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Leicestershire County Council Pension Fund

2025 valuation funding review – **summary document**

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5 March 2025

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Executive summary

When setting contribution rates at the 2025 valuation, the Fund will need to consider a variety of quantitative and qualitative factors. The analysis and results set out in this report provide the quantitative information required for the purpose of setting rates for the modelled employers over the 2026/29 period, and the key conclusions (after discussion with officers) are:

Long-term funding objective

- **Prudence** –there has been a significant shift in market conditions since the 2022 valuation and the results support the recommended **increase in prudence from 75% to 80%** to recognise increased levels of market volatility and uncertainty. Higher prudence will give the Fund greater flexibility to manage future funding strategy if markets restore to longer term norms.
- **Funding target** – the results support the recommendation to **increase the funding target to 120%** to retain a funding ‘buffer’ to protect employers against adverse market experience. Targeting 100% funding is potentially unsustainable and there is a greater likelihood that a deficit would emerge in the future which may become unaffordable for employers given the increasing payroll to liability gearing. Holding a funding buffer will also help the Fund to manage other potential risks that are harder to quantify within the contribution strategy – such as climate risks, which could have an extreme impact on funding levels in the future.



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Contribution rates

- **Contribution reduction** – we recommend that the Fund **reduces contribution rates by 6% of pay in total** (by 2028/29). Based on the results of all employers, the likelihood of success remains above 80% (including an allowance for higher prudence and an increased funding target, as set out above). The results show that an immediate reduction of 6% of pay (as opposed to 2% of pay pa for 3 years) does not negatively impact the results, and we are comfortable that this remains within the spirit of the current stabilisation policy over the 3-year period.
- **Stabilisation** – the Fund can continue to offer stabilisation to employers. This provides a valuable benefit (of security and budgeting certainty) without negatively impacting funding outcomes.
- **Long term cost efficiency** – assuming contribution reductions (and updated long-term funding objectives) as outlined above, the “risk of regret” metric is less than 20%*. We believe this strikes an appropriate balance of risk for the Fund and employers and helps satisfy inter-generational fairness.
- **Long term cost of benefits** – based on our recommendation of 80% prudence, the **Primary Rate is estimated to be around 18% of pay**.



*Blaby’s risk of regret is 22% - although we do not view this as a cause for concern or a reason to adopt an alternative approach for this employer

Further commentary on these conclusions and our initial recommendations are contained in the [‘conclusions and next steps’](#) section.

Setting funding plans

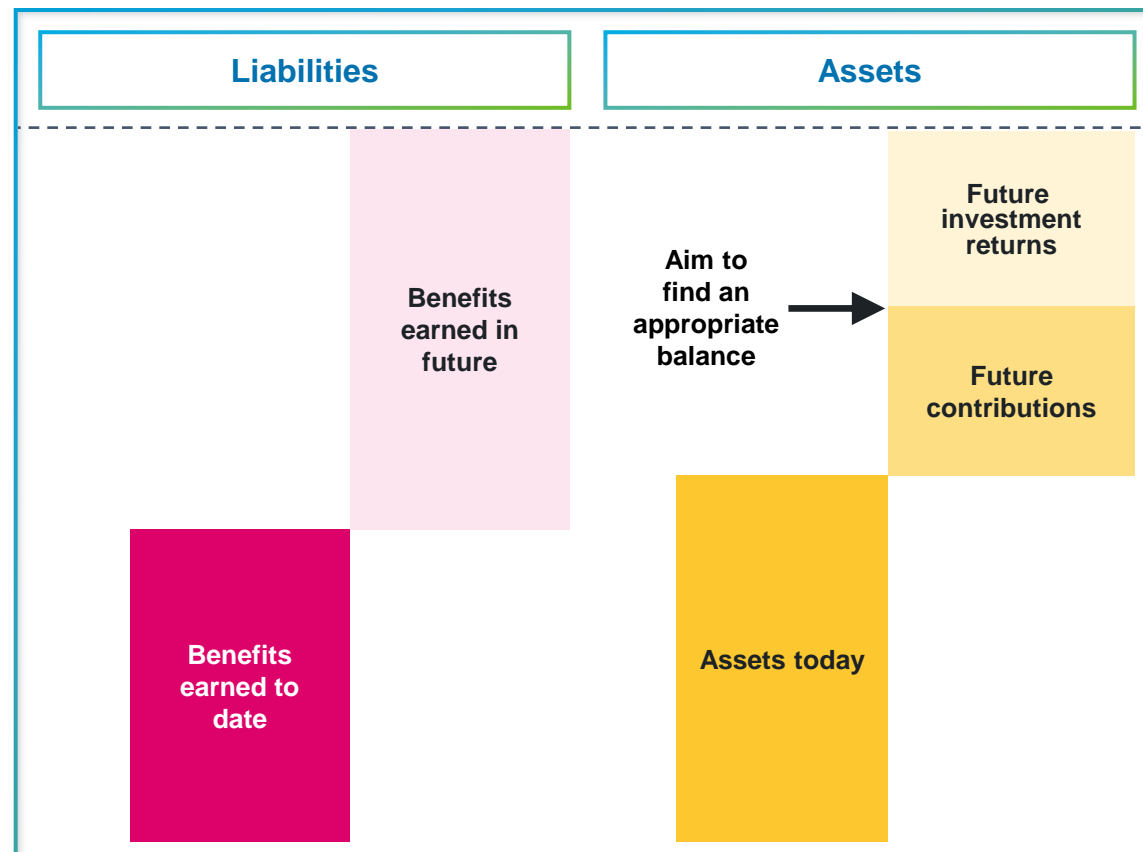
- The funding of members' benefits is achieved by a combination of contributions and investment returns.
- An employer's "funding plan" can be defined as the combination of its contribution strategy and its investment strategy. The funding plan should achieve an appropriate balance between future investment returns and future contributions. As future returns are unknown, there is uncertainty when setting a funding plan. Therefore, the plan needs to have a sufficiently high likelihood of being able to pay members' benefits over the long term.
- To meet this aim, the Fund set the following **funding strategy criteria** at the 2022 valuation for the modelled employers:

