Leicestershire Pension Fund | 2025 Valuation employer update

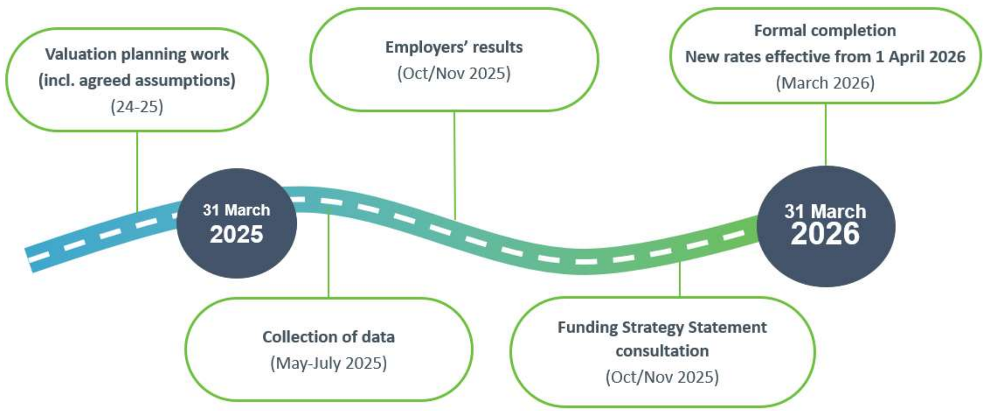
The Pension Fund carries out a formal valuation every three years to check solvency, review funding policies and set employer contributions rates. This report provides a high-level overview of the valuation, information on Fund performance since the 2022 valuation and the current funding environment as we begin the 2025 valuation.

2025 Actuarial Valuation background

The actuarial valuation is a significant risk management exercise that is carried out every three years. The planning work with our Actuary began last summer, and the valuation is required by legislation to be signed off 12 months after the valuation date. The key outcomes of the valuation are set out below:

- Calculate employer contribution rates
- Health check of the Fund Solvency
- Review the Funding Strategy Statement
- Analyse actual experience vs assumptions

The key stages of the 2025 valuation process are as follows:



Pension funding objective

A key objective for the Fund is to maintain stable contribution rates over the long term, to reduce the likelihood of larger cash contributions being required from employers in the future.

At the 31 March 2022 valuation, the Fund reported an overall funding level of 105% i.e. should the Actuary's future assumptions all prove to be accurate, the Fund had £1.05 for every £1.00 of pension benefits promised to members of the Scheme on that date.

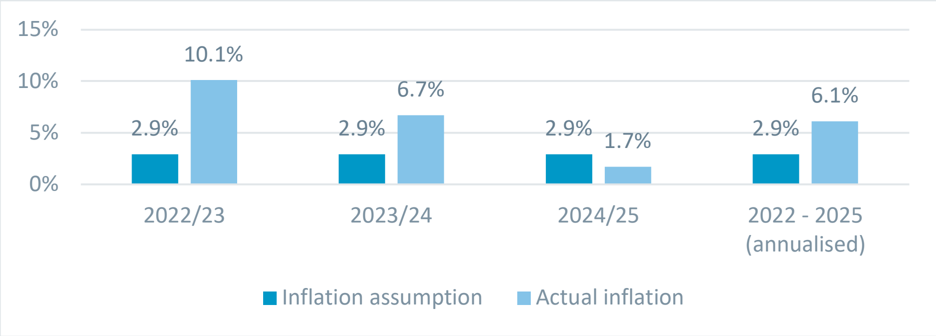
The funding level is a snapshot based on a date and single set of assumptions by the Actuary about the future – it is highly unlikely that actual outcomes will be as assumed. It is therefore important for the Fund (and employers) to monitor and understand the funding position over time. This note discusses the impact of two key areas on the current funding environment (inflation and investment returns) and what this may mean for employers as we prepare for the 2025 valuation.

Inflation: Pensions in payment, in deferment and CARE pots increase annually in line with the cost of living based on the September-to-September adjustments in the Consumer Price Index (CPI).

Investment returns: The Fund manages a diversified investment portfolio to support the Pension Fund's objectives. The expected/promise of future investment returns are important to calculate how much the Fund needs to hold now to provide members' pensions in the future.

