2022 Valuations - Detail Report

Details

Last Updated: 09 August 2023

Triennial valuation 2022 in the LGPS (England & Wales) - Detailed Report

2022 valuation results - executive summary

Funding level

Improved from 98% at 2019 to 107% at 2022 (on local funding bases) with all Funds reporting an improvement

Deficit

Improved from a deficit of £5.9bn at 2019 to a surplus of £22.1bn at 2022 (on local funding bases)

Membership

Total count of members increased from 6.2m at 2019 to 6.6m at 2022

Average primary rates

Increased from 18.6% of payroll p.a. at 2019 to 19.8% of payroll p.a. at 2022 (at

Average total contribution rates

Decreased from 22.9% of payroll p.a. at 2019 to 21.1% of payroll p.a. at 2022 (on an equivalent

Allowance for McCloud

Across the Funds analysed, the cost of McCloud was estimated to be £1.6bn (0.5%) of liabilities on a

whole Fund level)	whole Fund level)	local funding basis.

All LGPS Funds saw an improvement in funding position, largely driven by strong asset performance in 2020/21 which carried through to 31 March 2022, and deficit contributions paid by employers over the intervaluation period. As at 31 March 2022, the total funding level across the 85 Funds analysed was 107% which corresponded to a surplus of £22.1bn. Average total contribution rates decreased from 22.9% p.a. to 21.1% p.a., although primary rates generally increased. Therefore, deficit contributions (i.e. secondary contributions) were generally reduced to maintain stability of contributions. We continue to see participating employers under cost pressures so maintaining rates was welcome.

---

1. If comparing these figures to the 2022 Scheme annual report published by the Scheme Advisory Board you will notice that there are some minor differences and there are a number of reasons for this including that this analysis includes only 85 Funds, some of the treatment of benefits may have been calculated slightly differently i.e. membership counts. Some of the 2019 comparatives may also be different to previous reports where they have been recalculated to be based on the same Funds used in the 2022 analysis.

Employer Engagement

Due to the recent falls in gilt yields as well as the amendments made to the LGPS Regulations in September 2020 which introduced new employer flexibilities, we have seen a further increase in engagement by employers looking to understand their obligations to the LGPS. An increasing number of Funds undertook employer covenant reviews as part of the valuation process. This helps Funds to look at the appropriateness of the contributions being set and the integration of employer covenant risk, investment strategy risk and funding risk in a similar way to what we are seeing in the private sector.

Introduction

On 31 March 2023, the 2022 actuarial valuations for 87 Funds participating in the England & Wales Local Government Pension Scheme (LGPS) were completed. The purpose of these valuations was to set employer contribution rates in each Fund for the period from 1 April 2023 to 31 March 2026.

There was one fewer LGPS Fund in the 2022 analysis compared to 2019, due to the Northumberland County Council Pension Fund merging into the Tyne and Wear Pension Fund in 2020.

This report summarises the data collected from 85 of the 87 Funds (the two Environment Agency Funds have been excluded). It compares the 2022 valuation results to the 2019 valuation results as well as looking at the assumptions used, the investment strategies and the ranges of recovery periods. The full list of Funds analysed is shown here.

In carrying out our research we have reviewed the valuation reports provided and received support from the Local Government Association (LGA) and Barnett Waddingham. We have used the information as set out in the valuation dashboard for each Fund, as agreed between the Fund actuaries and the Government Actuary's Department (GAD).

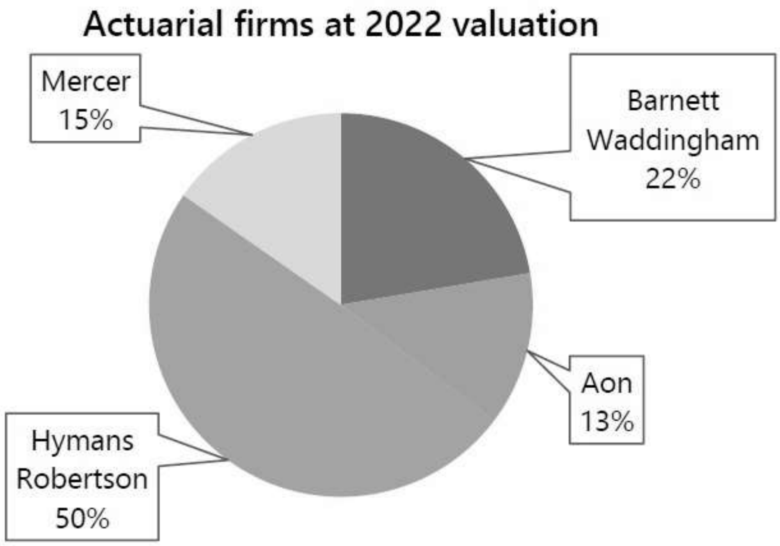
This report explores some of the key findings and is split into the following sections:

- Executive summary
- Data
- Financial assumptions
- Demographic assumptions
- Funding results

Please contact the Scheme Advisory Board secretariat for further information.