The employer must have at least a 75% likelihood of being 100% funded at the end of the 17 years funding time horizon

- When setting funding plans, different combinations of contributions and investment strategy are tested to see which is most appropriate (in the Fund's view).
- At the 2022 valuation, this testing was facilitated by a type of modelling known as 'Asset Liability Modelling'. This modelling considers a large number of simulations of the future economic environment - each with different paths for investment returns, inflation and interest rates. The results of this modelling were used to inform the setting of the current funding plans.
- It is expected that the Fund will set the following funding strategy criteria at the 2025 valuation for the modelled employers:

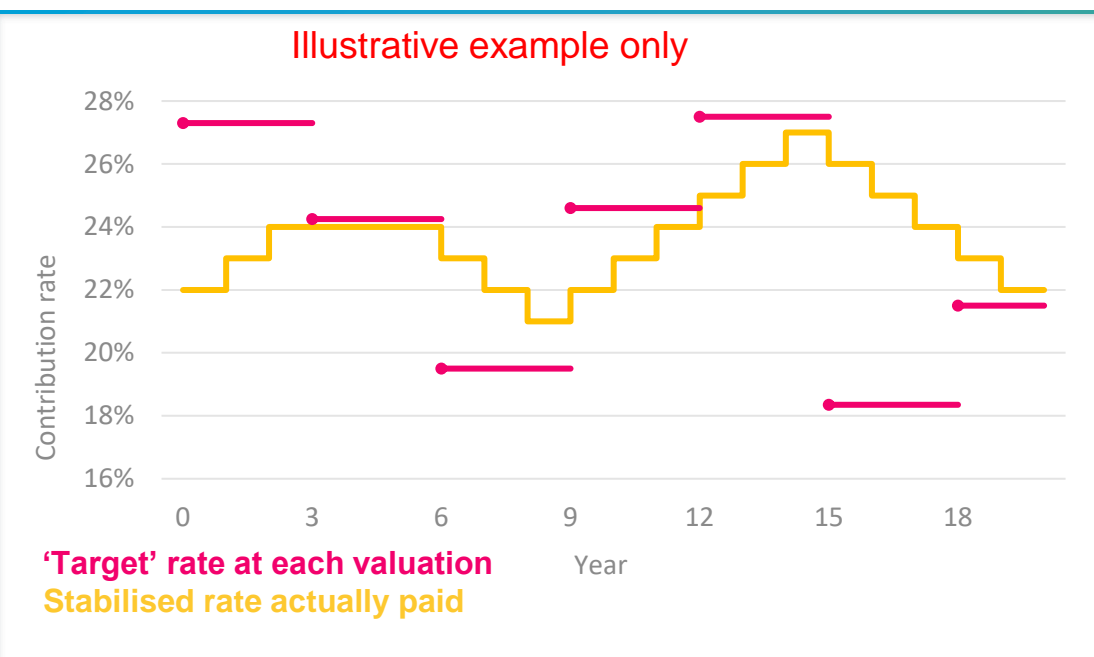
The employer must have at least a 80% likelihood of being 120% funded at the end of the 17 years funding time horizon

- Asset Liability Modelling has therefore been carried out to test contribution strategies against this criteria to assess the appropriate level of contribution from 1 April 2026.



Current contribution strategy for modelled employers

The Fund operates a contribution stability mechanism for its long-term, secure employers. Under a contribution stability mechanism, annual changes in contribution rate are restricted to a predefined maximum level (e.g. 2.0% of payroll). Stabilisation takes a long-term approach to setting contribution rates which cuts through short-term funding volatility (it is sometimes summarised as “underpay in the bad times, overpay in the good”). It is an explicit mechanism documented in the Funding Strategy Statement. The approach is summarised in the illustrative chart below.



As part of the 2022 valuation strategy review, the contribution stability mechanism was deemed an appropriate long-term contribution strategy for the modelled employers and the contribution rates payable over 1 April 2023 to 31 March 2026 were set. The below table sets out the current contribution rate in payment (with any monetary contributions expressed as the equivalent % of pay) and maximum stabilisation mechanism for each of the modelled employers:

Employer / Pool	Current rate in payment (% of pay) 2025 / 26	Stabilisation mechanism
Leicestershire County Council	29.4%	+/- 2.0% p.a.
Blaby District Council	29.3%	+/- 2.0% p.a.
Leicester City Council	27.8%	+/- 2.0% p.a.
Charnwood Borough Council	35.2%	+/- 2.0% p.a.
NW Leicestershire District Council	29.1%	+/- 2.0% p.a.
Oadby & Wigston Borough Council	36.4%	+/- 2.0% p.a.
Rutland County Council	27.8%	+/- 2.0% p.a.
The Chief Constable & OPCC	24.9%	+/- 2.0% p.a.
Melton Borough Council	30.3%	+/- 2.0% p.a.
Hinckley & Bosworth Borough Council	29.2%	+/- 2.0% p.a.
Harborough District Council	34.5%	+/- 2.0% p.a.
Fire Service Civilians	26.1%	+/- 2.0% p.a.
ESPO	28.3%	+/-2.0% p.a.

