Agenda Item 6

LOCAL PENSION COMMITTEE – 14 MARCH 2025

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

2025 FUND VALUATION – RESULTS OF THE STABILISED EMPLOYER MODELLING

Purpose of the Report

1. The purpose of the report is to recommend the Local Pension Committee (LPC) approve the results of the stabilised employer modelling, a consultation with the stabilised employers, and a mid-valuation cycle review in September 2027. Details of the Actuarial results are appended to the report.

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 2022 and the next valuation will take place on the 31 March 2025.

3. A report was taken to the LPC on the 29 November 2024 that laid out the valuation principles and timeline. The LPC provisionally agreed to the following funding principles which have been tested within the modelling exercise:

    - increase in prudence (from 75% to 80%) to recognise uncertainity in markets
    - adopt a funding target of 120% to provide a buffer against adverse experience and to protect employers
    - retain the stabilisation policy with increases/decreases of 2% of pay pa.

4. The actuarial calculations in the Appendix have been modelled using these funding principles. This is shown on page two of the Appendix.

5. As detailed in the valuation timeline the stabilised employers have been modelled earlier using prior membership data. This enables these employers to receive their expected employer rates approximately 9 months early, assisting them with their financial planning.

6. It is possible to model these employers in advance of the valuation date due to the long-term nature of their participation and the stability mechanism used in their funding strategy, which means their results are not so strictly dependent on the membership data or market conditions precisely on the valuation date.

7. The next stage in the 2025 valuation is to inform the stabilised employers of their expected contribution rates for the period 1 April 2026 to 31 March 2029.

8. The stabilised employers are the larger tax raising employers, namely Leicestershire County Council, Rutland County Council, Leicester City Council, the Borough and District Councils, ESPO, Police and Fire authorities.

9. The Fund's Funding Strategy Statement permits stabilisation if:

   - the employer satisfies the eligibility criteria based on tax raising status, financial security and time horizon in the Fund set by the Administering Authority and;

   - there are no material events which cause the employer to become ineligible, for example, significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring) or changes in the security of the employer.

10. Stabilisation is permitted in the expectation that the employer will be able to meet its obligations for many years to come. Stabilised employer contributions are limited to smaller annual increases and decreases of +/-2% of pay p.a. thereby a maximum of 6% of pay increase/decrease in a three-year valuation cycle. This is regardless of any larger fluctuations in the markets, thereby improving stability and affordability of contributions for the longer term.

11. This method is designed to protect these employers from volatility between the three-year valuation cycles by "smoothing" their employer rates meaning more gradual stepped increases when in deficit, but equally, gradual stepped decreases when in surplus.

12. Stabilised contribution strategies tested are detailed on page 15 of the Appendix.

Modelling

13. The Actuary modelled 5,000 economic simulations for future investment return and inflation, as these are unknown and volatile.

14. The likelihood of success is the percentage of the 5,000 simulations that meet the funding objective at the end of the employer's funding horizon.

Prudence

15. The Fund has adopted 80% prudence (previously 75% in 2022), meaning in 80% of the 5,000 simulations, the employers would need to meet the target funding level (see below), at the end of the employer's funding time horizon (17 years).

16. By using 80% prudence this provides the Fund greater flexibility to manage contribution volatility in future and is justified in the current uncertain economic environment.

17. The modelling looked at total contributions required (i.e. Primary Rate for the cost of future benefit accrual plus Secondary Rate for the cost of benefits already accrued).

18. It is noted, by increasing to an 80% prudence level, the actuarial results still enable the stabilised employers to receive the maximum rate reduction.

Target funding level

19. At the LPC meeting on the 29 November 2024, Committee approved maintaining the prudent funding target of 120%. The current contribution framework is detailed in the Fund's Funding Strategy Statement and is summarised below:

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

20. It is noted that targeting a 120% funding level (in addition to increasing prudence to 80%) still enables the stabilised employers to receive the maximum rate reduction (i.e. 6% of pay over 3 years).

21. The LPC has provisionally agreed (in November 2024) to increasing prudence and maintaining a target funding levels of 120%, decisions which are supported by the modelling results.

22. Final decisions on prudence levels and funding targets will be made later in the valuation process during the review of the actuarial assumptions and funding framework which is expected to be brought to the June Committee meeting.

Contributions

23. The modelling exercise supports a reduction in contribution rates to the maximum permitted under the Fund's stabilisation policy (6% of pay over three years).

24. Each Employer will pay a total contribution rate that reflects this outcome. This total contribution rate will be presented as Primary Rate plus Secondary Rate.

25. The Actuary has calculated the expected cost of future benefit accrual (Primary Rate) to be around 18% of pay for each employer.

