# Pensions Audit Sub Committee

2.00pm, Tuesday, 19 March 2024

# Actuarial Valuation for Lothian Pension Fund

**Item number 6.3**

## 1. Recommendations

The Pensions Audit Sub Committee (Committee) is requested to:

1.1 Note the results of the 2023 Actuarial Valuation of Lothian Pension Fund.

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# Actuarial Valuation for Lothian Pension Fund

## 2. Executive Summary

2.1 An actuarial valuation of Lothian Pension Fund (LPF) must, by law be carried out every three years. The fund actuary assesses the financial health of the pension fund and sets the employer contribution rates required for the next three years. The last actuarial valuation was carried out as at 31 March 2020.

2.2 The actuarial valuation of LPF, based on data as at 31 March 2023 has been carried out by the fund actuary, Hymans Robertson and the final valuation report is attached as Appendix 1.

## 3. Background

3.1 The Local Government Pension Scheme (Scotland) Regulations 2018 require each administering authority to obtain:

- An actuarial valuation of the assets and liabilities of each of its pension funds as at 31 March 2020 and on 31 March in every third year afterwards;
- A report by an actuary in respect of the valuation; and
- A rates and adjustments certificate prepared by the actuary.

3.2 The Regulations require that the actuarial valuation based on data as at 31 March 2023 must be completed by 31 March 2024.

3.3 The actuarial valuation has three main purposes:

- To assess whether the funding strategy and assumptions are appropriate;
- To assess the financial health of the pension fund; and
- To set the future rates of contributions payable by the fund employers.

3.4 In December 2023, Pensions Committee approved a draft revised Funding Strategy Statement (FSS) which outlined several key changes introduced for the 2023 valuation. The key change was the suspension of the Contribution Stability Mechanism for the period 1 April 2024 to 31 March 2027.

3.5 A separate report on the revised FSS is provided on this agenda.

## 4. Main Report

4.1 The 2023 Actuarial Valuation report for Lothian Pension Fund, as submitted by the actuary, is included at Appendix 1.

**Funding Level - Summary**

4.2 The table below summarises the financial position of the fund as at 31 March 2023.

| Past Service Position | 2020 | 2023 |
|---|---|---|
| **Past Service Liabilities £m** | £7,071 | 6,170 |
| **Assets £m** | £7,479 | 9,695 |
| **Surplus/(Deficit)** | 408 | 3,525 |
| **Funding Level** | **106%** | **157%** |

4.3 The results show the funding level has increased from 106% at the previous valuation to 157% at this valuation, and there was a surplus of £3,525 million at 31 March 2023.

4.4 Section 3.5 of Appendix 1 sets out the various factors that have led to the change in the funding position between the 2020 and 2023 valuations.

4.5 Committee will remember from previous training and briefing sessions that the key driver behind the improvement in results was investment performance over the three-year period and a higher discount rate that reduces the present value of accrued liabilities.

**Employer Contribution Rates**

**Whole Fund**

4.6 The table below compares the whole fund Primary and Secondary Contribution Rates at this valuation to those set at the previous valuation as at 31 March 2020:

| | Last Valuation 31 March 2020 | | This Valuation 31 March 2023 | |
|---|---|---|---|---|
| **Primary rate (% of pay)** | 23.1 | | 25.0 | |
| **Secondary rate (£)** | 2021/2022 | -11,262,000 | 2024/25 | -73,589,000 |
| | 2022/2023 | -11,378,000 | 2025/26 | -75,809,000 |
| | 2023/2024 | -11,530,000 | 2026/27 | -78,095,000 |

4.7 The increase in the primary rate is primarily the result of increasing the level of prudence in the valuation assumptions, whilst the larger negative secondary rate leading to an overall reduction in total contributions reflects the strong funding position of the fund.

**Common Contribution rate**

4.8 The rates in the table above show the position of the overall fund, however contribution rates are set for each employer depending on their individual funding position and membership. The minimum contributions to be paid by each employer from 1 April 2024 to 31 March 2027 are shown in the Rates and Adjustments Certificate - Appendix 5 of the actuary's report which is included as Appendix 1.

4.9 The actuary must provide a whole fund common contribution rate in the report. The Primary rate is the payroll weighted average of the underlying individual employer Primary rates, and the Secondary rate is the total of the underlying individual employer Secondary rates, calculated in accordance with the Scheme regulations.

4.10 As the common contribution rates are based on the weighted payroll average, the Primary contribution rate is impacted by the fact that the largest employers have seen a reduction in contribution rates. In addition, there has been a reduction in the number of employers since the 2020 valuation, and some of the employers with the highest Primary rates have left the fund.