Approach to funding review

Approach to funding

The Fund has a plan in place for each employer to meet its long-term funding objectives. The overriding funding objective is to have a sufficient likelihood of being able to pay members' benefits over the long term. A second objective is typically to have stable funding plans in place (given the long-term nature of the LGPS). However, the funding environment can change significantly from one actuarial valuation to the next which may affect funding plans. Therefore, it is important that funding plans are regularly reviewed to ensure they remain appropriate.

These reviews do not typically seek to discard the existing funding plan and devise a brand new one. Instead, funds may adjust/revise some key aspects of the funding plan in response to changes in the funding environment. Funding in this way helps to ensure long-term continuity in funding plans and improve engagement with employers. The aspects of the funding plan that are typically considered are:

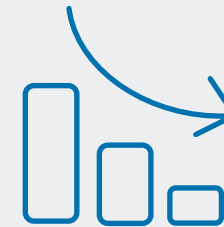
Long-term funding objective



Contribution rates



Investment strategy



Funding strategy decisions

To review each of the key aspects of the funding plan, the Fund should consider the following questions. These questions will be referenced throughout this report.

1. Long-term funding objective



Q1: Should the Fund change the amount of money it wants to set aside in the long-term to pay members' benefits? This can be achieved by:

- a) Changing the level of prudence in actuarial assumptions (an **implicit** adjustment to the long-term funding objective), and/or
- b) Changing the target funding level (an **explicit** adjustment to the long-term funding objective)

2. Contribution rates



Q2: What is an appropriate contribution rate in the short- and long-term? Consider:

- a) Is stabilisation still an appropriate long-term contribution strategy?
- b) What contribution rate should be paid during the next valuation cycle? (1 April 2026 to 31 March 2029)
- c) What is the expected long-term cost of benefits?

3. Investment strategy

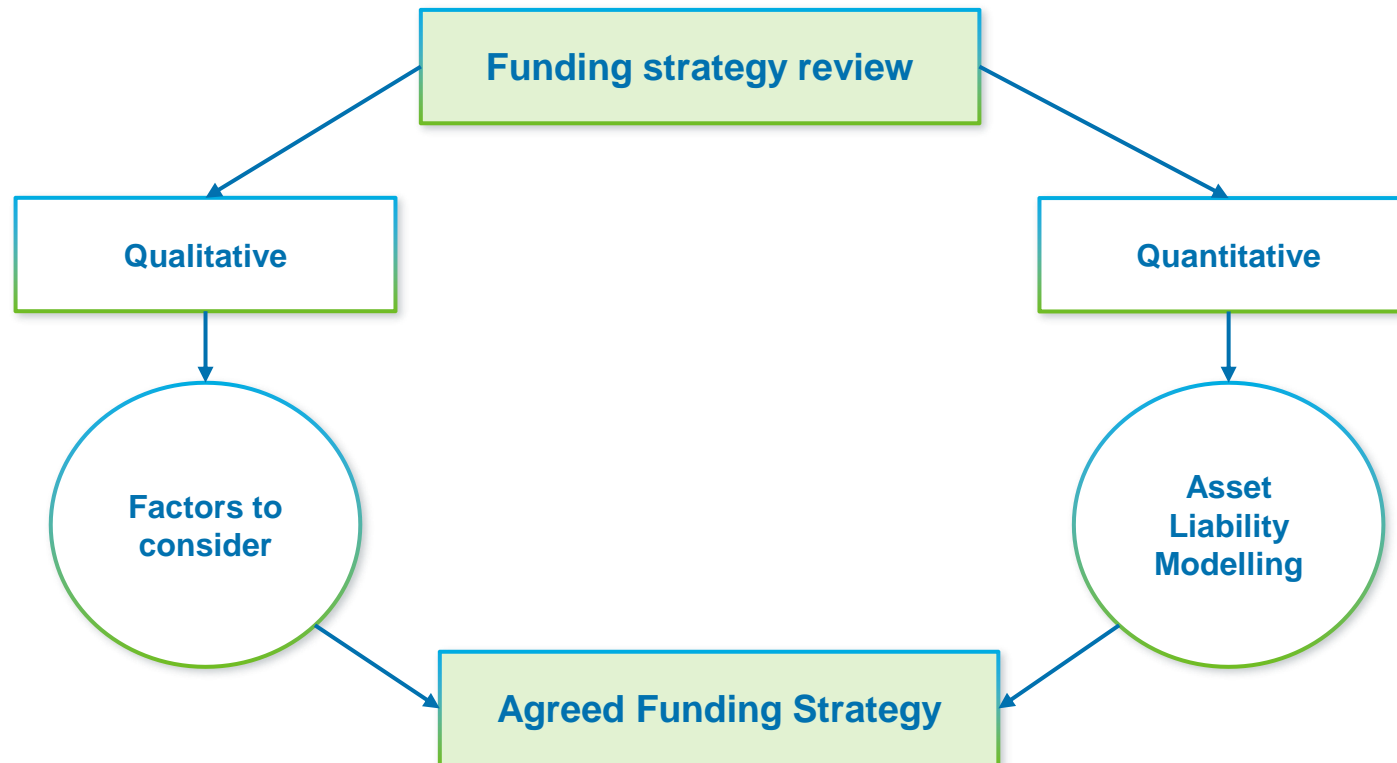


Q3: How may a change in investment strategy impact the funding strategy?

The Fund has recently undertaken a review of its investment strategy and has opted not to consider the impact of future changes in investment strategy on the funding strategy at this stage.

How should the Fund make these decisions?

When reviewing funding plans, the Fund should consider a combination of qualitative and quantitative information, as demonstrated in the diagram below.



