% as at 31 March 2022). Further details underpinning the key drivers in this funding level improvement are set out in the Funding risk update and 2025 valuation planning document, included as an Appendix to this report. The same Appendix was included in the Funding risk update and 2025 valuation planning report that went to Local Pension Committee (LPC) meeting on the 6 September 2024.

3. The Fund continues to manage risks and uncertainty within the financial markets and take appropriate action to mitigate the exposure for the Fund and its employers. While the strong past service funding position is positive for the Fund, the current economic environment remains volatile, and the Fund recognises a need for caution within the funding strategy framework ahead of the 2025 formal funding valuation.

4. As part of the planning for the 2025 funding valuation, it is proposed that the following four areas are focused upon in setting appropriate long-term funding objectives to maintain a strong position for employers and members:

    a. Employer contributions
    b. Target funding levels
    c. Prudence levels
    d. Investment strategy

5. Although the recent improvement in funding is good news, employers continue to face a wide variety of challenges from the evolving economic, demographic and regulatory environment. Higher inflation, interest rates and pay awards are all adding financial pressures on employers.

6. Finding the right balance between Fund security against the affordability of employer contributions is important. As proposed in the following section, the Fund aims to strike such a suitable and fair balance for employers when developing the funding framework to set employer contributions.

7. As part of the 2025 valuation, employer covenant risk will also be assessed to ensure early engagement with employers and appropriate risk categorisation. How this risk categorisation impacts on its holistic approach to setting employer funding strategies will also be considered.

Proposed Funding Principles - 2025 Fund Valuation

8. The Fund have considered its approach to four key funding principles for managing risk and setting employer contribution rates for the 2025 Fund valuation:

- *Stabilised employers*: maintain current approach to smoothing contributions
- *Target funding level*: maintain current approach to target funding levels.
- *Increased prudence*: to recognise uncertainty in funding environment.
- *Employer investment strategy*: retain single investment strategy for all.

Stabilised employers

9. In line with previous valuations, the Fund has adopted a stabilised approach to setting employer contribution rates for the employers that are considered lower risk. These employers tend to be tax raising bodies and include larger Councils, namely the County, City, Boroughs and Districts, and Police and Fire Authorities.

10. The stabilised approach is designed to protect these employers from volatility between the three yearly valuation cycles, by "smoothing" their employer rates, meaning more gradual stepped increases when in deficit, but equally, gradual stepped decreases when in surplus.

11. This approach has been widely accepted by the stabilised employers and is set out in the Fund's Funding Strategy Statement.

12. The Fund's current approach is to allow for up to +/- 2% per annum on employer contributions, thereby the maximum of 6% increase/deduction in a three-year valuation cycle.

13. Officers propose the current stabilised employer approach is maintained for the 2025 valuation.

14. The Fund Actuary is carrying out contribution modelling for the stabilised employers and the results of this modelling will be brought to the March 2025 Committee.

Target funding level

15. At the 2022 valuation, Officers introduced a higher funding level target in its approach to contribution reductions. This funding principle is designed to maintain a level of flexibility within the funding plan to protect both employers and the Fund against adverse market movements which could otherwise lead to more volatile future contributions for employers.

16. The target funding level acts as a cushion against key funding risks outlined in the appendix report titled 'Funding risk update & 2025 valuation planning' (for example, climate risks).

17. Employers were consulted on the introduction and methodology during the 2022 valuation process, which was approved by the LPC and is detailed in the Fund's Funding Strategy Statement.

18. The methodology used at the 2022 valuation is shown below and officers propose to adopt a similar approach for the 2025 valuation.

Employer Funding Level	**Total Contribution Rate**
Less than 100%	Employer pays a contribution rate to increase their funding level
Between 100% and 110%	Employer pays a contribution to continue to build up their funding level to between 110% and 120%
Between 110% and 120%	Employer pays a contribution to maintain their funding level to between 110% and 120%
Greater than 120%	Employer is allowed to benefit from a contribution rate reduction, to gradually reduce their funding level down to 120%, where applicable

19. When formalising funding strategy in 2025, Fund Officers will review whether the current targets (for example, 120% funding level target) remain appropriate for all employers or whether different levels should be adopted to recognise the current funding environment or to reflect varying employer risks. Changes in the Funding Strategy will be brought to the LPC in 2025 before a period of consultation with employers.

20. It is important to note; there may be some employers where the above approach is not appropriate, for example, where there are additional risk factors to consider. The administering authority retains full discretion over employer contribution rates.