Actuarial firms

The 2022 valuation reports were prepared by the Fund actuaries of each LGPS Fund. Although each Fund has their own funding approach, there are similarities between Funds advised by the same actuarial adviser. The split of the LGPS Funds by actuarial firm is shown in the chart below:



Current issues

In addition, Funds were faced with various issues surrounding the valuation including:

- **The potential impact of the McCloud/Sargeant case**: When the Government reformed public service pension schemes in 2014 and 2015 they introduced protections for older members. In December 2018, the Court of Appeal ruled that younger members of the Judges' and Firefighters' Pension schemes have been discriminated against because the protections do not apply to them. The Government has confirmed that there will be changes to all main public sector schemes, including the LGPS, to remove this age discrimination. A consultation has been run in relation to the changes proposed for the LGPS and a further consultation was issued on 30 May 2023 including draft regulations. For the purposes of the 2022 valuation, to enable a consistent approach, the Fund actuaries were instructed by the Department of Levelling Up, Housing and Communities (DLUHC) to assume that the legislation will bring forward the changes as proposed, and liabilities were calculated in line with this. Across the Funds analysed, the cost was estimated to be £1.6bn (0.5%) of liabilities on a local funding basis.
- **The potential impact of the cost management process**: There remain uncertainties around the 2016 and 2020 cost management exercises. Further cost management reviews will be carried out and may lead to future benefit changes.
- **Potential change to the valuation cycle:** The Government consulted on a change to the LGPS Funds valuation cycle to move to a quadrennial cycle in line with the other public sector pension schemes and also the LGPS Scheme valuation.

This issue remains outstanding and therefore the Fund actuaries have based their valuation reports on the next valuation being in 2025.

- **Climate change risk analysis:** Fund actuaries were required to consider climate risk in the 2022 valuations and include two scenarios in their analysis. The analysis was developed for LGPS Funds based on the Department for Work and Pensions regulations, as we await final regulations which apply directly to the LGPS. The analysis was discussed with GAD, who agreed a set of four key principles for how LGPS Funds would undertake climate risk scenario analysis as part of the 2022 valuation.
- **Current high levels of inflation:** Since the valuation date, there has been some significant market turbulence including material increases in short-term inflation which resulted in a 10.1% pension increase being awarded in April 2023. Funds took a variety of approaches in allowing for this which varied from making no additional allowance to including an additional explicit allowance. The approach each Fund took is set out in their valuation report.

Experience since 31 March 2022

The 2022 valuation saw a significant improvement in funding levels compared to 2019 (increasing from 98% to 107%), with all Funds reporting an improved funding position. This is a positive outcome for the LGPS, although recent events, in particular the impact of high inflation on liabilities, will bring challenges for the period to the next valuation.

On the liability side, the movement will depend on the impact that changes in market conditions will have had on each Fund's local funding basis. Generally, high short-term inflation will lead to an increase in the value placed on the liabilities, although, as detailed above, it may have been built into the valuation of the liabilities to some extent.

Since the valuation date, we have also seen significant increases in gilt yields. Therefore, there may be a further impact on Funds using a discount rate which is set in relation to the inflation assumption and/or gilt yields. For example, if a discount rate is set with reference to gilt yields, then liabilities may be expected to have decreased significantly following 31 March 2022 due to a significant increase in gilt yields since this date.

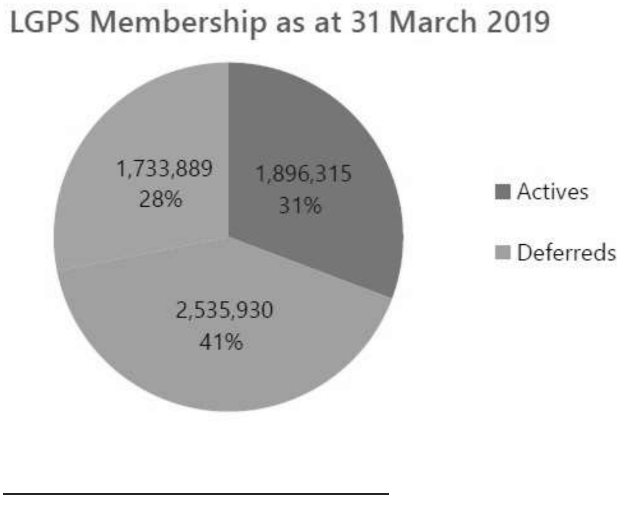
On the asset side, it is expected that investment returns across the LGPS will have been lower than that assumed at the 2022 valuation which will lead to a worsening in the funding position.

Results of Analysis

<u>Data</u>

Membership data

The LGPS continues to increase in size with total membership increasing from 6.2m[2] members in 2019 to 6.6m in 2022. The split of membership is summarised in the charts below. Please note that individuals may have multiple membership records due to different contracts etc. The actuarial valuations consider benefits by record rather than by member and therefore this count may be higher than the number of individual LGPS members.