Asset Liability Modelling details

Asset Liability Modelling methodology

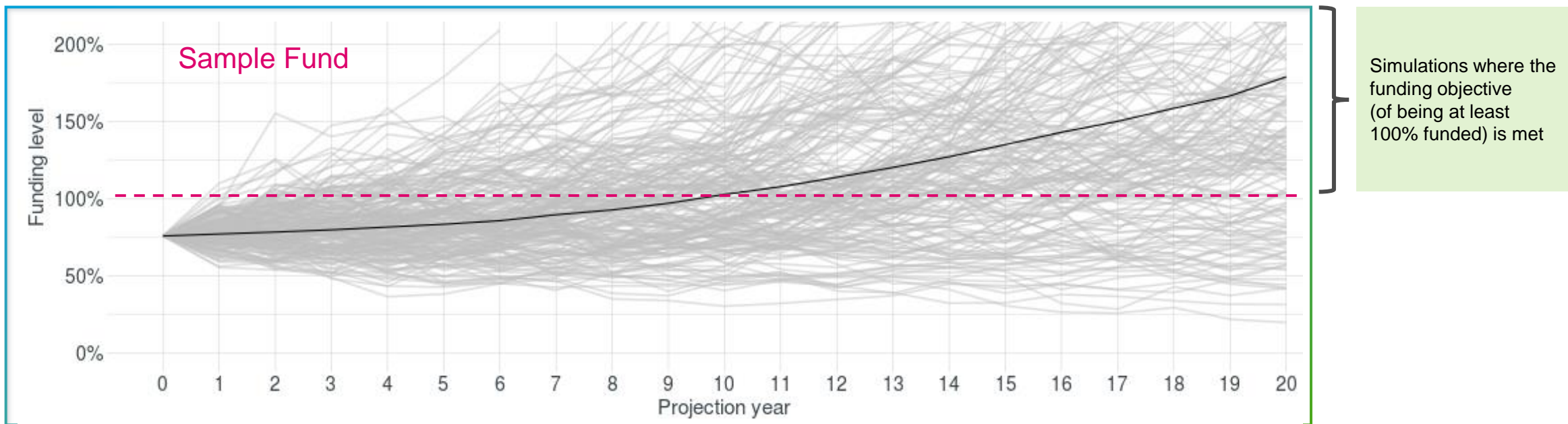
We have used Asset Liability Modelling to help LGPS funds review funding plans since 2010. This type of modelling allows the Fund to better understand the level of funding risk associated with different funding plans and make a more informed decision.

At a high-level, the methodology for Asset Liability Modelling is:

- Assets and benefits are projected forward from the valuation date under 5,000 different simulations for future market and economic conditions. A summary of the 5,000 simulations is set out in the Appendix of this report.
- For each simulation (of which there are 5,000 per funding plan modelled), we calculate the funding position annually throughout the projection period.
- The calculation of the funding position uses the same methodology as at the 2022 formal valuation. The assumptions underlying the funding position are set out in the 'Data and Inputs' section of this report.
- We rank the 5,000 simulations from best to worst and we plot the outcomes graphically.
- We can then compare the range of outcomes and risk metrics with other funding plans modelled.
- When comparing funding plans, we focus on two key risk metrics:
 - The “likelihood of success” metric shows the percentage of simulations that meet the funding objective at the end of the funding time horizon
 - The “risk of regret” metric shows the percentage of simulations which result in the funding plan needing to be revised (either through a change in investment strategy or increasing contribution rates) at the 2028 valuation (ie the percentage of simulations for which the likelihood of success in 2028 is no longer above the Fund’s threshold of 75%)
- Further detail on these metrics are set out on the following pages.
- For further technical detail on the Asset Liability Modelling approach please see the Appendix.

Likelihood of success

The chart below shows a sample of the 5,000 simulations for a certain funding plan tested. Each simulation projects the employers'/fund's assets and liabilities under a potential future outcome for investment returns, inflation and interest rates, allowing us to calculate the funding level over the period. Doing this 5,000 times then provides a range of future funding levels to analyse.



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 time horizon
 Under the current funding strategy criteria, the minimum acceptable likelihood of success is 75%

Risk of regret

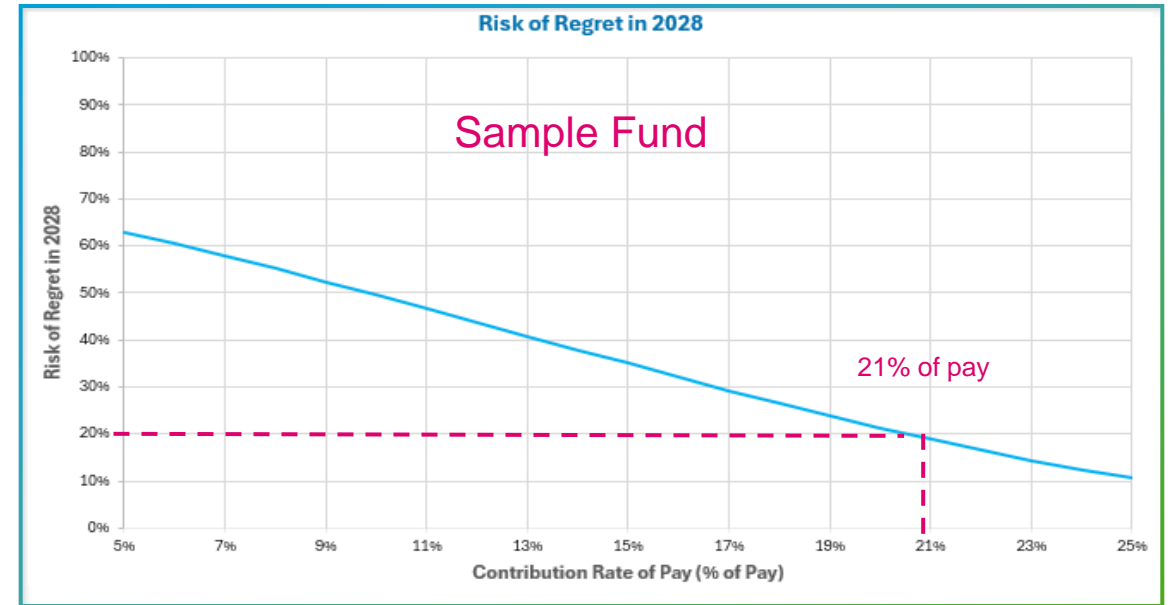
As well as understanding if a funding plan will be successful, it is also important to assess the level of potential downside risk. As the LGPS is an open, long-term scheme, most employers' primary focus will be on contribution rates. Therefore, a key question that needs considered is:

“If the contribution rate is set at a particular level now, what is the likelihood that it will need to increase at the next valuation?”

We refer to this as the “risk of regret”. To measure this 17-year we model a selection of contribution rates (keeping investment strategy the same) which are fixed. We then analyse the model at 31 March 2028 to see how many of the 5,000 simulations do not meet the expected 2025 funding strategy criteria (of having a 80% likelihood of being 120% funded at the end of a 17-year time horizon). In these simulations, we assume that the funding plan would need adjusted which will typically be done by increasing the contribution rate (but could also be achieved by a change of investment strategy).

So, if a funding plan had a 20% risk of regret, then there is a 1 in 5 chance that this plan would have an insufficient likelihood of success at 31 March 2028 and potentially require the contribution rate to be increased (or the investment strategy to be changed)

The chart on the right shows, for a sample fund/employer, how the risk of regret varies by contribution rate paid.



In this example, a contribution rate of 21% of pay has a 20% risk of regret. As the contribution rate decreases, the risk of regret increases (and vice versa).

The risk of regret measures the risk of having to raise the contribution rate (or change investment strategy) at the next valuation. Comparing different funding plans on this metric will be helpful for understanding the relative level of downside risk.

Change in economic environment since 2022

Since the 2022 valuation, there has been a significant shift in the UK and global economic environment. One such indicator of this shift is interest rates. The Bank of England Base Rate has risen from 0.75% pa at March 2022 to 4.5% pa at the date of this report. Similar rises have occurred in longer-term interest rates also.

In the model we use for Asset Liability Modelling, this change in economic environment has resulted in future investment return expectations being higher than at 2022. If investors can get a higher return on cash and other lower-risk assets, we generally assume that the return on riskier assets, such as equities, should also increase.

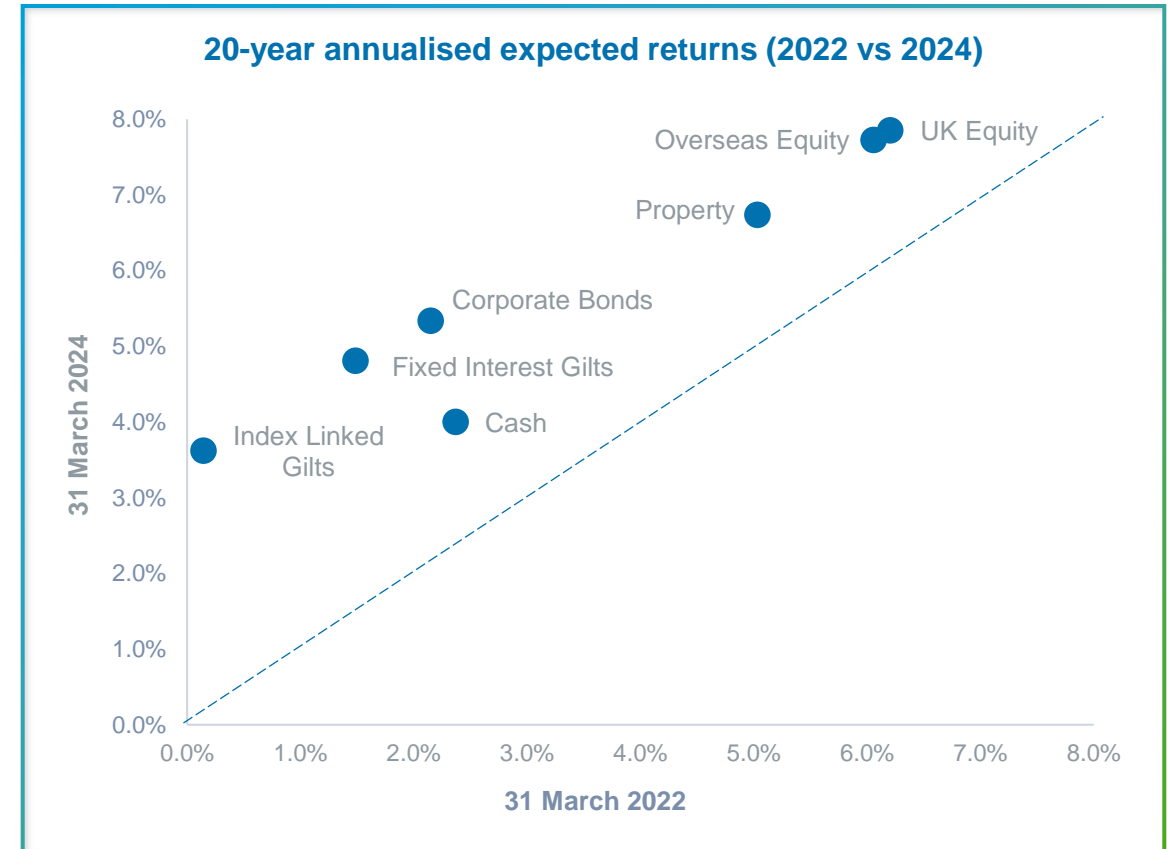
The chart on this page summarises how the expected future investment returns in our models, which underpin the advice in this report, have changed between 2022 and 2024.

