Leicestershire County Council

LOCAL PENSION COMMITTEE

27 JUNE 2025

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PENSION FUND VALUATION 2025 – ASSUMPTIONS AND EMPLOYER RISK

Purpose of the Report

1. The purpose of this report is to request that the Committee approve the proposed assumptions and note employer risk, 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 using market conditions on the 31 March 2025 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 2026 to 31 March 2029). To set the contribution rates, the Fund Actuary Hymans Robertson, must take account of a number of factors, most of which are assumptions of what is likely to happen in the future. These assumptions do not impact the ultimate cost of paying benefits to members. Instead, they simply calculate the liability derived from these benefits, which in turn impacts the level of employer contributions payable.

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.

5. In practice, being prudent means that the Fund is retaining a 'buffer' against the many risks and sources of uncertainty within the funding of its LGPS benefits. This buffer helps to protect the Fund (and its members) in the event of adverse future experience, for example, if future returns from its investments are worse than expected.

6. The Fund builds in prudence to its assumptions via the discount rate. How it achieves this is covered in more detail in the following section.

Assumptions

7. The assumptions required for the valuation are;
    1. Discount rate
    2. CPI Inflation (benefit revaluation)
    3. Salary increases
    4. Longevity
    5. Others

Further details can be found in the Appendix at slide 5.

8. The discount rate (the investment return) and CPI inflation (benefit revaluation) generally have the greatest influence on employer contribution rates.

Discount Rate

9. Benefits accrued in the Fund will be payable for many years into the future. To compare their value against the Fund's assets, officers need to express this future value in today's money. This is achieved by discounting the future benefits payable.

10. When calculating employer contribution rates, the Actuary stress tests their resilience to 5,000 different economic environment scenarios. The discount rate needs to reflect the uncertainty demonstrated by the 5,000 scenarios, and in order to do this, the discount rate is determined by the Fund's required level of prudence.

11. The funding environment in which the Fund operates continues to be challenging. Whilst employer funding positions have improved since the previous valuation in 2022, financial markets have become more uncertain amid increasing geo-political risks, which may adversely affect future inflation and investment returns.

12. As a result of this extra uncertainty, increasing the prudence level from the 75% agreed for the 2022 valuation to 80% for the 2025 valuation was proposed to Pension Committee at the meeting on the 29 November 2024 with Officers keeping this under review for 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 market risk, whilst accepting that there is still a 20% chance that actual returns will be lower than we assume at this prudence level).

13. Following the ongoing review since the 29 November 2024, Officers recommend increasing prudence to 80% at the 2025 valuation, for calculating funding levels and contribution rates, given the continuing uncertainty in financial markets.

14. 80% prudence was used for modelling the stabilised employer rates and should also be adopted for the remaining Fund employers.

15. By adopting an 80% prudence level, this generates a 6.0% pa discount rate for the Fund, which is effectively the assumption about future investment returns. This gives an estimated funding level of 146%, and an estimated 18.1% of pay as the primary contribution rate (the employer rate for new benefits).

16. Officers have discussed this with the Fund Actuary and are comfortable with a 6.0% discount rate and 80% prudence.

Further details can be found on slide 6 of Hymans' report at the Appendix.

<u>CPI Inflation (benefit revaluation)</u>

17. Members' pension benefits in the LGPS are linked to CPI. This is for pensions in payment and deferred, but also for the element of active members' pensions linked to the career average scheme.

18. The Actuary's 5,000 different economic environment scenarios include CPI inflation in the modelling.

19. At the 2022 valuation the Fund used a best estimate (median) CPI assumption of 2.7% pa plus an inflation risk premium of 0.2% pa, totalling 2.9% pa.

20. In the period since the last valuation, inflation was 10.1% in 2023 and 6.7% in 2024 but has continued to fall since 2024 with the general view inflation will trend towards the Bank of England's target of 2% pa in the longer term.