---

2 Please note that this figure differs from the Scheme Advisory Board’s 2022 Scheme annual report and we believe this is to do with how aggregated membership and multiple records have been treated. The figures in the table also differ due to the treatment of undecided members.

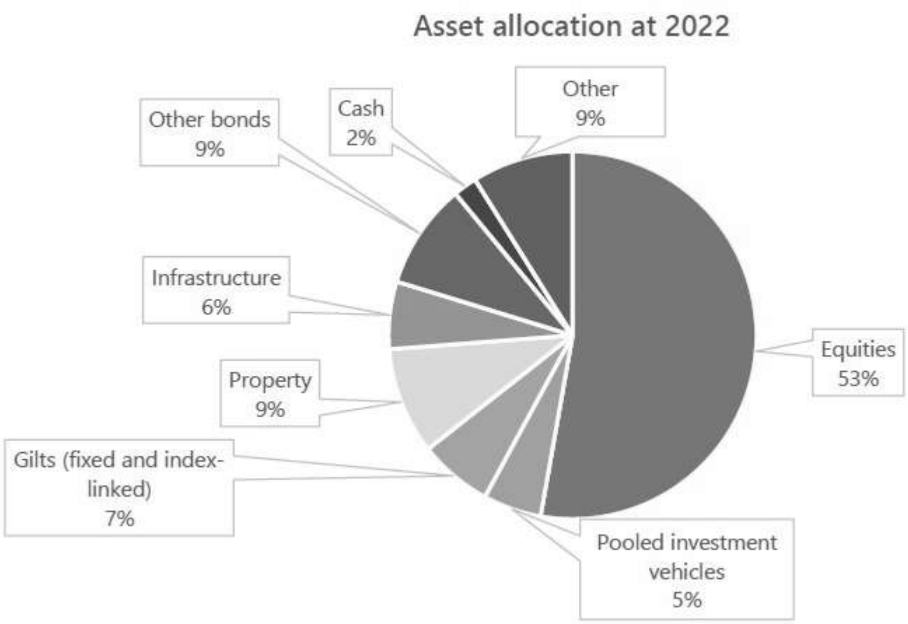
The following table sets out a comparison of the key membership statistics at the 2019 and 2022 valuations:

Membership summary	Number (000s)			Total annual pensionable pay/pension (£ms)			Average age	
	2022	2019	% chg	2022	2019	% chg	2022	2019
Actives	1,975	1,896	4%	39,229	34,370	14%	50.7	51.0
Deferreds	2,708	2,536	7%	3,947	3,540	11%	51.4	50.3
Pensioners	1,922	1,734	11%	9,659	8,636	12%	70.0	69.3
Total	6,605	6,166	7%					

Please note that the average ages disclosed in the 2022 valuation reports are weighted by pension or by liability depending on the Fund. The average age shown in the table above is a simple average of the disclosed average ages and so is representative of neither.

Investment strategy

The overall allocation of assets of the Funds analysed in this report is set out in the chart below. For some more specific asset classes an allocation has been made to a class which is believed to be appropriate.



This is roughly a 70/30 split between growth and protection assets (classing equities, pooled investment vehicles, property and infrastructure as growth assets). This is a similar split to 2019, however there are some differences to note:

- It appears that Funds are reducing the proportion of their assets held in bonds and gilts and are moving into more diversified strategies and into less conventional asset types; for example the “Other” allocation at 2019 was 7% but has now increased to 9%. This includes assets such as derivatives, unitised insurance policies and liability driven investments. In addition, the pooled investment vehicle allocation has increased from 4% to 5%.
- There has been a slight increase in allocation to infrastructure from 4% at 2019 to 6% at 2022.

Financial Assumptions

This section outlines findings split between the different key assumptions which are:

- Discount rate
- Inflation
- Real discount rate (margin above inflation)
- Salary increases