Higher future expected investment returns generally mean:

- A higher funding level because a lower value is placed on the Fund's liabilities
- Lower required contributions (all other things being equal)

In our briefing note [a new funding era in the LGPS?](#) we acknowledge that people may have different beliefs regarding this change in economic environment and some may be concerned with setting long-term funding plans solely on a very recent significant shift in environment.

Given this, for the 2025 valuations, we have evolved the Asset Liability Model to allow the impact of different beliefs on funding plans to be understood.



Uncertainty around the current economic environment

The Asset Liability Model performs 5,000 simulations of the future economic environment to capture a wide range of possible eventualities and outcomes. This reflects the uncertainty and volatility surrounding economic variables such as interest rates, inflation and the returns on different asset classes. The distribution for each of these variables at March 2024 is summarised in the Appendix. These distributions are generated by the Economic Scenario Service (“ESS”) (Hymans Robertsons’ proprietary economic scenario generator).

There may be some users of this report who wish to understand the outcomes under certain alternative scenarios due to differing beliefs or concerns related to the current economic environment. Therefore, in addition to the core modelling we have also carried out analysis of specific alternative scenarios. The scenarios reflect the following broad economic environments:

Lower returns on growth assets

In this scenario, expected future returns from growth assets are lower than the Core ESS projections. This can be interpreted as simulating the effect of a reduction in valuations in equity markets from current elevated levels back to longer-term averages or experiencing higher than average default losses in credit markets over the long term. **The investment return expectations in this scenario broadly replicate the investment return expectations from the ESS model at the time of the previous actuarial valuation at 31 March 2022.**

Higher inflation

This scenario models a structurally higher inflation environment owing to expectations of more persistent labour shortages, a greater prevalence of supply shocks (climate change and geopolitical tensions disrupting trade, food and energy supplies), diminishing returns from globalisation, the transition to net zero and looser fiscal policy than in the period after the financial crisis. **In this scenario, nominal yields rise relative to the median ESS projection, reflecting a rise in inflation expectations.**

To do this scenario testing, we have reweighted distributions from the ESS towards simulations which reflect the themes of each scenario. The results of the scenario testing are intended to complement the core modelling exercise to help users understand the sensitivity of the results to the central assumptions within the Asset Liability model and give comfort that their own beliefs/concerns about the economic environment are included in any decisions made.

Given the nature of the methodology used to derive the scenario testing, **funding decisions should not be made solely on the results of the scenario analysis.** Instead, they should be considered alongside the core modelling results. Further technical detail on the alternative scenarios is set out in the Appendix.

Contribution strategies tested

The following **stabilised contribution strategies** were modelled to inform decision making on short- and long-term contribution rates:

Rate Pattern (% of pay)	2024/25	2025/26	2026/27	2027/28	2028/29	Thereafter
Reduce by 2% pa then stabilise (at +/- 2% pa)*	Contributions as certified in the Rates and Adjustment certificate		2025/26 rate - 2%	2025/26 rate – 4%	2025/26 rate – 6%	+/- 2% p.a.
Reduce by 6% then stabilise (at +/- 2% pa)			2025/26 rate - 6%	2025/26 rate - 6%	2025/26 rate - 6%	+/- 2% p.a.
Reduce by 1% pa then stabilise (at +/- 1% pa)			2025/26 rate - 1%	2025/26 rate - 2%	2025/26 rate - 3%	+/- 1% p.a.

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In addition to the above stabilised contribution strategies, we have modelled a series of **fixed contribution rates** payable in perpetuity: 5%, 10%, 15%, 20%, 25% & 30%. This allows us to isolate the impact of altering key funding parameters and investment strategy as part of the analysis.

*We have also modelled an **unconstrained** contribution strategy. This contribution strategy assumes the contribution rate will be as above from 1 April 2026 to 31 March 2029 and then will vary as required in each future year to satisfy the Fund’s funding strategy criteria, without the contribution stability mechanism overlay. This allows the Fund to test and understand the appropriateness of the contribution stability mechanism as a long-term funding strategy.

Summary of results

Summary of results

Based on initial discussion with Fund officers on 6th February, it is expected that the Fund will adopt an 80% prudence level and target 120% funding to provide a 'buffer' for employers against adverse experience (partly due to the increased difficulty for employers to repay future deficits should one emerge). Based on an 80% prudence and 120% funding target, we have summarised the results. The likelihood of success and risk of regret below assume that employer rates are reduced by 6% of pay (in total) over the next 3 years.

Employer / Pool	Proposed contribution rate in 2028/29 (% of pay)	Likelihood of success ('LoS') of core model	Risk of regret	Lower return on growth assets ('LoS')	Higher inflation ('LoS')
Leicestershire County Council	23.4%	88%	11%	83%	82%
Blaby District Council	23.3%	85%	22%	79%	77%
Leicester City Council	21.8%	87%	13%	82%	81%
Charnwood Borough Council	29.2%	87%	11%	81%	81%
NW Leicestershire District Council	23.1%	87%	15%	81%	80%
Oadby & Wigston Borough Council	30.4%	86%	15%	80%	79%
Rutland County Council	21.8%	86%	20%	81%	78%
The Chief Constable & OPCC	18.9%	85%	20%	80%	79%
Melton Borough Council	24.3%	86%	16%	80%	79%
Hinckley & Bosworth Borough Council	23.2%	86%	16%	81%	79%
Harborough District Council	28.5%	87%	11%	81%	81%
Fire Service Civilians	20.1%	86%	19%	81%	79%
ESPO	22.3%	Similar in funding profile to Leicester City Council – see results above as suitable proxy			

