HYMANS ROBERTSON

60-second summary

2023 valuation results – early insights

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Now that we're halfway through the Scottish valuation year, we're seeing the first few whole fund level results and things are looking positive. We've been studying these results, and the emerging picture more generally, and look at them in more detail in this summary.

How are the results looking?

In summary, the funding levels are much higher than they were at the 2020 valuation, but the increase is variable and dependent on a number of factors, such as investment returns and the fund's margin for prudence. However, we've seen a couple of funds where the reported funding level has increased by more than 50%, which is a significant change in position.

Asset performance over the last three years

Good investment performance over the last three years has played a role in the change in funding position. The last valuation date was 31 March 2020, in the midst of the market lows arising from the uncertainty caused by the Covid-19 pandemic. Markets have more than recovered over that period, with investment returns largely exceeding 25% for funds over the last three years, and in some cases have been closer to 40%.

What other factors have influenced the change?

Largely, the change in funding position has been driven by changing market conditions. Interest rates have risen over most developed economies and as interest rates rise, so do expectations of returns across most asset classes. For a typical fund and their investment strategy, expectations for future investment returns have increased, by around 2% pa on average. Since future investment returns are expected to be higher, liabilities are lower meaning we've seen significant improvements in funding positions as a result of lower liabilities.

However, we can't lose sight of the impact of inflation. Higher than expected inflation has not only influenced higher benefit payments being made (particularly following a 10.1% pension increase in April 2023), but also higher expected inflation since the last valuation means that we expect higher benefit increases in future. As LGPS benefits are CPI-linked, higher inflation results in higher liabilities and a higher cost of providing the benefits that are earned each year. Allowance has been made within the 2023 calculations for the impact of higher inflation.

Life expectancy

We haven't seen any significant impact in the valuation results as a result of the Covid-19 pandemic since actual numbers of deaths has been closely aligned with the previous assumption. However, we've made some allowance for emerging changes in life expectancy following higher-than-expected deaths over the last two years, and therefore funds will see slightly lower life expectancy figures being quoted in their 2023 valuation reports.

The changing funding position

As a reminder, throughout this valuation year, we've spoken about funds having four options in a surplus environment:

- Decreasing contributions
- Increasing prudence
- Reducing risk in investment strategy
- Retaining some surplus

We expect funds will do a combination of the above, or may even do all four approaches. Many funds are either considering investment strategies now or will do so after the valuation, and some are opting to build in additional margins for prudence. We expect contribution decreases to be the outcome for many employers, but that will depend on their own circumstances. The extent to which contributions decrease will also influence how much surplus is retained to act as a buffer for future adverse experience.

Decreasing contributions

The impact of decreases in contributions will vary depending on where a fund is on their funding journey. For some funds, this will be their first valuation in surplus for a number of years, and so they may decrease contributions at a slower pace, whilst taking the opportunity to rebuild some margins for prudence. Other funds will be further on their funding journey and so we may see larger reductions in contributions for them.

We expect that all funds will be looking to pass on some contribution rate savings to their employers. The pace and magnitude of that will depend on the surplus position.

All funds are focused on setting realistic long-term sustainable contributions. Over the past 10 years, most Scottish LGPS funds have more than doubled their assets meaning Scottish funds have more money than previous valuations, to meet each pound of pension.

Other considerations for funds throughout their valuation exercise

Communication with employers will be key. Funding positions will look significantly different within a more diverse group of employers, which may lead to different questions than previously, so communicating clearly and effectively with employers is important.

Likewise, funds should also consider, if they haven't already, how to set assumptions for cessation valuations. Is the gilt yield still appropriate for the discount rate where funds don't subsequently buy bonds with an exiting employer's assets?

Next steps for the Scottish Funds

- Review of the funding strategy statement and communicating employer results will be the top priority for the next few months.
- We encourage funds to engage with their employers as early as possible to allow time for results to be explained and discussions to take place where required. Our actuaries will be on hand to help.
- We're halfway through the valuation year, with reports due to be signed off by **31 March 2024**.

If you have any questions, please get in touch, or contact your usual Hymans Robertson consultant.

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