26. Therefore, all employers will be paying a positive Secondary Contribution Rate in addition to this Primary Rate to ensure they meet the total contribution rate modelled.

27. The Secondary contribution rate should **not** be conflated with deficit recovery payments (as the employers are currently in surplus).

28. For stabilised employers, their long-term funding strategy is based on paying a total contribution rate – meaning there should not be a focus on the specific construct of Primary and Secondary.

29. In the recent past, many of the employers have ‘underpaid’ against the Secondary Rate that would have otherwise been payable (had stabilisation not been in place) when they were in deficit. Conversely, employers are now continuing to pay Secondary contributions while in surplus.

30. For administrative ease for the employers and Fund Officers, the total contribution rates payable will now be certified as a percentage of pay at this valuation, noting that Secondary contributions at 2022 were certified as a lump sum for many employers.

<u>Other considerations – risk of regret</u>

31. The modelling also assessed the chance that contributions may need to be increased at the next valuation, if they are reduced from April 2026. This metric is known as the ‘risk of regret’.

32. Assuming contribution reductions of 6% of pay (in total) and updating the prudence (to 80%) and target funding level (to 120%), the risk of regret is around 20% (or less) for all employers, i.e. there is a about a one in five chance that contributions could increase at the next valuation – based on the modelling.

33. This supports the view that the decisions from the modelling strike an appropriate balance of risk and helps to satisfy intergenerational fairness, i.e. employers get the benefit of contribution reductions without placing undue pressure on future generations.

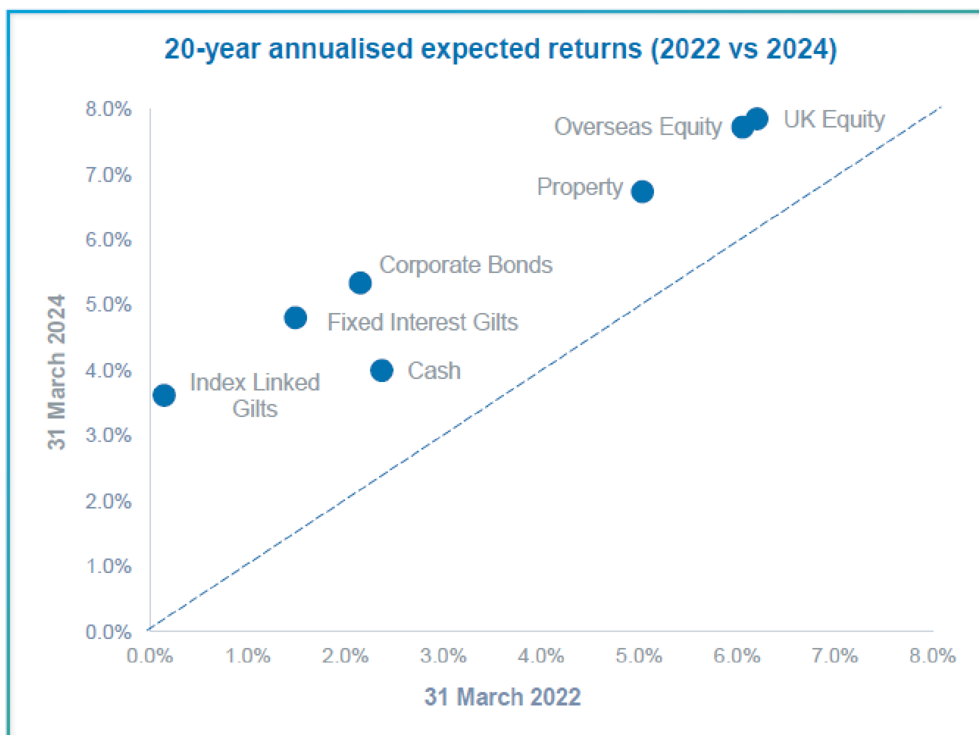
<u>Other considerations – alternative economic views</u>

34. The core modelling is based on the standard calibration of the Actuary’s model - which simulates 5,000 possible future economic outcomes with varying inflation and investment returns, to reflect uncertainty in the real world.

35. The Actuary also stress-tested the contribution strategy against alternative economic views with lower returns on growth assets or higher inflation – with both views representing credible concerns about increased uncertainity in future markets.

36. Under these stress-tests the results remain positive. Assuming contribution reductions of 6% of pay, 80% prudence and 120% funding target, the likelihood of achieving the funding target is around 80% for all employers.