Increased Prudence

21. There are many risks and sources of uncertainty within funding LGPS pension benefits. Employer funding positions have improved since the previous formal funding valuation at 31 March 2022, however many of the same risks and

challenges remain. The Fund propose to increase prudence levels within the funding strategy at the 2025 valuation to manage and protect against poor future funding outcomes from increased uncertainty in markets (for example, future inflation and investment returns).

22. The Fund adopted a 75% prudence level within the future investment return assumption at the 2022 funding valuation. To reflect and manage increased uncertainty in financial markets, the Fund is minded to increase the level to 80% at the 2025 valuation, but to continue to keep this under review over the coming months. All else being equal, this change means that the Fund will assume a lower investment return when setting funding plans (which helps to mitigate investment risk, however there is still a 20% chance that returns will be lower than we assume at this prudence level).

23. At 30 June 2024 this proposed change to 80% prudence would lead to a lower estimated funding level of 138% (instead of 150%) by assuming a lower level of future investment return of 5.8% pa (instead of 6.4% pa). See page 8 in the Appendix for context of the impact of increasing prudence on the funding level.

24. The Fund will also review the full range of actuarial funding assumptions for the 2025 valuation and return to present the analysis and results in June 2025 (in line with the 2025 timetable below).

Employer Investment strategy

25. The Fund is currently undergoing its annual investment strategy review. As part of 2025 valuation planning, Fund officers, alongside Hymans Robertson, have considered its approach to employer investment strategies.

26. The Fund currently operates a single investment strategy for all employers. From initial discussions, Fund Officers believe that it is not appropriate at this stage to operate any additional strategies (for example, an alternative / lower risk option for certain employers) given the current employer make-up and the potential challenges in implementing multiple employer investment strategies.

27. To ensure robust governance and decision making, Fund Officers, the Actuary with the support of the investment advisor will consider the case for continuation of a single strategy for all employers, which is the case for most of the LGPS funds in England and Wales. Officers will provide an update next year.

2025 valuation – Expected outcome

28. Officers accept the 150% funding position as at June 2024 was an estimation based on a single set of assumptions about the future, and asset values at a single point in time. Caution therefore remains, when setting assumptions and setting employer expectations.

29. However, officers feel the proposed principles provide sufficient prudence to protect the Fund and its employers yet provide well-funded employers the opportunity to have future contribution rate reductions from the 2025 valuation.

Timeline for the 31 March 2025 Valuation

30. The following table provides a guide to the estimated timeline for the 31 March 2025 valuation. Note, these dates are intended to provide the LPC with an awareness of the upcoming milestones, however, at this stage the exact timing of each item remains under discussions with Officers and Hymans.

Date	**Topic**	**Stakeholder(s)**
November 2024	Calculate indicative stabilised employer rates	*Hymans (currently ongoing)*
November 2024	Agree principles for the 2025 valuation	**Committee – current stage**
March 2025	Results of the stabilised employer modelling	Committee
March/April 2025	Review funding policies and employer risk management	Pension Section
April 2025	Provide the stabilised employers with their indictive rates. 1 April 2026 to 31 March 2029	Pension Section/Stabilised employers
June 2025	Agree final valuation assumptions	Committee
August 2025	Provide Hymans with all Fund data	Pension Section
September 2025	Calculate Fund results	Hymans
September/October 2025	Whole Fund valuation results	Committee / Local Pension Board
October/November 2025	Provide the other employers with their indicative rates. 1 April 2026 to 31 March 2029	Pension Section/Fund employers
November/December 2025	Changes to Fund Funding Strategy Statement and Investment Strategy Statement	Pension Section/Fund employers
February 2026	Finalise funding Strategy Statement and Investment Strategy Statement	Committee / Local Pension Board
March 2026	Final valuation report produced with final employer rates	Hymans

Date	Topic	Stakeholder(s)
April 2026 to March 2029	Employer rates implemented	Pension Section/Fund employers

Recommendation

31. It is recommended that the Local Pension Committee approves the following principles for use in the 2025 valuation:

- To maintain the current stabilised approach for the employers deemed lower risk;
- To maintain the higher funding level target introduced at the 2022 valuation;
- To increase prudence level to 80%.

Equal Opportunities Implications

32. There are no direct implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance ("ESG") factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund's fiduciary duty. The Fund will not appoint any manager unless they can show evidence that responsible investment considerations are an integral part of their decision-making processes. This is further supported by the Fund's approach to stewardship and voting through voting, and its approach to engagement in support of a fair and just transition to net zero. There are no changes to this approach as a result of this paper.

Human Rights Implications

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Appendix

Appendix – Funding risks update & 2025 valuation planning

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