**Individual employer results**

4.11 The rates in the table above show the position of the overall fund, however contribution rates are set for each employer depending on their individual funding position and membership. As noted above, the minimum contributions to be paid by each employer from 1 April 2024 to 31 March 2027 are shown in the Rates and Adjustments Certificate - Appendix 5 of the actuary's report which is included as Appendix 1.

4.12 As previously advised to Committee in previous briefings and training sessions, the improved valuation results have meant that the Contribution Stability Mechanism (CSM) has been suspended for the three-year period from 1 April 2024 to 31 March 2027. The CSM would have led to a reduction of no more than 0.5% per annum from 1 April 2027 for stabilised employers. Due to the improved funding position, the fund and the actuary have been able to reduce rates to a greater extent. The majority of stabilised employers will have a flat rate of 17.6% for the three years from 1 April 2024. Any stabilised employer with rates already below this level will have rates frozen at the 2023/24 level.

4.13 The CSM is only available to certain employers, specifically those which are open to new entrants, have sufficiently strong covenant and, where applicable their guarantor agrees to their participation. Further information is set out in Section 7.5 of the FSS. For non-stabilised employers, consideration of specific employer circumstances, including covenant strength and time horizon have been taken into account when setting employer rates.

4.14 Committee will recall that in setting contribution rates, in order to build in additional prudence, the following steps have been taken:

- Building in an asset shock of 20% to protect the fund against a fall in asset values and future expected investment returns;
- Increasing the likelihood of success to 80%; and
- Making a moderate reduction in the amount of assets invested in more volatile assets. More detailed information on this point is set out in the investment strategy review paper.

4.15 Further details about contribution rates for specific employers are detailed in Appendix 2.

**Communication**

4.16 Indicative employer results were provided to employers in November 2023, following a presentation from the actuary at an employer seminar. Fund officers met with employers on an individual basis to provide further information on their draft valuation results and proposed employer contribution rates.

4.17 Some employers provided information to their employees about their draft valuation results and indicative employer contribution rates which are lower than those paid in the 2023/24 year. This has led to the fund receiving a number of queries from members concerned about the impact this might have on their pension benefits. Fund officers have responded to these queries providing reassurance that as a statutory defined benefit pension scheme, benefits are not based on the amount of contributions paid, but instead on the rules of the scheme which are set out in law.

4.18 A press release and website update regarding the valuation results have been prepared and these will be published following Committee. In future valuations, employers will be reminded that initial results are draft only and information should not be more widely disclosed prior to the Committee approving the FSS, having sight of the final valuation report and thus confirming the new contribution rates.

**Confirmation of affordability**

4.19 Section 7.7 of the FSS requires employers to provide written confirmation that minimum contribution rates set by the actuary are not unaffordable.

4.20 At the time of writing, such confirmation has been provided by 45 out of 60 employers. Fund officers are continuing to engage with the remaining employers and a verbal update will be provided to Committee.

**Climate change risk**

4.21 As noted above, several training and briefing sessions were held for members of Committee and the Pensions Board. At these sessions, Committee asked for additional information on how additional information on how climate change risk was being taken into account within the valuation. This followed publication of the report 'The Emperor's New Climate Scenarios' by the Institute and Faculty of Actuaries and the University of Exeter which questioned whether current economic models underestimated the risks of climate change Climate change. Similar views were also expressed by Carbon Tracker at an event hosted by the City of Edinburgh Council.

4.22 To this end, a paper outlining the risks climate change poses to the funding strategy, and the measures currently being taken to manage these risks is attached as Appendix 3.

## 5. Financial impact

5.1 The funding strategy should ensure that the fund has sufficient assets in the long term to meet its liabilities.

5.2 The results of the actuarial valuation have significant financial impact on the fund's employers. The actuarial valuation sets the minimum contribution rates payable by the employer over the next 3 years.

5.3 The fund is required by law to carry out an actuarial valuation once every three years. Regular actuarial valuations manage the risk of not meeting funding objectives.

## 6. Stakeholder/Regulatory Impact

6.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the fund and they are invited to comment on the relevant matters at Committee meetings.

6.2 Training sessions on the draft valuation results were held for members of the Committee and Pensions Board in October and November 2023. The session in October included a presentation by the fund actuary.

6.3 Employers have been consulted on changes to the Funding Strategy Statement.

6.4 Further meetings and discussions were held with employers in December 2023 and January and February 2024 to consider the valuation results in greater detail.

6.5 The requirements of the Local Government Pension Scheme (Scotland) Regulations 2018 as they pertain to the valuation have been met in full.

## 7. Background reading/external references

7.1 None.

## 8. Appendices

Appendix 1: Lothian Pension Fund 2023 Valuation Final Valuation Report
Appendix 2: Employer contribution rates.
Appendix 3: Managing Climate Risk.