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Conclusions and next steps

Conclusions

Key observations from the modelling results are set out below:

1. Funding objective

- The Fund currently utilises a 75% prudence margin when setting its discount rate.
- It also targets a funding level of 100%.
- Moving prudence margins to 80% can be done without increasing current contribution levels (all rates tested meet the Fund's minimum criteria).
- Additional prudence gives us greater flexibility to manage contribution volatility in future and can be justified in the current economic environment.
- Moving the target funding level (to 120% for example) is also possible, noting that the Fund already has a similar framework in place for non-stabilised employers.
- Final decisions on prudence levels and funding targets will be made later in the valuation process when we undertake a review of the actuarial assumptions and funding framework.
- The results of the modelling supports an increase in prudence and/or an increase in the target funding level (ie a funding 'buffer'). In either case, it will be important to consider the messaging to employers (and other stakeholders).

2. Contributions

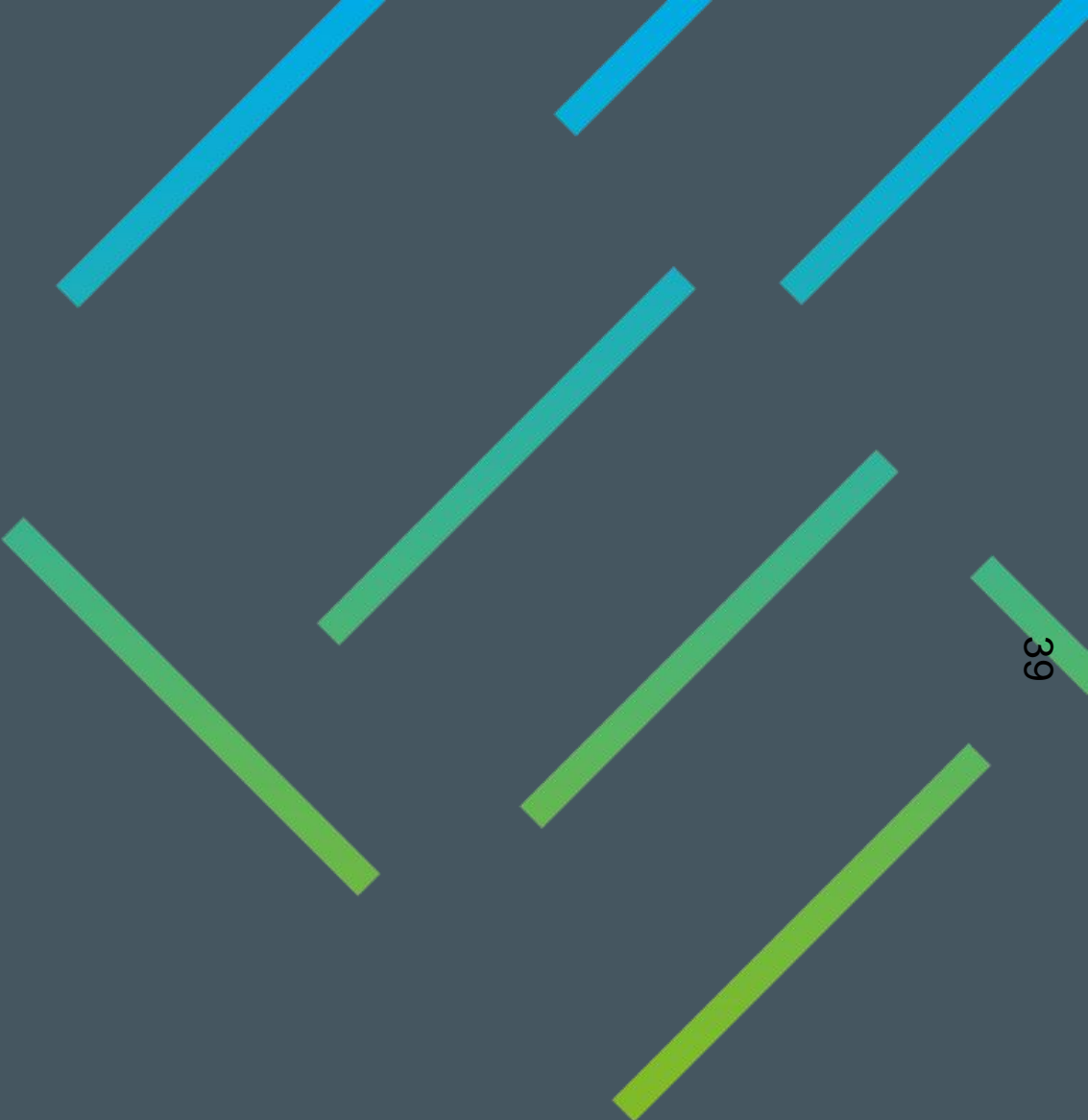
- The Fund's stabilisation approach remains appropriate, limiting changes in contribution rate to (a maximum of) +/-2% of pay pa for long-term secure employers.
- The results show that there is scope to reduce rates by 2% of pay pa for all of the modelled employers (with each strategy meeting the required minimum likelihood)
- In all cases, the total contribution rates (at the end of the period, 2028/29) will be higher than the estimated cost of benefits (which is around 18% of pay at an 80% prudence level for all employers). Messaging to employer will therefore be important given the strong funding position and the extremal market commentary.
- Given the strong funding positions for all employers (and budgeting challenges for many councils) the Fund could agree to change the shape of the reductions, without impacting the outcomes of the modelling. For example, this could be -3%, -3%, 0%, or even -6%, 0%, 0%.
- As all employers are now in a strong funding position, we would recommend certifying all contribution rates as a % of pay (as opposed to monetary amounts) for administrative ease.
- Based on this analysis, we have proposed contributions on the following page

Recommended contributions

Based on each of the modelled employers meeting the minimum criteria to satisfy a 2% of pay pa reduction in contributions over the period from 1 April 2026 to 31 March 2029, we recommend the following rates.