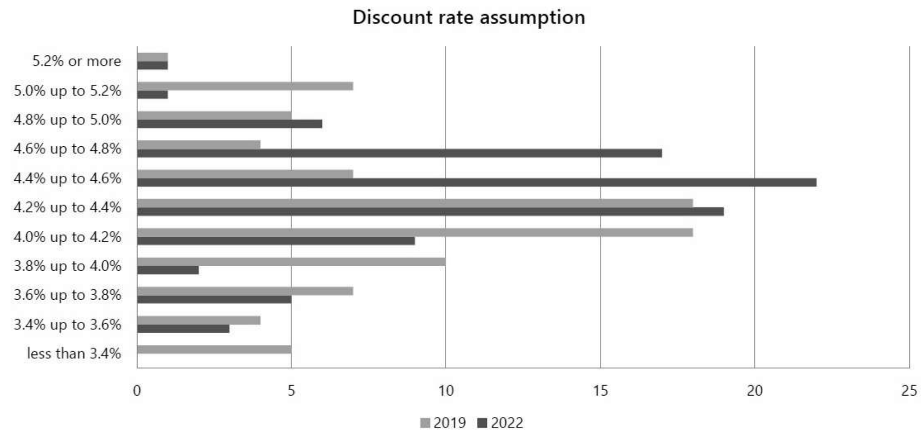
Discount rate

The discount rate assumption is the key assumption driving the value of each Fund’s liabilities. To determine the value of accrued liabilities and future contribution requirements at any given point in time it is necessary to discount future payments to and from the Fund. There are a number of different approaches which can be adopted in deriving the discount rate to be used and the approach that is most appropriate will depend on the purpose of the valuation and the overall funding objectives and risk appetite of the Fund. Therefore each actuary and Fund will derive their assumptions in an appropriate way.

The discount rate sometimes varies between employers and employer groups in each Fund, reflecting covenant strength. It is important to note that analysis here is of the average discount rate for each Fund.

The average disclosed discount rate used in the valuation increased from 4.2% p.a. at 2019 to 4.3% p.a. at 2022, but spanned a smaller range of 3.4% to 5.2% p.a. compared with 3.1% to 5.3% p.a. in 2019. The average discount rate assumption of 4.3% roughly translates to an assumption of CPI plus 1.5%. This is based on the average CPI assumption of 2.8% across the Funds but as noted above, the approach in deriving the discount rate differs by Fund. All else being equal, an increase in the discount rate decreases the value of the liabilities.

The chart below illustrates the number of Funds adopting discount rates within each range shown (and includes 2019 for comparison):



The majority of Funds saw an increase in the discount rate assumption since the last valuation. Out of the 85 Funds analysed, 55 Funds saw an increase, 20 Funds saw a decrease in the discount rate assumption and 10 Funds adopted the same discount rate assumption. The increase in discount rates would be largely driven by expectations of higher investment returns on assets whilst the reduction in discount rates have been primarily driven by an increased level of prudence adopted.

Inflation

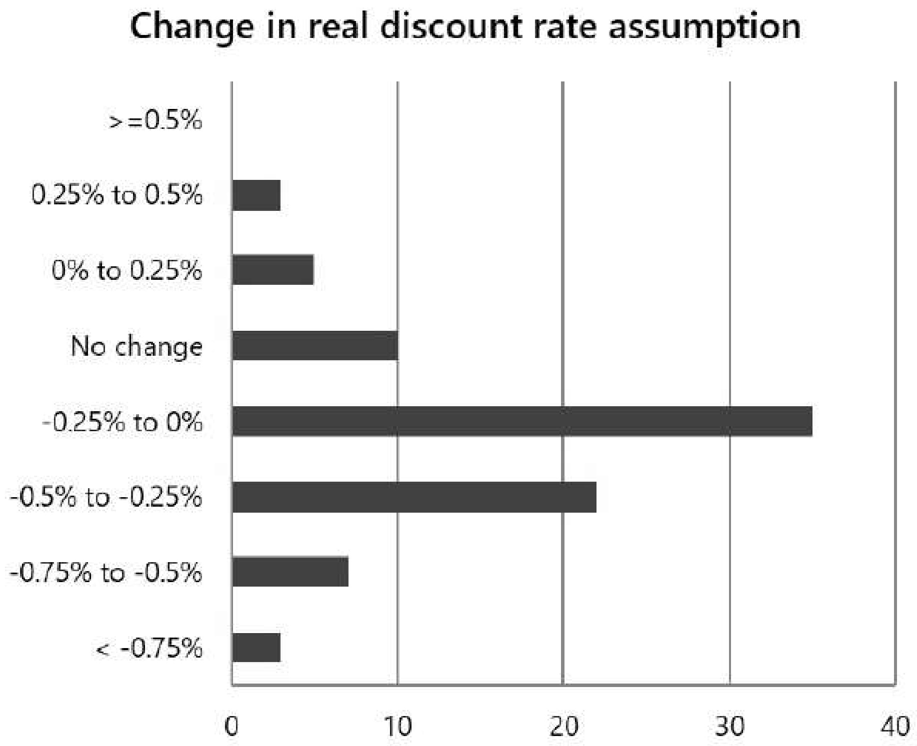
In the LGPS, the Consumer Prices Index (CPI) is the current inflation measure used to index pensions in payment and deferment, and to revalue members' CARE benefits for service accrued after 31 March 2014. The increase is set out each year in the public service pensions increase order issued by HM Treasury.

The average disclosed CPI inflation assumption used increased from 2.4% p.a. in 2019 to 2.8% p.a. in 2022. All else being equal, this would have led to an increase in the value of the liabilities as benefits are assumed to increase at a faster rate.

