

Sixty second summary

Setting funding strategy at the 2022 valuation: My recipe for success



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The 2022 valuation is a time to review funding strategies and make any necessary changes to keep plans on track. In this summary we share our recipe for successful funding strategy decisions.

There are four key ingredients to setting strategy at the 2022 valuation:

- 1 Understand employers' expectations
- 2 Establish clear long-term objectives
- 3 Take a transparent approach to setting and communicating strategy
- 4 Do all of this within a robust decision-making framework

Combining these with the Funding Strategy Statement and a high-quality consultation with participating employers, you will be well on the way to having a successful valuation year.

Understand employers' expectations

Employers will remember the 2019 valuation – it wasn't that long ago – and this will inform their expectation of what will happen at this valuation.

Employers will also be aware that assets have generally performed well over the last three years, pushing up funding levels. They will likely expect for this to translate into lower contribution rates following the 2022 valuation (forgetting about the impact of increased inflation on pension costs).

Employers will also be acutely aware of their own budgetary constraints, and it is always useful for Funds to be aware of any significant constraints early in the valuation process.

Engaging early with employers will help funds understand their expectations and, more importantly, manage them.

Establish clear long-term objectives

LGPS Funds should not be reinventing the wheel at the 2022 valuation. Funding strategies are already in place and the 2022 valuation is essentially a 'health-check' of these existing strategies.

When defining objectives, the specific assumptions used to calculate contribution rates are less important than the level of prudence included in these assumptions. Our risk-based approach allows LGPS Funds to understand exactly how

much prudence is included in the funding plan and to compare this to the previous valuations and different employers in the Fund.

Reviewing the level of prudence in funding plans, and clearly aligning it with employer covenant, ensures plans remain appropriate to each employer.

A transparent approach

The third ingredient is transparency – the funding strategy should be transparent to employers.

Employers don't need to understand the nuts and bolts of the valuation – this can lead to confusion, and focussing on the wrong things is not a good use of time. Funds should be able to justify the approach taken to set strategy and provide evidence to back up key funding strategy decisions.

The most successful valuations are based on a collaborative approach with employers. This means providing detailed valuation results, along with an explanation of how things have changed, and welcoming challenge and feedback from employers.

A robust decision-making framework

The final ingredient is a robust decision-making framework which recognises that a fund is made up of a large and diverse group of employers. It is really important to recognise this when setting strategy – a strategy that suits one employer is unlikely to be appropriate for all employer groups.

The key factor here is the covenant provided by, and background of, each employer and adjusting the funding objectives, time horizons and level of prudence, where required.

Mix it all together

The method for creating a successful outcome from our high-quality ingredients is the Funding Strategy Statement (FSS). This is the key document in respect of funding strategy. It sets out exactly how the fund set contribution rates at the valuation and the funding approach taken in other circumstances, i.e. new employers, transfers and exiting employers.

To fully utilise the potential this has to be the cornerstone of a successful consultation with employers, I would suggest the following improvements at the 2022 valuation:

- 1 **More accessible to employers.** A lot has been 'bolted on' to the FSS in recent years and a review at the 2022 valuation should lead to a document which is shorter and more readable.
- 2 **Early delivery:** The earlier this can be provided, the earlier it is for employers to digest, engage in the consultation and be of real use.
- 3 **Refresh the structure.** A 'standard' FSS now contains several policies which are crucial for employers to understand as part of their participation in the LGPS. Funds may wish to prepare separate policies (e.g. on pre-payments and ill health risk) and attach these to the FSS in a sensible way which makes it easy for employers to access and navigate.

All of us are looking forward to helping funds with their funding strategy over the coming months. In the meantime, if you have any questions please contact your usual Hymans Robertson contact.