Employer / Pool	Current rate in payment (% of pay) 2025 / 26	Proposed rate (% of pay) 2026/27	Proposed rate (% of pay) 2027/28	Proposed rate (% of pay) 2028/29
Leicestershire County Council	29.4%	The results support an immediate reduction to the 2028/29 rates. The Fund may apply discretion on how quickly to reduce to the 2028/29 rate over the 3-year period while remaining within the confines of the existing FSS (where maximum permitted reductions over a 3-year period are limited to 6% of pay).		23.4%
Blaby District Council	29.3%			23.3%
Leicester City Council	27.8%			21.8%
Charnwood Borough Council	35.2%			29.2%
NW Leicestershire District Council	29.1%			23.1%
Oadby & Wigston Borough Council	36.4%			30.2%
Rutland County Council	27.8%			21.8%
The Chief Constable & OPCC	24.9%			18.9%
Melton Borough Council	30.3%			24.3%
Hinckley & Bosworth Borough Council	29.2%			23.2%
Harborough District Council	34.5%			28.5%
Fire Service Civilians	26.1%			20.1%
ESPO	28.3%			22.3%

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Appendices

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Additional detail for the ESS

The ESS uses statistical models to generate a future distribution of year-on-year returns for each asset class e.g. UK equities. This approach is also used to generate future levels of inflation (both realised and expected). The ESS is also designed to reflect the correlations between different asset classes and wider economic variables (e.g. inflation). In the short-term (first few years), the models in the ESS are fitted with current financial market expectations. Over the longer-term, the models are built around our long-term views of fundamental economic parameters e.g. equity risk premium, credit-spreads, long-term inflation etc. The ESS is calibrated every month with updated current market expectations (a minor calibration). Every so often (annually at most), the ESS is updated to reflect any changes in the fundamental economic parameters as a result of change in macro-level long-term expectations (a major calibration). The following table shows the calibration at 31 March 2024.

Annualised total returns													
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Developed World ex UK Equity	Property	Corp Medium A	Inflation (RPI)	17 year real yield (RPI)	Inflation (CPI)	17 year real yield (CPI)	17 year yield
5 years	16th %'ile	3.1%	0.9%	1.6%	-0.3%	-0.8%	-0.2%	1.4%	2.3%	0.4%	1.3%	0.5%	3.7%
	50th %'ile	3.9%	3.8%	3.7%	7.8%	7.7%	6.4%	4.1%	3.9%	1.3%	2.8%	1.4%	4.8%
	84th %'ile	4.7%	7.0%	5.9%	16.0%	16.1%	13.8%	6.5%	5.4%	2.3%	4.4%	2.3%	6.0%
10 years	16th %'ile	2.9%	1.6%	3.1%	1.8%	1.5%	1.6%	3.2%	1.5%	0.2%	1.0%	0.2%	3.2%
	50th %'ile	3.9%	3.6%	4.3%	7.8%	7.7%	6.6%	4.7%	3.2%	1.5%	2.6%	1.4%	4.6%
	84th %'ile	5.1%	5.9%	5.5%	13.8%	13.9%	11.9%	6.2%	4.9%	2.7%	4.2%	2.7%	6.3%
20 years	16th %'ile	2.6%	1.9%	4.0%	3.3%	3.1%	3.0%	4.3%	1.1%	-0.5%	0.8%	-0.5%	1.6%
	50th %'ile	4.0%	3.6%	4.8%	7.9%	7.7%	6.7%	5.3%	2.7%	1.2%	2.4%	1.2%	3.5%
	84th %'ile	5.7%	5.4%	5.5%	12.4%	12.5%	10.7%	6.3%	4.3%	2.9%	4.0%	2.9%	6.1%
	Volatility (Disp) (1 yr)	0%	7%	6%	16%	17%	16%	7%	1%		1%		

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Reliances and limitations

This summary document has been prepared solely for the purpose of presenting the key outputs of the contribution strategy review to Pension Committee. It should not be used for any other purpose and third parties should not place reliance on these results. Full details of the advice which was prepared for officers is contained in the report entitled Leicestershire County Council Pension Fund – 2025 valuation funding review (dated 19 February 2025). The reliances & limitation of this fuller report are stated below for completeness.

This paper has been commissioned by Leicestershire County Council as administering authority to the Leicestershire County Council Pension Fund. It intended for the use by Leicestershire County Council in its role as Administering Authority only for the purposes of carrying out a review of funding plans for the Fund's stabilised employers as part of the 2025 formal valuation. It has not been prepared for any other purpose and should not be used for any other purpose.

It should be noted that this paper contains a significant amount of technical detail and is not an exhaustive analysis of all possible strategy options and combinations. It is intended to facilitate discussion with Officers of the Leicestershire County Council Pension Fund after which additional analysis may be required. Any final decisions on the funding strategy based on the analysis in this report will be need to be documented in an audit trail with associated reasons.

Given the above, we would expect the administering authority to consider and discuss the contents raised in this paper before making any funding decisions.

This paper has not been prepared for any other third party or for any other purpose. We make no representation or warranties to any third party as to the accuracy or completeness of this report, no reliance should be placed on this report by any third party and we accept no responsibility or liability to any third party in respect of it.

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- *TAS100 (Principles for Technical Actuarial Work)*
- *TAS300 (Pensions)*

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