Real discount rate

The relationship between the CPI inflation assumption and the discount rate assumption, the real discount rate, is arguably the most important financial assumption. For example a 0.1% increase in the inflation assumption combined with a 0.1% increase in the discount rate assumption results in very little change to the estimated value of the liabilities but a 0.1% increase in the inflation assumption combined with a 0.1% decrease in the discount rate assumption, i.e. a fall in the real discount rate of 0.2%, could lead to an increase in the value of the liabilities of around 4%.

The graph below shows the change in real discount rate assumptions between the 2019 and 2022 valuations:



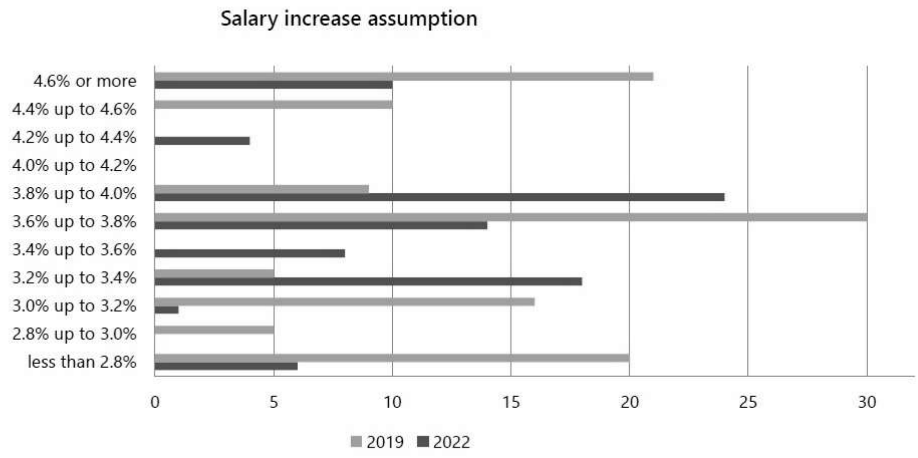
The majority of Funds saw a decrease in the real discount rate assumption which, all else being equal, would have led to an increase in the value of the liabilities. This would offset at least some of the improvements in funding position brought by the strong 2020/21 asset performance. Ten Funds saw no change in the real discount rate assumption whilst eight saw an increase.

Salary increases

As the LGPS is now a CARE scheme, the benefits earned after 31 March 2014 are revalued with inflation rather than salary increases. This means that the overall effect on valuation results of the salary increase assumption is less significant than it has been previously (ignoring any effects of McCloud remedies) and would not affect the contribution calculations. However, it still affects all pre-2014 accrued active liabilities.

In the intervaluation period, additional national pay awards were awarded to some employees participating in the LGPS. For lower paid workers these would have likely resulted in an increase in pay over the salary increase assumption used in the valuation. These increases may impact the pre 2014 past service liabilities as at 31 March 2022, depending on whether or not the award was included in the member data or whether an adjustment was made by the Fund actuary. Nonetheless, the reported average real salary increase (the difference between the salary increase assumption and the CPI inflation assumption) has marginally increased across the Funds from 0.8% in 2019 to 0.9% in 2022 which would increase the value of the active liabilities. The range of salary increase assumptions used by Funds has also marginally increased, reflecting the circumstances of the individual Fund.

The chart below shows the range of long-term salary increase assumptions used by Funds at this valuation and the previous valuation:



The average long term salary increase assumption across the Funds at 2022 was higher than the 2019 valuation, increasing from 3.2% to 3.7% which largely reflects the increase in the inflation assumption. Furthermore the range for the salary increase assumption widened slightly from 2.3% p.a. – 3.9% p.a. at 2019 to 2.7% p.a. – 4.6% p.a. at 2022.

At the 2019 valuation, Mercer applied a short-term overlay which allowed for a lower salary increase assumption in the short term. Mercer removed this approach for most of their Funds at 2022, however, we believe three Funds still retained a short-term overlay to their salary increase assumption. We understand that none of the other advisors applied a short-term overlay for 2022.

Please note that this analysis does not consider the use of promotional salary scales which have been used by some Funds.

Demographic assumptions

There are a number of demographic assumptions (also known as statistical assumptions) made as part of a valuation, such as post-retirement mortality, rates of retirement and rates of withdrawal from active service.

The key demographic assumption is the post-retirement mortality assumption as it influences how long each Fund expects pensions to be paid for. We analyse this further in this section.