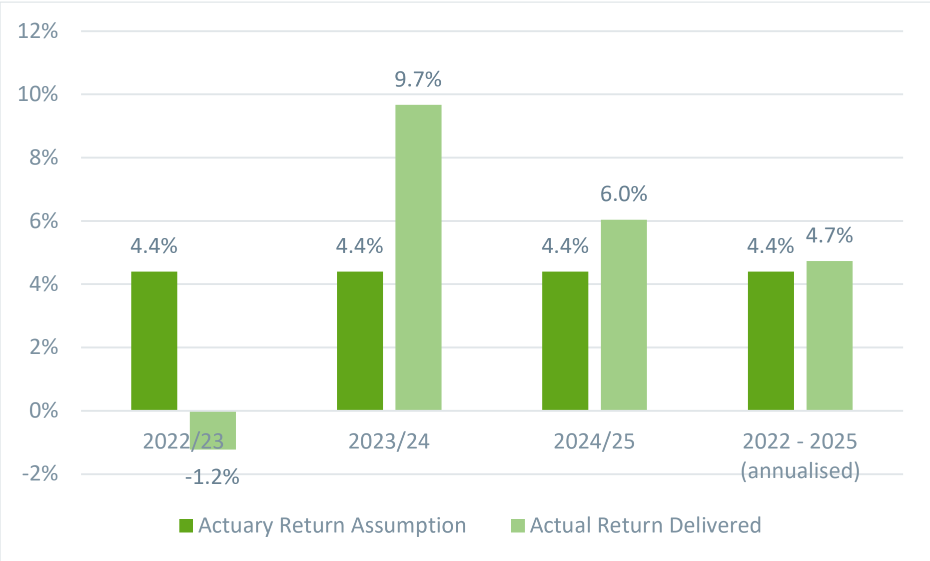
What has happened | Inflation

The chart below illustrates actual short-term inflationary increases against the Actuary's assumed long-term inflationary increases of 2.9% per annum.



What has happened | Investment return

The chart below illustrates actual returns delivered by the Fund's investment portfolio against the 4.4% pa return assumed by the Actuary at the 2022 valuation.



The outlook | Inflation

Whilst inflation has now fallen, and is closer to the Bank of England's target of 2% pa, the higher than assumed inflation increases over the past three years have placed a higher value on the pension liabilities (c.10%), and uncertainty remains around future inflation.

Persistently higher inflation over the longer-term is a risk to the Fund (and employers). For example, long-term pension increases which are 1% pa higher than that assumed by the Actuary, would result in a reduction in an employer's funding level by around 20%.

The outlook | Future investment return

Since the 2022 valuation, central banks have increased interest rates on "risk free" cash investments (from 0.75% to 4.5% at March '25). This has led to an expectation that the Fund's investment portfolio will achieve a higher rate of return in the future than the Actuary assumed at the 2022 valuation, which in turn reduces the value placed on future pension benefits (liabilities), i.e. you can hold less money now to still be able to pay the same future benefits, as the money currently held will be earning a higher return.

It is worth noting that assumptions relating to future investment performance are particularly uncertain, especially during periods of increased market volatility. An example of this is the recent volatility due to uncertainty around the longer-term impact of global trade tariffs.

The outlook | Other key risks

Other key risks that can impact funding position include:

- **Longevity** – recent data indicates that life expectancy improvements are slowing down. However, funds are now facing the challenge of how to best allow for recent longevity trends in this post pandemic era.
- **Climate change** – climate risks could have a significant impact on future funding position. The Fund monitors climate risks, however, the uncertainty makes it difficult to make a direct allowance for such risks in funding plans.
- **Membership** –membership changes can have a significant impact:
    - *Pay awards* – can inflate your final salary linked benefits.
    - *Early retirements (including ill health)* – members retiring early with unreduced benefits increases your liabilities. For ill-health cases, employers may wish to mitigate this risk with external insurance.
    - *Incomplete or inaccurate data* - it is important to provide the Fund with timely and accurate data. Gaps or errors in data can have a negative impact on your funding or lead to receiving your results later than expected.

What this means | Whole fund funding position update

Taking the changes since 2022 into account, the estimated **Whole Fund funding position** at 31 March 2025 has improved, as demonstrated below.

Whole fund	31 March 2022	31 March 2025
Assets (£bn)	5.8	6.7
Liabilities (£bn)	5.5	4.6
Surplus/(deficit) (£bn)	0.3	2.1
Funding level	105%	c146%

*Please note, **the above 31 March 2025 funding position is an estimate at whole fund level**. The funding level will be recalculated as part of the 31 March 2025 valuation process with updated membership data and assumptions.*

- The improved funding is a result of changes in the financial markets, notably an increase in the assumed level of future returns, linked to central banks increased interest rates on “risk free” cash investment, which reduces the value placed on future pension benefits (**liabilities**).
- **Assets** have broadly kept pace with expectations. Therefore, the improved funding position is driven by the promise of greater future returns rather than actual investment returns earned.

What this means | Employer funding

Whilst improvements in funding level can be expected for most employers, each employer is different, and results may vary to those shown at whole fund level.

