

LGPS 2023 Valuations: The Big Picture in Scotland

June 2024



Executive summary

With the 2023 valuations in the LGPS in Scotland now concluded, we have analysed results for all 11 regional funds to understand the national picture. And the results are very positive.

- The past service funding level is strong – an increase in the overall funding level in Scotland from 104% at 31 March 2020 to 141% at 31 March 2023.
- Administering authorities have, on average, been able to offer some contribution rate relief. The average total employer contribution rate across the 11 funds has reduced from 20.3% of pay in 2023/24 to 17.5% in 2026/27.
- The outlook for the long-term sustainability of the scheme is robust. In aggregate, current LGPS funding plans have a more than 85% likelihood of being sustainable over the long-term.

This means that the LGPS in Scotland is in a very strong and enviable position, not just within the public sector pension scheme environment, but also when compared against other open, long-term defined benefit pension schemes.

Introduction

31 March 2024 saw the official completion of the 2023 triennial valuations in the LGPS in Scotland, and a collective sigh of relief. The 2023 valuations were a different experience for many Administering Authorities to those we have seen in the last couple of decades. Whilst recent LGPS valuations have largely been focused on managing funding deficits and contribution rate increases, the 2023 valuation brought for some a completely new challenge: how to manage a (in many cases, significant) funding surplus.

In the lead up to the 2023 valuation date, [we advised](#) funds to set aside time to consider the options available when faced with a funding surplus. Should an improved funding position mean immediate contribution rate cuts for employers, or should funds retain some surplus to hold as a buffer against potential future adverse experience? Should funds build additional prudence into the valuation? Or should they seek to reduce future funding position volatility by reducing investment risk? These are the decisions that Administering Authorities in Scotland have been navigating during the 2023 valuation exercise.

Now that the 11 regional 2023 valuation reports have been published, we are able to examine the overall picture for the LGPS in Scotland and gain some insights into the funding plans that have been adopted.

Laura McInroy
Head of LGPS Valuations
June 2024



Funding position

National level

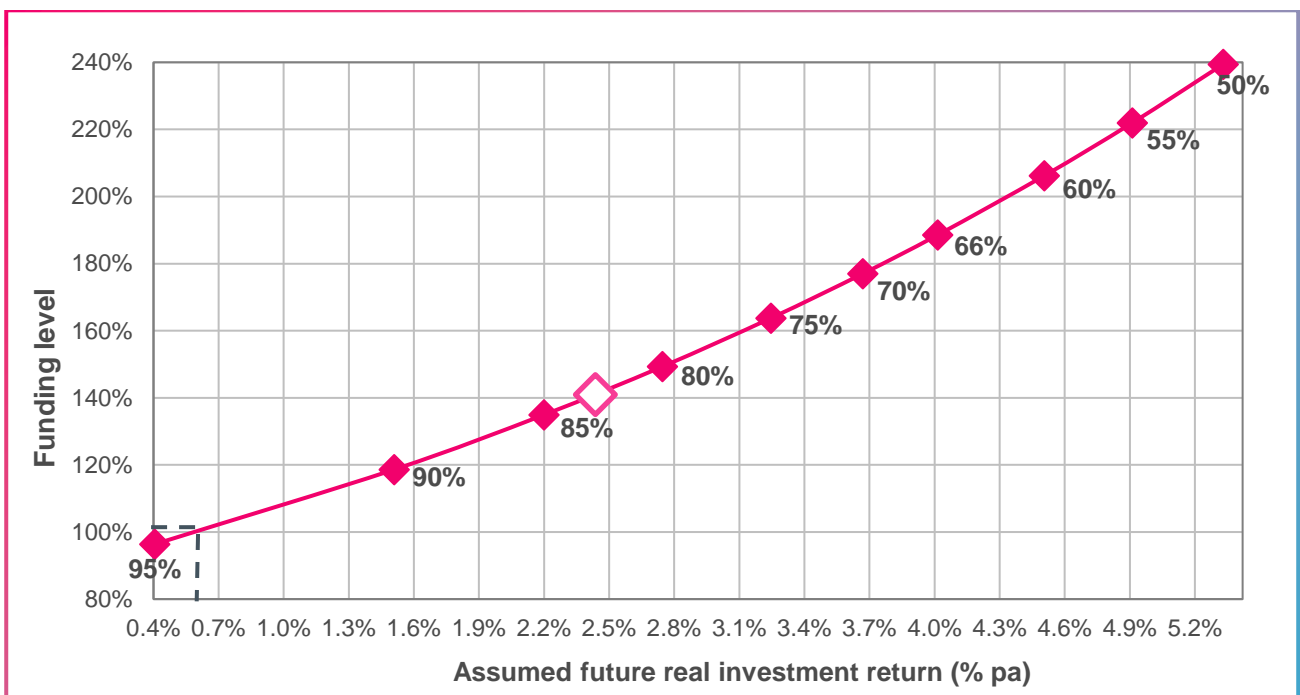
Heading into the 2023 valuations, it was predicted that LGPS funds in Scotland would see a significant improvement in funding levels. This was a prediction that largely proved correct as the overall funding level for the LGPS in Scotland increased from 104% at 31 March 2020 to 141% at 31 March 2023. The key factors contributing to this result were:

- Investment performance: The average increase in fund asset value between March 2020 and March 2023 was 30%, although this varies at individual fund level with increases ranging from 19% to 43%.
- Future investment outlook: due to substantial change in the economic environment since 2020, the outlook for future investment returns was higher at 31 March 2023. All 11 funds adopted a higher future investment return assumption at the 2023 valuation compared to the 2020 valuation, placing a lower value on liabilities. The average increase in future investment return assumption was 1.7% pa, although again this varies at individual fund level with increases ranging from 0.4% pa to 2.4% pa.

These factors outweighed the impact of increasing short-term inflation expectations, resulting in a collective increase from a c£2bn funding surplus at 31 March 2020 to a c£17bn funding surplus at 31 March 2023.

Whilst a single funding level, the ratio of assets to liabilities, is an easy-to-understand metric, it hides a lot of important detail. The market value of assets at the valuation date is known. However, the value of the liabilities is dependent on assumed future investment returns. Therefore, we have calculated the liabilities and funding level for the Scottish LGPS across a range of different real (net of CPI inflation) investment returns (the 'real discount rate'). To help better understand funding risk, the likelihood of the Scottish LGPS's aggregated investments achieving each level of return has also been calculated (the numbers next to each pink diamond)¹.

Chart 1: Scottish LGPS funding level at 31 March 2023 across a range of future real investment returns



¹ All likelihoods based on Hymans Robertson's economic scenario generator model

The white diamond on the chart shows the total overall reported funding level quoted earlier – 141%. This is based on an assumed future real investment return of c2.4% pa. At 31 March 2023, the required real return for the Scottish LGPS to be 100% funded was c0.6% pa (shown by the dotted grey line). We estimate that there is around a 94% likelihood of the Scottish LGPS being able to deliver that level of real return over the next 20 years – a very high level given the current level of uncertainty in financial markets. This is a very positive funding position for the Scottish LGPS.

Individual fund level

When moving from national level to individual fund level, the story is similar – improvements in funding level since 2020 across the board – albeit there is some variation, as shown in Chart 2.

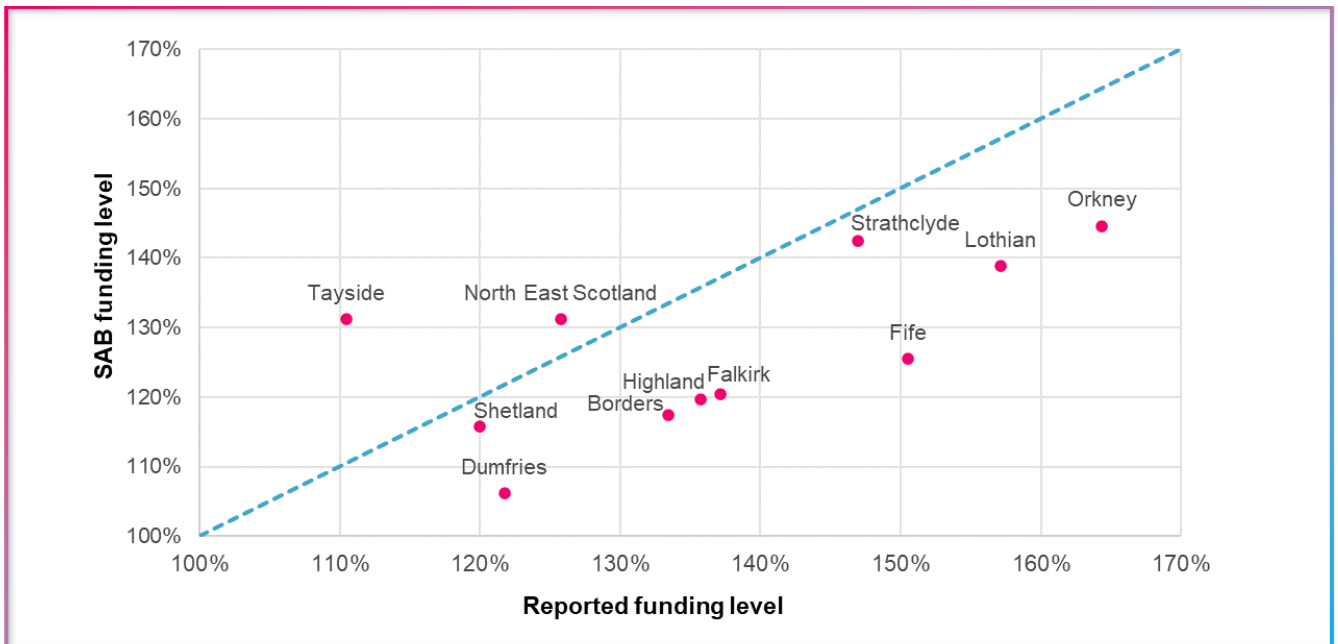
Chart 2: distribution of reported funding level across individual funds