Post retirement mortality

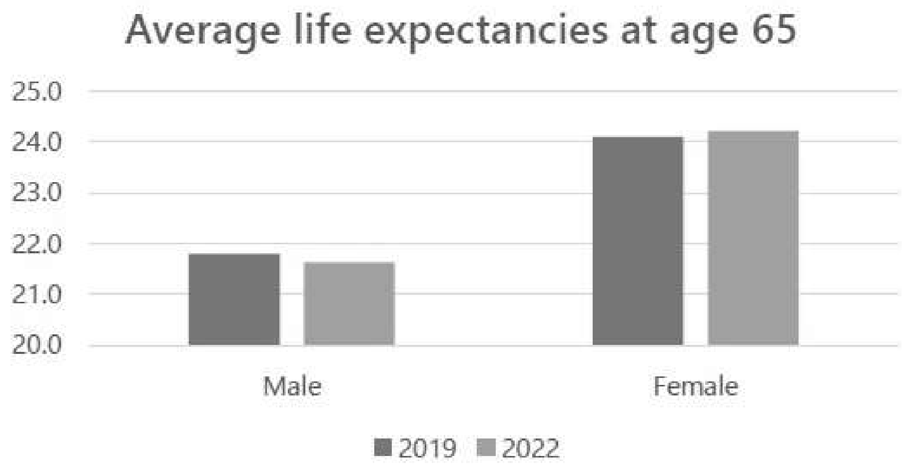
The post-retirement mortality assumption will generally vary from Fund to Fund as this may take into account the specific profile of each Fund and its members.

There are two aspects to consider in determining appropriate post-retirement mortality assumptions:

1. choosing an appropriate mortality base table assumption applicable today taking into account characteristics of the Fund members; and
2. making an appropriate allowance for mortality to improve in future.

The base table (and any adjustments made to it) will generally vary between Funds but the allowance for mortality to improve in the future is a more subjective assumption which will tend to be consistent between Funds, although the different actuarial firms have taken different views on what this should be and which version of the CMI Model to use.

The average life expectancies assumed at age 65 as set out in the dashboard are detailed in the chart below:



The average life expectancy assumption for males has reduced at 2022 compared to 2019. This is largely driven by the recent heavier mortality experience observed due to the

Covid-19 pandemic as well as lower expectations of improvements in future life expectancy observed in recent years (they have plateaued). The average life expectancy assumption for females has marginally increased at 2022 compared to 2019. Whilst there has been a small increase, the increase observed is still significantly lower than might be expected between valuations, showing that the assumption has taken into account recent experience. It is worth noting there is a large range of life expectancies adopted across all 85 Funds, and only 44 Funds saw an increase in their female life expectancies since 2019. This range is to be expected given the differing views on life expectancies of each administering authority and the different membership profiles of each Fund.

The assumptions used have resulted in a range of life expectancy assumptions across the LGPS as set out in the table below:

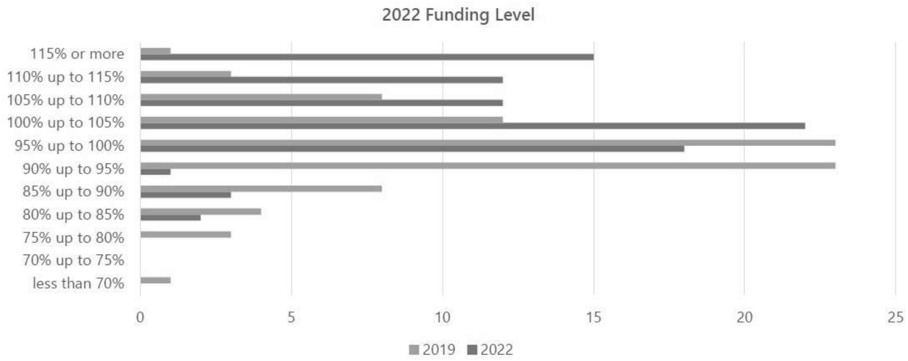
Life expectancy at age 65 (years)	Average	Minimum	Maximum	Range (max - min)
Male	21.6	19.5	23.2	3.7
Female	24.2	22.9	25.6	2.7

Funding results

Funding level

Based on the 85 reports analysed, the results of the 2022 valuation reported assets of £361.1bn and liabilities on local funding assumptions of £339.0bn, i.e. a surplus of £22.1bn and a funding level of 107%. This is an overall improvement compared to the position in 2019 which showed assets of £285.8bn and liabilities of £291.7bn i.e. a deficit of £5.9bn and a funding level of 98%.

The chart below shows the range of funding levels at 2022 and 2019:



As can be seen from the chart, there has been a significant improvement in funding levels across the LGPS since the 2019 valuation. Published funding levels ranged from 80% to 154% (an improvement from the range at 2019 of 70% to 125%), with an average of 106%3 (compared to an average of 96% at 2019). 61 Funds were reported as more than fully funded (i.e. higher than 100% funding level) as at 31 March 2022 compared to 24 Funds as at 31 March 2019.

All Funds analysed saw an improvement in funding level, however, this ranged from 1% for four Funds (Enfield, Hillingdon, Teesside and Waltham Forest) to 29% for the City of Westminster Pension Fund and the Royal Borough of Kensington and Chelsea Pension Fund. The Fund with the highest reported funding position was the Royal Borough of Kensington and Chelsea Pension Fund at 154% funded and the lowest reported funding level was the London Borough of Havering Pension Fund at 80% funded.

