

Briefing

# 2019 LGPS valuations

## The good, the bad and the ugly

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The 2019 formal valuations are well progressed. All Local Government Pension Scheme (LGPS) funds will have received the whole funds results. Many employers will know their funding position and contribution rates for the next three years from 1 April 2020.

In this briefing note we examine the emerging trends and issues that have impacted the valuations in England and Wales.

## The good

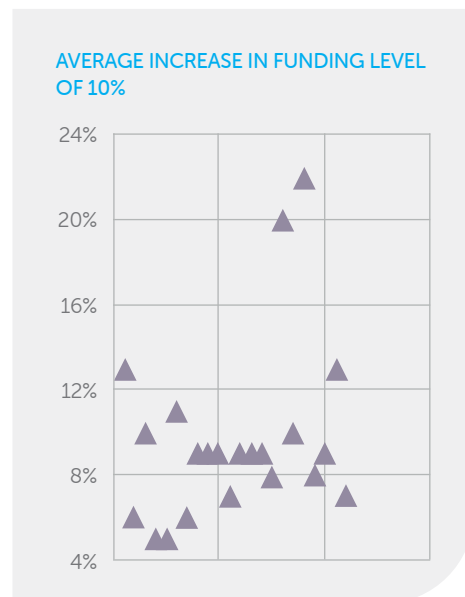
### Investment performance and funding levels

The good news is, due to very strong investment performance over the period 2016 to 2019, the LGPS funding levels have typically increased in the range 5% to 13%, with some funds achieving (or being close to achieving) fully funded status. The funding level for every Barnett Waddingham LGPS fund has increased, with an average growth of around 10%, rising from 86% in 2016 to 96% in 2019.

This is an excellent result given that the funding plan in 2016 was, typically, targeting a fully funded position in around 2036. For a number of funds, this has almost been achieved in just three years.

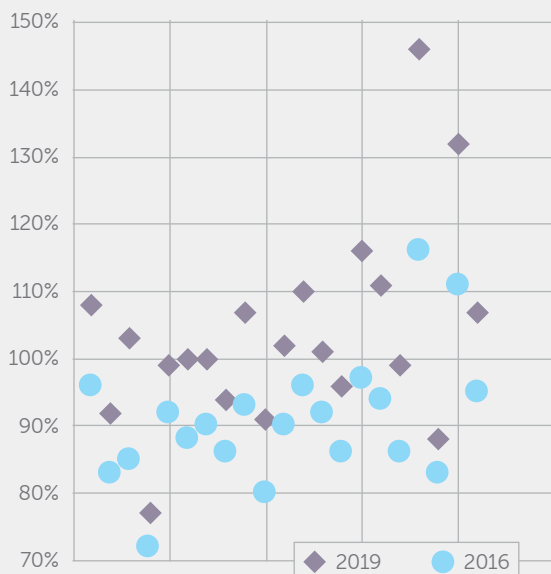
There has been a range of investment returns but, for all funds, they have 'beaten' the investment return assumption made in 2016.

The chart to the right shows the net improvement between the 2016 and 2019 funding levels for Barnett Waddingham funds.



We have also considered the funding level on the standardised assumptions that are used for the Section 13 valuation, carried out by the Government Actuary's Department (GAD). Again, this shows an improvement for all funds since 2016. In 2016 the average standardised funding level for the same group of funds was 91%. This has increased by 13% to 104% in 2019.

**2019 STANDARDISED FUNDING LEVELS - AVERAGE OF 104%**



There are lots of factors that affect the funding level of a fund because it depends on how the assets and the liabilities move independently of each other. One effect of strong investment performance across all funds that may not be fully appreciated is that, given the diverse range of funding levels in 2016, funding positions may have diverged further. This is a symptom of the funding level being the ratio of the assets and the liabilities.

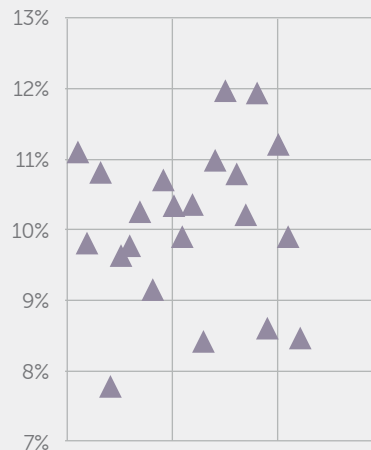
For example, consider two funds that both achieved an investment performance of 35% over the three years while their liabilities both increased by 15%. If fund A was 100% funded in 2016, it will now be 120% funded. On the other hand if fund B was 80% funded in 2016, it will be now have a funding level of 94%.