Funding level is sometimes used to compare the relative funding strength of individual funds. But it's clouded by differences such as different underlying actuarial assumptions. Given this, the Scottish Public Pensions Agency (SPPA) asked funds to report a 2023 funding level using a set of standard assumptions. The assumptions are those set by the Scheme Advisory Board (SAB) in England and Wales for the purpose of comparison; hence it's known as the 'SAB funding level' (reported as part of the 'Section 13 dashboard' in 2023 local valuation reports).

Chart 3 shows how each fund's reported funding level compares to its SAB funding level: SAB funding level is shown on the vertical axis and reported funding level is shown on the horizontal axis.

Chart 3: local reported funding level and SAB funding level



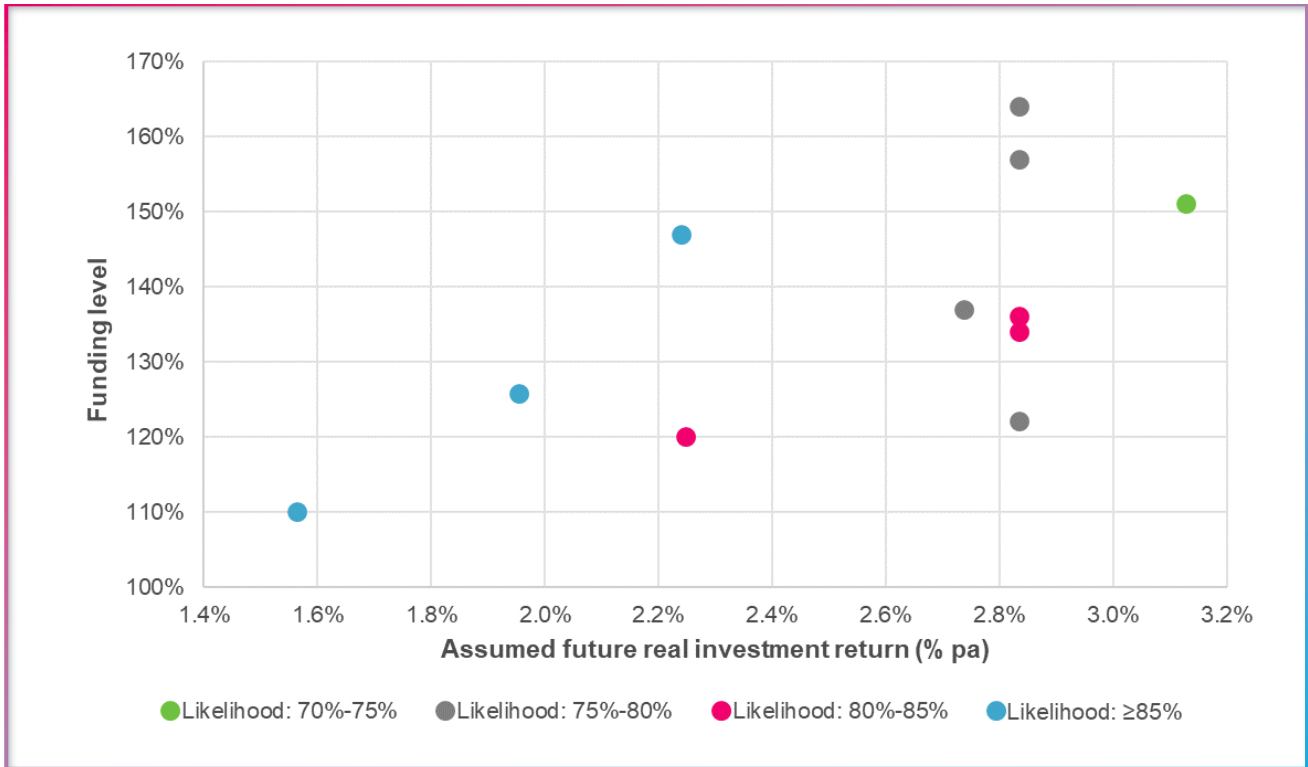
Analysing the SAB funding levels allows us to compare the relative funding levels of the 11 funds when valued using the same set of actuarial assumptions, including the assumed future real investment return. However, this still does not allow a true comparison of funding strength because it ignores differences in investment strategy. This is an important factor when setting the assumed future investment return assumption – a lower growth investment strategy is likely to deliver a lower level of future returns than a higher growth strategy – and in recent years there has been increasing divergence in investment strategy between funds.