Each employer has its own funding position and own objectives. You have a responsibility to ensure that there is enough money in your section of the Fund to pay for all past and future employees’ pensions.

What this means | Understanding your funding position

Fully funded: If you are fully funded (>100%), that means that we believe we are currently holding enough money today to pay for all benefits that have been earned by your past and present employees (based on the Actuary's calculations), provided that the assets deliver the expected return. This position is very sensitive to future assumptions and does not allow for new benefits that your employees continue to accrue, so **this funding level will change over time.**

Future contributions: Your funding level is only calculated in respect of benefits already earned ('past service') and is not the endgame for employers who continue to participate and build up benefits ('future service'). The cost of new benefits which continue to be built up by members each year, still need to be paid.

For most employers, a key Fund objective is to smooth contribution rate changes. This means that any short-term volatility is managed, with the long-term goal of keeping contribution rates stable and affordable over the longer term.

Improvements in funding may result in contribution relief for some employers, however **any reductions will likely be gradual to support the longer term aims of stability and affordability.**

Future exit costs: The funding level is more meaningful for employers approaching exit (eg when the last employee leaves or retires). On exit, the Actuary calculates your funding level, and you will be asked to pay any exit debt (if one exists) at that point. **This calculation is carried out on a 'cessation' basis** (see further reading below).

Summary and next steps

The key takeaways from this communication are:

- **Funding level** – The improvement in funding level is mainly attributed to the promise of future investment returns - which are <u>not</u> guaranteed. The Fund includes a prudence margin within their actuarial assumptions to reflect this uncertainty.
- **Inflation** - has fallen recently, but future inflation is uncertain and remains a risk to funding.
- **Contribution rate** – improvements in funding may result in contribution relief for some employers, however short-term reductions need to be balanced with the longer-term aims of stability and affordability.
- **Data quality** - is a vital part of administration and valuation calculations.

All employers can play their part in ensuring a smooth valuation process over the coming year, including:

- Reviewing the membership data you hold and ensuring this is up to date
- The Fund will hold a consultation regarding updates to the Funding Strategy Statement. This is planned to take place in the next few months. We encourage all employers to:
    - Read this document
    - Ask questions – especially if this is your first valuation
    - Communicate any changes in your circumstances to the Fund

Continued engagement with the Fund, keeping up to date with all valuation communications and communicating any change in circumstances with your Fund contact should contribute to successful outcomes for all stakeholders.

Further reading | Different funding positions for different purposes

Each employer is responsible for funding their own pension benefits. However, the value placed on obligations (liabilities) will differ depending on the purpose of the valuation and the set of assumptions being adopted (the "basis").

"Ongoing funding" This is the basis used to calculate contribution rates for secure, longer-term employers, where the Fund can use a more optimistic funding basis due to the longer time period available for investment returns to make up any funding gap. A strong funding position on the 'ongoing' basis will help to maintain lower contribution rates.

"**Accounting**" In line with IAS19 or FRS102 accounting standards, a different set of assumptions is adopted to use in yearend disclosures. Accounting valuations have no impact on your pension funding or contributions. If you have a net asset (surplus) on your yearend balance sheet, you may need to show a restricted position (asset ceiling).

"**Cessation**" This is the basis used for setting contribution rates for higher risk, shorter term employers where market volatility could impact short term funding levels, so the Fund uses more prudent financial assumptions.

This is also **the basis normally used for exiting employers**. If you are below 100% funded on the cessation basis on exiting the Fund, then you will have to pay an exit debt.

Further reading | Outsourcings

If you are outsourcing a contract, it is important to consider the pension impact:

- **Notify the Fund** – the intention to outsource a contract should be notified to the administering authority well in advance of the contract starting.
- **Understand the risks** – the Fund's preference is for 'pass-through' to be used for new admission as this generally benefits all parties (see below).
- **Admission agreements** – employers cannot be admitted to the Fund until all paperwork is completed. This is a very important step.

Further reading | Pass-through

The Fund has a preference for pass-through to be used for new admissions. Prior to a contract starting, the scheme employer awarding the contract should complete a risk sharing agreement. Typically, the risks not within the contractor's control will remain with the awarding employer. This has the following benefits:

Awarding employer

- Value for money through lower contract pricing (as pension risk removed)
- Less risk of bad publicity if contractor does not meet pension costs.
- Level playing field for all contractors encouraging a wider pool of bidders.
- Access to any surplus (if any) on cessation.

Contractor

- Stable and potentially lower contributions over the term of the contract.
- Reduced/mitigated risk of pension cost volatility.
- No cash sum debt payment required on exit.