Local funding level versus real discount rate assumption

The chart below shows the range of funding levels on a local basis, against the real discount rate assumption (i.e. the margin above the CPI inflation assumption) adopted at 2022:

As can be seen in the chart above, there is no clear correlation between the real discount rate and the funding level. It can also be observed that there is a wide range of funding levels corresponding to each real discount rate. For example, the funding levels for Funds who adopted a real discount rate of 1.70% ranged from 92% to 154%. The differences in funding level will be due to the value of the

Fund assets and the range of investment returns achieved by the individual Funds.

Tier 3 Employers

Since the 2016 valuation, there has been an additional focus on understanding the potential funding, legal and administrative issues in the Scheme relating to Tier 3 employers. Tier 3 employers are largely admitted and scheduled bodies that do not benefit from local or national tax payer backing. More information on Tier 3 employers has been set out by the SAB here.

Based on the information set out in the valuation dashboards, 12% of the total liabilities as at 31 March 2022 for the 85 Funds analysed were in respect of Tier 3 employers, which represents a slight increase from 11% of the total liabilities as at 31 March 2019.

SAB Standardised Basis

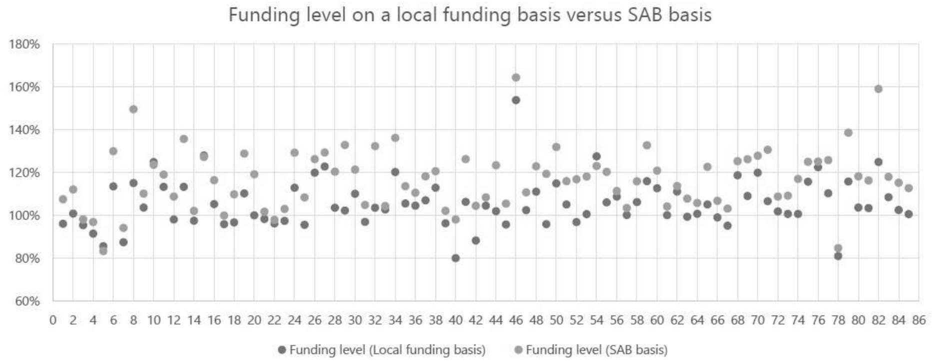
It should be noted that the funding positions above are calculated using local funding assumptions which will differ by Fund. Funds use different assumptions to reflect their individual circumstances and attitudes to risk. Funds were also asked to submit results on the same set of agreed assumptions to the Scheme Advisory Board (SAB) standardised basis.

The average funding level reported on the SAB basis was 117% which compares to the average reported funding level of 106% on the local funding bases. Please note that the average funding level is a simpler metric which does not take into account Fund size.

Further analysis is expected in the Section 13 report to be published by GAD.

Funding level on a local funding basis versus the SAB standardised basis

The chart below shows the funding levels as at 31 March 2022 on both the SAB basis and local funding basis for the 85 Funds analysed:



The majority of Funds were better funded on the SAB basis when compared to their local funding basis. There were four Funds with a lower SAB funding level, which ranged between 1% and 4% lower, and the other 81 Funds saw a SAB funding level that was between 2% and 34% higher than the funding level calculated on a local funding basis. The main reason for this will be that Funds include more prudence in their local funding basis compared to the SAB basis.

Contributions

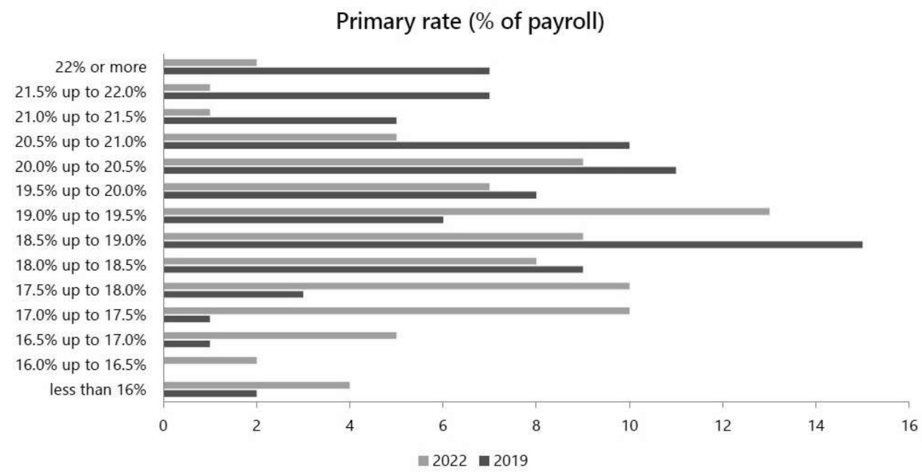
The purpose of the 2022 actuarial valuations was to set appropriate contribution rates for each employer in the Scheme for the period from 1 April 2023 to 31 March 2026. This is required under Regulation 62 of the LGPS Regulations. Regulation 62 specifies four requirements that the actuary "must have regard to" when setting contributions and these are detailed below:

- "the desirability of maintaining as nearly constant a primary rate as possible";
- "the current version of the administering authority's funding strategy statement";
- "the requirement to secure the solvency of the pension fund"; and
- "the long-term cost efficiency of the Scheme (i.e. the LGPS for England and Wales as a whole), so far as relating to the pension fund".