A better way of comparing current and understanding relative funding strength is to look at:

- the reported funding level at 31 March 2023
- the assumed future real investment return (ie real discount rate) the funding level is based on; and
- the likelihood of the fund’s investment strategy achieving the assumed real return over the long term

This is what has been done in Chart 4. For the purpose of this analysis, we have estimated the likelihood for each fund based on our economic models and achieving the return over a time period of 20 years.

Chart 4: individual fund analysis of funding level, assumed future real investment return and likelihood of investment strategy achieving the assumed return



The chart shows that there is broad positive correlation between the assumed future real investment return and the reported funding level. Furthermore, the chart shows that the likelihood of achieving the future assumed return is broadly reducing as you increase the level of assumed return.

This is good news as it gives comfort that there aren't any funds in a situation where they have a low reported funding level using a high assumed future return which has a low likelihood of being achieved.

Overall, Chart 4 shows that whilst there are differences in funding strength between the LGPS funds in Scotland, there are no significant outliers or causes for concern at 2023.

Contribution rates

National level

The LGPS continues to offer future accrual of benefits to existing and new members. Given the 'open' status of the scheme, the main focus of a valuation is on the cost of providing the benefits, with any changes falling to employers (as employee rates are fixed in the LGPS regulations).

When setting employer contribution rates, LGPS Administering Authorities are seeking to provide security (ensuring there will be enough money in the future to pay benefits), affordability (for the employer) and stability (avoiding significant changes from year to year). All three objectives conflict with each other.

At the 2023 valuation, the key challenge facing Administering Authorities was to decide how to factor an improved funding level into funding plans. The emergence of a (in some cases, significant) funding surplus is typically associated with subsequent reductions to employer contribution rates. However, Administering Authorities had to strike a balance between offering full contribution rate relief and other avenues (retaining surplus, increasing prudence, reducing investment risk) to deliver security, affordability and stability.

Overall LGPS employers in Scotland have (on average) seen reductions in contribution rates, which is unsurprising given the improvement in funding levels. The average employer contribution rate² across the 11 funds in the Scottish LGPS at the 2023 valuation will be 17.5% of pay. This is 2.8% of pay lower than the 2020 valuation employer contribution rate (20.3% of pay). The breakdown of these rates is set out in the table below.

	2023 valuation	2020 valuation
Primary rate	21.9% of pay	23.0% of pay
Secondary rate	-4.4% of pay	-2.7% of pay
Total employer rate	17.5% of pay	20.3% of pay

The reduction in total contribution rate is positive news, especially when rates are increasing in other public service pension schemes. However, some may see this decrease as small when compared to the magnitude of the improvement in funding position. The LGPS in Scotland saw a c£15bn increase in funding surplus between the 2020 and 2023 valuation dates. Distributing this £15bn improvement over a prudent period (20 years) and the total payroll at 2023 for the Scottish LGPS funds (c£6.8bn) would suggest a contribution rate reduction of around 14% of pay. The actual reduction in the secondary contribution rate (the element typically associated with the past service funding level) was 1.7% of pay. This suggests funds are taking a steady approach to contribution rate reductions, perhaps choosing to prioritise contribution rate stability.