21. However, Officers remain cautious about future inflation levels, given the continuing economic uncertainty and recommend retaining the inflation risk premium of 0.2% pa. The 2025 modelling suggests that the best estimate (median) assumption of future CPI is now 2.3% pa; adding on the inflation risk premium gives a total of 2.5% pa for the 2025 valuation.

22. The stabilised employer rates have been stress tested against various levels of future CPI within the 5,000 modelling scenarios.

<u>Salary increases</u>

23. 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, this had dropped to 40% at 2022, and has dropped further to approximately 35% at 2025.

24. Officers recognise that increases to the national minimum wage and national living wage have put pressure on salary rates across the whole workforce. However, from a Fund perspective, the impact on liabilities is not material as these increases affect a relatively small number of members with lower earnings and lower levels of pension benefit. There is therefore no need to increase the assumption that is used for salary increases.

25. At the 2022 valuation, salary increase assumption was CPI of 2.9% per annum plus 0.5% pa plus a promotional element to account for people moving through the scale points within their pay grade, totalling 3.4%.

26. Officers recommend using the 2025 CPI assumption of 2.5% per annum plus 0.5% per annum, totalling 3.0% for the 2025 valuation.

27. Various levels of future salary growth within the 5,000 modelling scenarios have been used to stress test the stabilised employer rates.

    A summary of the proposed financial assumptions at the 2025 valuation, alongside those used at the 2022 valuation, is on slide 7 of the Appendix.

<u>Longevity</u>

28. The Leicestershire Pension Fund use Club Vita to assist with life expectancy. The Fund's membership data is used to assess life expectancy using demographics including where pensioners live (based on latest postcode), salary and pension. 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.

29. Longevity assumptions are based upon two components:

    1. Baseline
    2. Future improvements

    Further details on slide 8 of the Appendix.

30. Baseline longevity assumption is an estimate of how long people are expected to live based on current levels of mortality.

31. Future improvements in longevity are uncertain, and there has been volatility in recent years, in particular COVID-19 and the ongoing longer-term uncertainty that remains linked to it.

32. There are many other uncertainties in relation to longevity; in isolation, the impact of changes to any one of the many factors that feed into the longevity assumption does not have a material impact on the Fund's overall liabilities or funding position.

33. Hymans have considered the various aspects that could impact on longevity and modelled three possible options that would affect the overall assumption, labelled as ‘low’, ‘default’ and ‘high’.

34. If longevity improvement is considered “low”, Fund liabilities could be expected to reduce by up to 3%. However, if it’s considered “high”, Fund liabilities could be expected to increase by up to 6%.

35. Officers considered the three options with the Actuary. Given the various scenarios and the longer-term uncertainty with aspects that impact on longevity, Officers recommend the Actuary’s default view for the 2025 valuation.

36. The ‘default’ assumption is designed to be a best estimate of future experience. It suggests there is some adaption to address climate change (but at a relatively slow pace), the level of deaths because of COVID-19 have stabilised with a slowdown of long COVID cases, a general reduction to NHS waiting times, and Government’s health and social care budget remains constant in real terms.

37. The Fund’s stabilised employer rates were calculated using the default option. For reference, stabilised employers are considered low risk (tax raising bodies such as larger Councils). A stabilised approach is applied to the setting of their contribution rates to provide protection from volatility between the three yearly valuation cycles. The approach allows rates to be “smoothed”, meaning more gradual stepped increases when in deficit, but equally, gradual stepped decreases when in surplus.

<u>Other assumptions</u>

38. There are several other demographic assumptions that are listed on page 9 of the Appendix.

These are:

- Withdrawals from the scheme (excluding ill health)
- Ill health retirements
- Death in service
- Promotional salary scale
- Members leaving dependants
- Age differences
- Commutation
- 50/50 scheme take up

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

Funding Strategy Statement and Investment Strategy Statement

39. The Fund is required to maintain two key governance documents.

40. The Funding Strategy Statement (FSS) sets out how the Fund plans to meet its long-term obligations to pay member benefits by collecting appropriate contributions from employers, using a prudent and transparent approach tailored to each employer's circumstances. It aligns closely to the Fund's investment strategy.