The primary rate is the employer's share of the cost of benefits accruing in each of the three years beginning 1 April 2023. In addition, each employer pays a secondary contribution as required under Regulation 62(7) that when combined with the primary rate results in the minimum total contributions certified for each employer. This secondary rate is based on their particular circumstances and so individual adjustments are made for each employer.

Primary rate of contributions

The following chart shows the range of primary rates calculated at whole Fund level at 2019 and 2022:



Please note that the disclosed whole Fund level primary rate looks at the average rate payable by employers in the Fund. It may not be paid by any individual employer.

> The average primary rate increased from 18.6% of payroll p.a.[4] at 2019 to 19.8% of payroll p.a. at 2022. As can be seen from the chart above, there has been a general trend of an increase in primary rates.

69 Funds saw an increase in average primary rate; 3 Funds saw no change in average primary rate and 13 saw a decrease in average primary rate.

Please note that these are the average primary rates at whole Fund level; individual employer primary rates will exhibit greater variability.

Secondary Rate of Contributions

> In terms of secondary contributions, the total amounts expected from employers are £488m, £425m and £443m for the 2023/24, 2024/25 and 2025/26 Scheme years respectively, which corresponds to an average secondary contribution of approximately 1.3% of payroll p.a. over the

> three years (although this could vary significantly by Fund). The higher amount in year one is likely due to some employers having a preference to front end load their contributions. What is actually paid in secondary contributions may also vary if there are changes in timings to contributions.

Most secondary contributions will be certified as an amount to recover any deficit over a specified period or may be an amount to reflect any surplus attributable to an employer. 23 of the 85 Funds have reported total secondary contributions in 2023/24 as a negative amount. This could be due to the improvements in the funding levels observed and the secondary contribution rate being used to offset any increase in primary rate in order to maintain stable total contribution rates where appropriate.

There is limited information in the valuation reports about the length of surplus/deficit recovery periods used by Funds and participating employers and there may be more detail in each Fund’s Funding Strategy Statement. Some Funds have reported an average recovery period and some have reported the longest agreed recovery period for their employers (and sometimes both).

It is not necessarily appropriate to consider a recovery period at Fund level for a number of reasons including:

- each employer or group of employers could be given their own recovery period depending on their individual circumstances; and
- some employers are in surplus and the surplus is not allocated to other employers so may result in a misleading whole Fund rate if it were assumed that it was shared.

---

4 Figure not included in 2019 analysis as recalculated to be based on Funds included in 2022 analysis.

In addition, recovery periods are used by some Funds as a tool to reflect employer covenant and therefore different recovery periods are offered to different employers; this will also be set out in the Funding Strategy Statement of the relevant Fund.

Based on the information set out in the valuation dashboards, there were no Funds with recovery periods greater than 20 years.

Total contributions

Combining the primary rate of contributions with the secondary rate of contributions, as a percentage of payroll the average total contribution rate at whole Fund level for the certified three year intervaluation period is lower at 2022 compared to 2019.

The total average contribution for the three years following the 2019 valuation was 22.9% of payroll p.a.; this has fallen to 21.1% of payroll p.a. for the three years following the 2022 valuation.

Across the analysed Funds, there is significant variation in this change in average total contribution rate (ranging from a drop in total equivalent contributions of 27.1% of payroll, to an increase of 7.9% of payroll). The average change was a decrease of 1.5% of payroll, generally reflecting the reduction in secondary rates (due to strong asset performance helping to reduce deficits) balancing out the increase in primary contributions.

However, contributions are paid on an individual employer level rather than a whole Fund level, and we expect even more variation at the individual employer level.

Employee Contributions

In addition to employer contributions, employees also contribute towards the LGPS. The contributions for each member are set with reference to salary bands which are updated annually in line with CPI inflation. The average employee contributions have marginally increased from 6.5% of pensionable pay in 2019 to 6.6% of pensionable pay in 2022.

Please contact the Scheme Advisory Board secretariat for further information on the results of this research.

Appendix 1

List of LGPS Fund reports analysed (the two Environment Agency Funds we have excluded for the purposes of this analysis)

Local Government Pensions

SAB

England and Wales

Valuation Summaries

2022 Valuations - Report

2019 Valuations - Report

2016 Valuations - Summary

2016 Valuations - In Detail

2013 Valuations - Summary

2013 Valuations - In Detail

Fund Valuations

Fund Valuations 2022

Fund Valuations 2019

Fund Valuations 2016

Fund Valuations 2013

Fund Valuations 2010