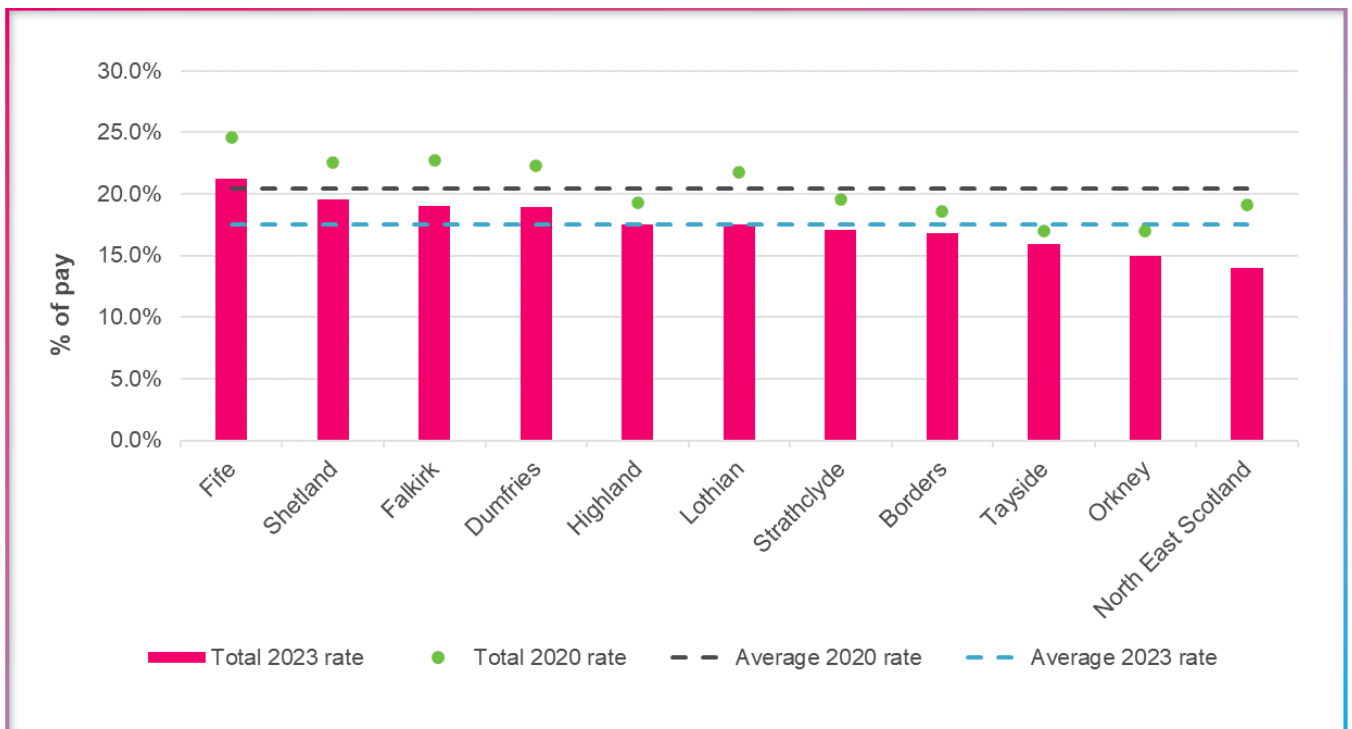
² The average rate is that payable in 2026/27 (the final year of the 2023 valuation Rates & Adjustments Certificate). This ensures any phasing of contribution rates is fully captured. For consistency, the 2020 valuation contribution rate is that payable in 2023/24 (the final year of the 2020 valuation Rates & Adjustments Certificate).

Individual fund level

Although the LGPS is one scheme, the ‘local’ aspect allows each Administering Authority to decide how best to manage the funding of the benefits. These decisions lead to different employer contribution rates across the country.

Chart 5 shows the total employer contribution rate³ at the 2023 valuation for each individual LGPS fund in Scotland. The total contribution rate at the 2020 valuation is shown for comparison.

Chart 5: total employer contribution rate at 2023 valuation (compared with total employer contribution rate at 2020 valuation)



As was the case at the 2020 valuation, there is a wide range of total contribution rates across the individual funds. The total contribution rate has reduced from 2020 to 2023 for all funds, however some contribution rate reductions have been larger than others (difference between green dot and pink bar).