In other words, funds that were better funded in 2016 will benefit more from the strong investment performance than those with a lower funding level.

## Investment performance

As funds' investment strategies continue to become more diverse, the range of fund returns continues to diverge. The investment return over the three year period ranged from 25% to 40%, with an average of 33%. This is equivalent to an annual return of between 8% and 12% p.a. with an average return of around 10% p.a. All compare very favourably with an investment return assumption of around 15% to 17% over the same period, although it should be noted that the investment return assumption is over the very long term.

**ASSET RETURNS - % P.A. - AVERAGE OF 10.1% P.A.**

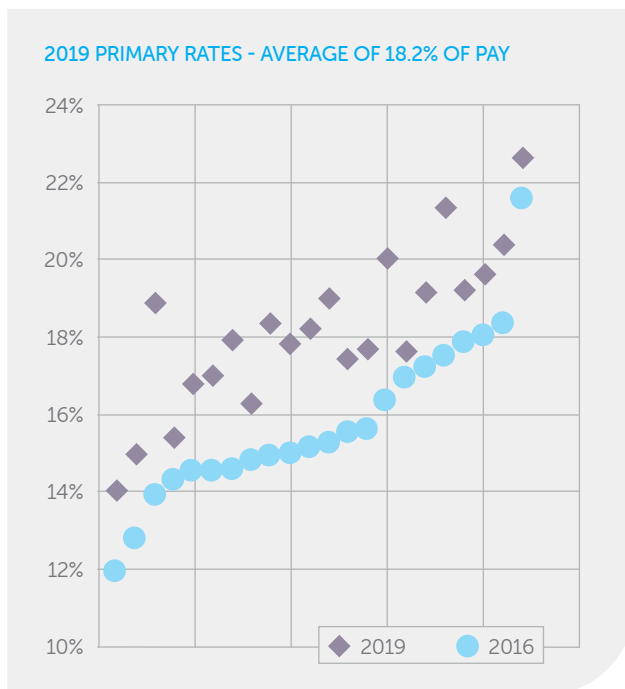


## The bad

### Primary rates

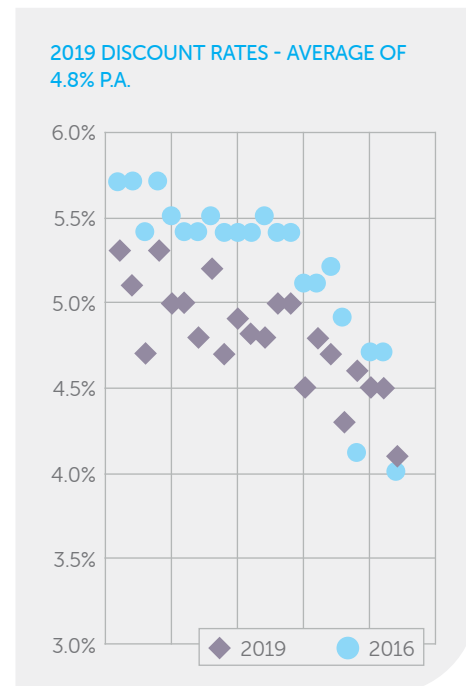
Because the LGPS still has around two million employees accruing pension benefits, the contributions made to pay for these future benefits will still need to be invested. Typically, strong returns are followed by a lower future outlook. If markets are significantly higher than they were in 2016, the same amount of cash now buys less of the same asset.

The bad news, therefore, is that these higher prices result in an increase in the amount of cash required to meet the cost of future benefit accrual. This then leads to an increase in the primary rate of about 2% to 4% of payroll, relative to 2016, with the average primary rate now just over 18% p.a. of pay. The chart below shows a comparison of the whole fund primary rates in 2016 and 2019.



Of course, the valuation results are heavily dependent on the assumptions made. One of these is the discount rate assumption (also known as the investment return assumption) and this has a significant impact on the valuation results. Our discount rate is determined by basing it on the long-term investment strategy of each fund. That means we consider the best estimate long term return and then make an explicit, transparent allowance for prudence.