37. The Actuary has also incorporated the effect of higher UK base rates on longer term investment returns. Since the last valuation the Bank of England base rates have risen from 0.75% to 4.5%. As a result of the methodology used future investment returns are expected to be higher. This is illustrated on the graph below where all asset classes are showing higher rates of expected return ranging from 1.0% to 3.5%.



38. As we know future investment returns are not guaranteed and just a short look backwards illustrates that returns can be volatile from one year to the next but there have been periods where returns can be lower than expected or negative for multiple years. For a listed equity world index like MSCI world, years 2000, 2001 and 2002 generated large negative investment returns and in 2008 alone the MSCI world index returned minus 41%; it would take until 2013 to erase the losses from 2008 if an investor was wholly invested in a wide range of listed equity like the MSCI world index.

39. The Fund is well diversified but the investment environment for many assets would be negatively impacted in the event of poor stock market performance.

Indicative Contribution Rates from 1 April 2026

40. Considering the results modelled by the Actuary, Fund Officers can recommend the stabilised employers receive the maximum 2% of pay per annum rate reduction during the three-year valuation cycle, i.e. 6% of pay reduction in total.

41. The chance contributions may need to increase at the next valuation, known as the risk of regret, is included in the table below. Officers are comfortable with these results.

42. Indicative rates for the employers based on 80% prudence level, targeted 120% funding, with a 6% reduction in rate for each employer are shown in the table below:

	Contribution rates (% of pay pa)				
Employer	Current rate (2025/26) *	Primary (2026 -29)	Secondary (2026 - 29)	**Total (2026 -29)**	Risk of Regret
Leicestershire CC	29.4%	18%	5.4%	**23.4%**	11%
Blaby BC	29.3%	18%	5.3%	**23.3%**	22%
Leicester CC	27.8%	18%	3.8%	**21.8%**	13%
Charnwood BC	35.2%	18%	11.2%	**29.2%**	11%
NW Leicester DC	29.1%	18%	5.1%	**23.1%**	15%
Oadby & Wigston	36.4%	18%	12.4%	**30.4%**	15%
Rutland CC	27.8%	18%	3.8%	**21.8%**	20%
Police	24.9%	18%	0.9%	**18.9%**	20%
Melton BC	30.3%	18%	6.3%	**24.3%**	16%
Hinckley & Bosworth	29.2%	18%	5.2%	**23.2%**	16%
Harborough DC	34.5%	18%	10.5%	**28.5%**	11%
Fire	26.1%	18%	2.1%	**20.1%**	19%
ESPO	28.3%	18%	4.3%	**22.3%**	**

*% of pay equivalent where secondary is paid as a lump sum currently
** Modelled using Leicester City Council that has a similar funding profile

43. The full summary of results is found on page 17 of the Appendix.

44. The Actuary and Officers have considered the profile of the contribution reductions and are supportive of allowing all employers to take the full reduction immediately to assist with budgeting pressures. This decision is supported by all the modelling.

45. It is recommended to the Committee the indicative contribution rates for employers will therefore reduce by 6% of pay in 2026/27, followed by to a freeze at these rates in 2027/28 and 2028/29.

46. This enables the stabilised employers to benefit from the maximum reduction immediately (from April 2026) whilst still maintaining the long-term financial sustainability of the Fund.

Cashflow impact

47. Officers have also considered the reduction in cashflow (due to less contributions being received) and are confident this does not present a risk to the Fund.

48. The Actuary carried out a cashflow modelling exercise in February 2023 and modelled a 6% of pay reduction across the whole fund. At that time, these projections showed that the Fund is expected to remain in a relatively strong positive net cashflow position over the medium term (>£20m pa).

49. The Fund will carry out a review of the cashflow position after the valuation has been finalised to refresh this analysis. Results of this updated analysis will be brought to a future committee in 2026.

50. Officers recommend a mid-valuation cycle review to assess the position of the Fund in September 2027. The results of this will then be brought back to Committee.

Timeline for the 31 March 2025 Valuation

51. The updated valuation timeline is as follows.

Date	Topic	Stakeholder(s)
March 2025	Results of the stabilised employer modelling	**Committee – current stage**
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

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

52. Officers recommend a consultation with the stabilised employers commences to discuss the maximum 6% reduction from April 2026.

Recommendation

It is recommended that the;

a. Committee approve the proposed changes to the stabilised employer contribution rates from 1 April 2026 to 31 March 2029, subject to there being no material changes.

b. Committee approve the consultation with the stabilised employers to discuss the proposed rates from 1 April 2026 to 31 March 2029.

c. Committee approve the mid-valuation cycle review in September 2027.

Equal Opportunities Implications

None specific

Appendix

Appendix – Hymans slides on the proposed stabilised employer results

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