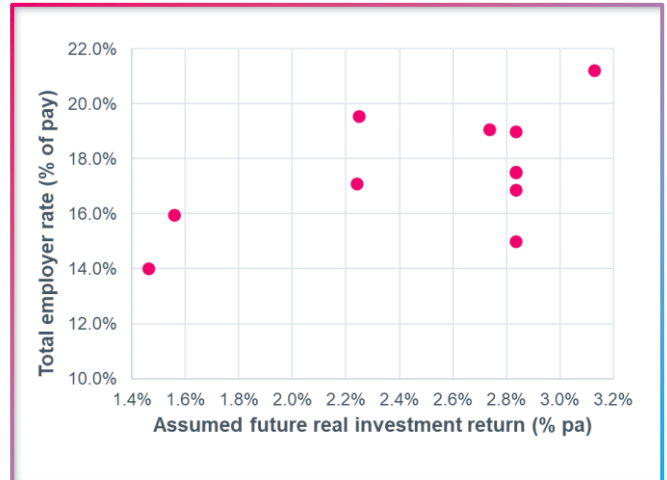
The most common question asked by observers is what’s driving the differences in contribution rates and why is everyone not paying the same, like the other public service pension schemes. At previous valuations, the main causes of contribution rate variation have been local differences in investment strategy and funding levels. Charts 6 (which compares 2023 total employer contribution rate with reported funding level) and 7 (which compares 2023 total employer contribution rate with the assumed level of future investment return – a reasonable indicator of the underlying investment strategy) on the next page explore if this is the case at the 2023 valuation for the 11 regional funds.

³ The total employer contribution rate for each fund is that payable in 2026/27 (“2023 valuation”) and 2023/24 (“2020 valuation”)

Chart 6: 2023 total contribution rate and 2023 funding level



Chart 7: 2023 total contribution rate and 2023 assumed future investment return



Both charts show little correlation between contribution rates and funding levels or assumed future returns. This weakening of correlation suggests that LGPS funds were taking other factors into account when setting contribution rates at the 2023 valuation. Given the current market volatility and relatively recent shift in economic environment, these other factors are likely to mainly focus around increasing prudence margins and avoiding knee-jerk reactions (in terms of contribution rates). This highlights how LGPS funds in Scotland have taken a rounded approach to allocating the improvement in funding position between security, affordability and stability.

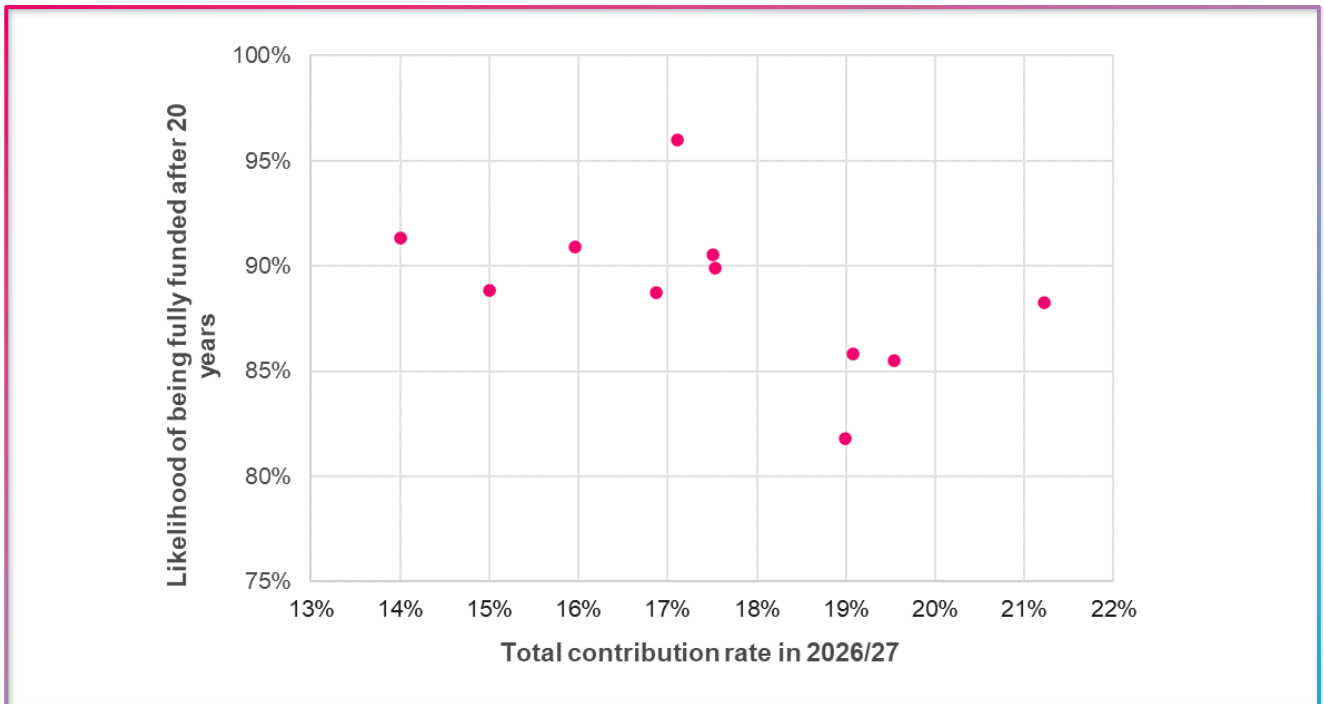
As LGPS funds have taken different approaches to key funding decisions at the 2023 valuation, an important question to consider then is: are the funding plans robust? In other words, for the LGPS funds in Scotland, *“how likely is it that the combination of current funding level, contribution rate and investment strategy results in there being enough money to pay benefits in the future”*.