The range of discount rates adopted for 2019 is shown in the chart below. In general, the discount rate adopted for the 2019 valuation lies in the range 4.5% - 5.0% p.a., with an average discount rate of 4.8% p.a. The discount rate is, on average, 0.4% lower than in 2016 to reflect the higher market valuations. Importantly, the net discount rate (the gap between the discount rate and CPI) is 0.6% lower than in 2016. This would typically increase liabilities by around 10%. This is consistent with the reduction in the net discount rate used in the Section 13 valuation which has reduced from CPI plus 3.0% in 2016 to CPI plus 2.4% in 2019.



## The good and the bad

### Longevity experience

For many decades now, life expectancy has been increasing and the reasons are fairly well understood – a better healthcare service, introduction of vaccines, greater affluence and changes in lifestyle. However, there is evidence to suggest that during 2011-2018 improvements in life expectancy have slowed down.

Recently, we've seen headlines in the media that stated people are dying earlier. This is not the case. It is important to note that people are still living longer than before but just not as long as was expected in 2016.

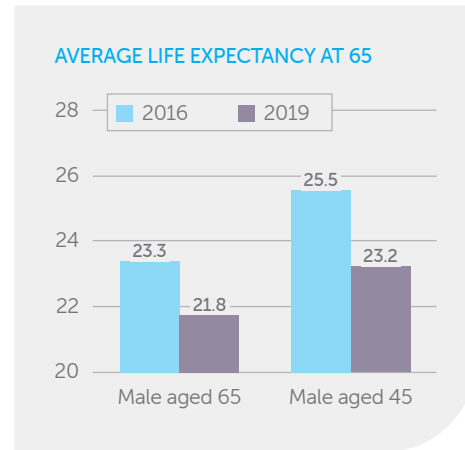
Whether this is good or bad news depends on whether you are a member or a sponsor.

Life expectancy is a difficult assumption to predict as there are so many factors that can have an impact and this can change over time. It is also a somewhat bespoke assumption; bespoke to the fund, employer and even the member. This means that lots of factors are used to make as good a guess as possible.

The chart on the right is a simplified illustration of how longevity has changed over the period 2016 to 2019. Of course, this could change again at the next valuation but below are some key points to note.

1. Life expectancy (from age 65) for a 65 year old male member in 2019 and a 45 year old male member in 2019 retiring in 20 years' time is lower in 2019 (purple bars) than in 2016 (blue bars). The same trend can be seen for females. This shows future improvements in life expectancy appear to be slowing down based on data to 2018.
2. The member aged 45 at 2019 is expected to live longer (23.2 years from age 65) than the member currently aged 65 (21.8 years), illustrating that life expectancy is still increasing.

This is therefore bad news for members but good news for employers as it would typically reduce liabilities by around 3% - 4%.



## The ugly

### Lots of uncertainty

Unfortunately, the LGPS continues to become more complicated and there is greater uncertainty than ever before. This includes the below:

- the uncertainty around the timing and remedy for McCloud and Sargeant and the retrospective nature of the remedy could materially increase the administrative burden for a scheme that is already fairly complicated
- the stalled cost management process and, again, how this will be applied retrospectively – given that employers will already be paying their new contribution rates certified from the 2019 valuation
- the timing of the next funding valuation, although it looks like this triennial valuation cycle will continue for now at least
- GMP equalisation – how this will be achieved and how the LGPS implements this
- not to mention, the political and economic uncertainties of a new UK government and any changes to pension legislation this may bring (e.g. a change in the State Pension Age and implications for the LGPS retirement age)

## In conclusion

This has been a very positive valuation and the LGPS goes from strength to strength. The above analysis is based on about 25% of the England and Wales LGPS funds but it is safe to say that, on the Section 13 valuation assumptions, the LGPS as a whole will have had enough assets to pay all the past benefits accrued by March 2019.

However the Section 13 is not a particularly robust way of assessing the financial position of the funded LGPS. It uses a market related approach in the asset valuation but uses the non-market related approach to assess liabilities in the unfunded public service schemes. It was only ever supposed to be used to compare funds' financial positions.

As always, as fund actuary, we try to keep total contribution rates as stable as possible and, although this will vary by fund and employer, in general this should be achievable for the major employers in each fund.

For the first time in a long period, some employers may even benefit from a reduction in the total contribution rate, albeit this is probably only going to be for those currently paying much higher than average rates.

Perhaps the immediate next steps will be for funds to consider cash flow modelling and any changes to their investment strategy, given the continuing maturing of the LGPS, especially with some employers considering advance payments on their contributions.

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Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch with Barry McKay, Fund Actuary, via the following:

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