41. The Investment Strategy Statement (ISS) outlines the principles governing how the Fund invests to meet its long-term obligations. It covers the Fund's objectives, risk appetite, asset allocation strategy, and governance framework, ensuring alignment with regulatory requirements and its own funding strategy.

42. The key policy changes in the Fund's draft FSS will be reviewed by Officers and will be presented to Committee in September 2025.

43. The Fund will propose a consultation with employers on the FSS and ISS to commence in November 2025. To assist administration, this will commence at the same time employers receive their indicative employer rates.

44. The final FSS and ISS will be presented to Committee in early 2026.

Timeline

45. The valuation timeline is as follows;

Date	**Topic**	**Stakeholder(s)**
June 2025	Agree final valuation assumptions	**LPC – Current stage**
July 2025	Provide Hymans with all Fund data	Pension Section
August 2025	Calculate Fund results	Hymans
September 2025	Initial draft FSS and ISS changes, and request approval to consult with employers	LPC/LPB (Local Pension Board)
September/October 2025	Whole Fund valuation results	LPC/LPB
October/November 2025	Provide employers with their indicative rates. 1 April 2026 to 31 March 2029 and commence FSS and ISS consultation	Pension Section/Fund employers
November/December 2025	Changes to the FSS and ISS	Pension Section/Fund employers

Date	Topic	Stakeholder(s)
February 2026	Finalise FSS and ISS	LPC/LPB
March 2026	Final valuation report produced with final employer rates	Hymans
April 2026 to March 2029	Employer rates implemented	Pension Section/Fund employers

Employer Risk

46. Part of the valuation process requires Officers to consider employer risk. Officers and the Fund Actuary have assessed employers by group and provided a risk rating (high, medium, low). The table below provides a broad outline of the risk rating and considerations.

47. Officers are working with high risk rated employers to understand their individual employer pension risk pressures and to mitigate these for the Fund where possible.

48. Specifically, Officers are in ongoing dialogue with the university group to understand their longer-term objectives and financial position.

49. Officers are working with the fund actuary to manage an appropriate funding strategy for this group which balances employer affordability, and the increased risks posed to the fund. Officers may bring further information on pertinent outcomes to future committees.

Employer Group	Pension Risk Rating	Considerations
Stabilised employers – (Councils, Police, Fire)	Low	Tax raising bodies
Academies	Low	DFE pension guarantee
Further Education Bodies	Low/Medium	New DFE pension guarantee so risk level has reduced
Contractors	Low/Medium	Employer guarantor sits behind each contractor Usually, short term contract lengths
Town/Parish Councils	Medium	Small employers Resolution bodies so can decide to come out of the Fund
Community Bodies	Medium/High	Each employer considered individually Security in place Regularly assessed
Universities	High	No employer has DFE as guarantor

		Financial pressure in the University sector Ongoing work to identify and manage these risks

Recommendation

50. It is recommended that the Committee approves the valuation assumptions.

Assumption	Approach for 2025 Valuation
Discount Rate	Adopt an 80% prudence for calculating funding levels and contribution rates, equating to a 6.0% pa discount rate
CPI Inflation	Continue to use the modelled CPI best estimate assumption plus the inflation risk premium of 0.2% pa, totalling 2.5% pa
Salary Increases	Retain the 2022 salary increase assumption of 0.5% pa above CPI inflation. 2.5% pa plus 0.5% totalling 3.0% pa for 2025
Longevity	Use the Actuary’s default assumption
Others	Assumptions have been modelled using the Leicestershire Fund data and based on the Club Vita analysis

51. It is recommended that Committee notes the valuation employer risk.

Equality and Human Rights Implications

52. 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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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.

Appendices

Appendix – Hymans Robertson Assumptions Paper

Background Papers

2025 Valuation Principles Report – 29 November 2024

https://democracy.leics.gov.uk/documents/s186699/2025%20Valuation%20Principles%20Report.pdf

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