Using modern risk-based modelling techniques, we can estimate the likelihood for each individual fund and at an overall LGPS scheme level. We estimate that at scheme level, LGPS Scotland has more than an 85% likelihood of having sufficient money in the future to be able to pay benefits based on current strategies. An alternative way to think about this, is that there is less than a 15% chance that current investment strategies and contribution rates would need to change to fund benefits in the long-term.

Given the sources of uncertainty for an open, defined-benefit pension scheme (inflation, investment returns, longevity), to have such a high likelihood represents a very strong position. And again, much better than the other public sector pension schemes which have no assets and rely on future generations of taxpayers to pay for benefits being earned today, resulting in higher and more volatile contributions as a result.

Breaking the overall scheme level analysis down into individual funds, the good news continues. Chart 8 shows that all LGPS funds in Scotland have over an 80% likelihood of having sufficient money in the future to pay benefits.

Chart 8: likelihood of success vs total employer contribution rate



The high likelihoods we've calculated in this analysis suggest:

- Scottish LGPS funds have built up a strong funding buffer against potential future market volatility
- If markets play out broadly as expected, then future contribution rate reductions are likely to be possible

All this is strong evidence of solvency and long-term cost efficiency in LGPS Scotland, two of the key metrics the Government Actuary's Department will be analysing as part of their Section 13 valuation over the next few months.

Other areas of interest

When looking at the big picture, we have not solely focused on funding position and contribution rates.

Life expectancy

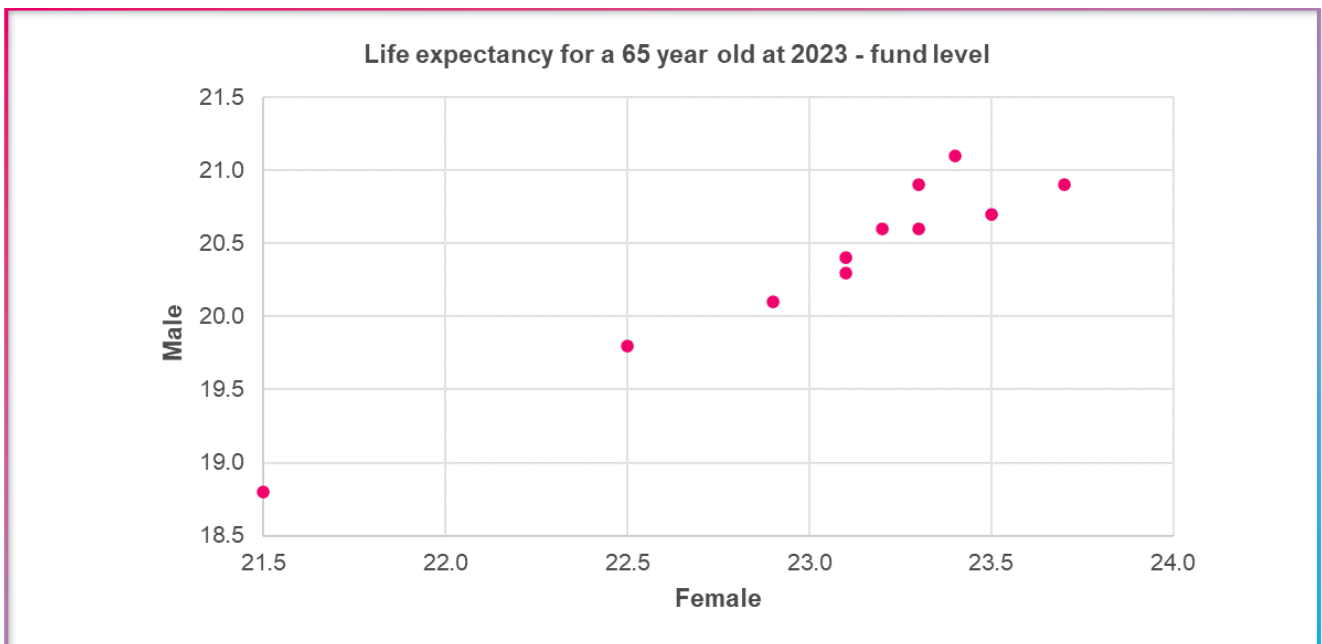
One of the most significant events to occur since the last valuation in 2020 was the Covid-19 pandemic. This resulted in increased focus on the assumption around future life expectancy at the 2023 valuation. Based on recent trends, we may normally expect life expectancy to improve by around two years over a decade (roughly three LGPS valuation cycles). So over one valuation cycle, we may expect life expectancies to increase by around 0.5-0.6 years. However, this is not the case when looking at the unweighted average life expectancy assumption adopted for the Scottish LGPS as a whole at 2023 – assumed life expectancy is slightly lower (by c0.2 years) compared to the 2020 valuation. This is evidence of Administering Authorities taking some of the recent heavier mortality experience and potential slowdown in future life expectancy improvements into account.

Assumed life expectancy from age 65	2023 valuation	2020 valuation
Females	23.0 years	23.2 years
Males	20.4 years	20.6 years

Life expectancies are unweighted averages across all 11 regional funds for members aged 65 at valuation date

As with funding levels and contribution rates, there is variation in life expectancy between different LGPS funds as shown in Chart 9.

Chart 9: individual fund average assumed life expectancy for a 65-year-old at 2023





The differences in life expectancies between individual funds suggest there are differences in:

- **Outlook:** each administering authority will probably have differing views on future life expectancy improvement trends. A perfectly valid source of difference as no-one knows what will happen to life expectancy in the long-term.
- **Profile of the fund's membership:** it's well known that life expectancy can vary significantly between individuals depending on factors such as lifestyle and affluence (the difference can be in excess of 10 years).

McCloud

There has been a significant amount of discussion about the McCloud case in recent years. At the 2023 valuation, every fund made allowance for the potential impact the McCloud remedy could have on members' benefits (in line with guidance from the Scottish Public Pensions Agency (SPPA)). On average, the impact of the McCloud remedy is estimated to result in a 0.5% increase in liabilities. This relatively small increase highlights that the real cost of McCloud will be on the additional administration required of Administering Authorities to implement the remedy.

Employee contribution rates




The focus on contribution rates has so far been limited to employer costs. However, employees also contribute to their LGPS benefits. At the 2023 valuation, the average employee contribution rate was 6.1% of pay. This is a small reduction from the average at the 2020 valuation (6.2% of pay). This suggests that, on average, wage growth across the LGPS has been slightly lower than CPI inflation over the 2020-2023 period (given the tiered nature of the employee contribution rate bands and annual inflationary increases to the tier band thresholds).

The UK is currently in the midst of a cost-of-living crisis with household finances being increasingly stretched. It's perfectly understandable that people will be questioning every item of expense, including pension contributions. However, given that our analysis shows the total average cost of LGPS benefits is around 23.5% of pay, members are getting very good value-for-money from their contributions. We hope this analysis can be used to complement the good work already being done by Administering Authorities in raising awareness of the LGPS's value-for-money with members and helping avoid mass opt-outs (which could potentially store up pensioner poverty problems for the future).



Reflections

At the 2023 valuation, the Scottish LGPS is in a very strong position.

-  The past service funding level is strong, with an overall funding level of 141%
-  Administering Authorities have been able to offer contribution rate relief to most employers, but evidence suggests they have done so in a balanced way
-  The outlook for the long-term sustainability of the scheme is robust

This is not an accident. It is a result of the hard work across the whole scheme. Actions such as increasing rates during the adverse times in the early 2010s, monitoring, reviewing and diversifying investment strategies as the financial environment frequently changed, and increasing engagement with participating employers on a more regular basis have all contributed to the successful outcome we see today.

Outlook for 2026

The environment in which the LGPS operates never stands still. Whilst it would be foolhardy to predict the funding position of the LGPS at the next valuation in 2026, we can be certain that there will be a new set of challenges to overcome and risks to manage. To be in the best place possible, we would encourage LGPS funds to use the next two years to systematically review all their funding risks. Our hub page on [Managing Risks in the LGPS](#) is a great source of information to help Administering Authorities with this.



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