Sixty second summary

Optimising investment strategy at the 2022 valuation

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Funding plans which are optimised for each employer lead to the best possible funding outcomes. Contribution rates are front and centre during a valuation but don't forget about optimising the other tool at your disposal – the investment strategy.

In the absence of investment returns, LGPS benefits would cost upwards of 70% of pay. A return of 4% p.a. brings this to around 20% of pay. Achieving this return, whilst balancing the associated risk with investing in financial markets, is key to the long-term sustainable funding of LGPS benefits.

Where and when to focus

The focus should be on the high-level strategic asset allocation. This is the key driver of long-term investment performance, backed up by various studies over time. Spend time considering and reviewing your long-term strategy allocation as part of the valuation and ensure it is still optimised for your requirements.

Deciding when to focus on investment strategy can be like the chicken and egg question – which one comes first, contributions or investments? The two are heavily dependent on each other, so we recommend that they should always be considered in tandem. Otherwise you run the risk of setting contribution rates that may not be appropriate based on your desired investment strategy, or you set an investment strategy that puts too much pressure on the affordability of contribution rates.

Optimising in 2022

Traditionally, investment strategy has been optimised at fund level to suit the 'average' employer – for most, this employer is usually the largest in the fund e.g. a county council. However, many funds today have 100s of employers. All of these have different objectives (contribution affordability vs. funding position stability), funding profiles (current funding position, future cashflow profiles) and engagement levels.

In response, there has been significant evolution in the contribution strategy. But so far, the investment strategy is still primarily set as "one for all". For some employers, this is unlikely to be the optimal strategy.

Themes at 2022 valuation

For 2022, this 'clash' between whole fund vs. individual employer may arise due to:

- Strong funding position: this may present the opportunity to de-risk, but there may be some employers still in deficit who need additional exposure to growth assets to help improve their funding position.

- Increasing employer diversity: the increase in the number and type of employers in the fund, all with differing objectives, will test the viability of a single approach to all.
- More employer engagement: interest by employers in managing pension costs continues to grow, with more seeking independent advice. With this additional interest, it's fair to assume that expectations of how funds will help manage their risks will also grow.

If this is the case for your fund in 2022, then there is a course of action you can take.

Employer focused investment strategies

A simple solution is to implement different investment strategies for different employers to meet their specific needs. An example could be:

- core strategy which serves the majority of employers;
- higher growth strategy for those with a weaker funding position and need for additional returns to return to full funding; and
- lower growth strategy for those employers on the path to exit seeking to reduce funding position volatility.

We believe employer focused investment strategies are the long-term general direction of travel, given the themes already mentioned. But we are also aware that the thought of implementing this can seem quite daunting. However, it's not as hard as it sounds!

Implementing different investment strategies

Based on our experience to date of supporting some LGPS funds implement employer focussed investment strategies, we've set out a high-level route map from a single investment strategy to multiple strategies.

- **Identify groups of similar employers in the fund.** This is something your actuary can do for you by analysing a number of risk metrics such as funding level, cashflow profile and maturity.
- **Rationalise the groups to a smaller number.** There will likely be several groups of employers that, despite their differences, have very similar investment objectives. We can usually cut down the number of groups to around 3 or 4. At this stage you'll likely consider whether you think it's appropriate to proceed.
- **Identify an appropriate investment strategy for each group.** Your investment consultant can help you by carrying out an investment strategy review.
- **Implementation.** You can use the Hymans Robertson Employer Asset Tracker (HEAT) to track investment strategies and individual employer asset values.

It is possible to carry out all these steps as part of the 2022 valuation. Alternatively, you can use this valuation to investigate if there is a need for such a solution and then carry out the above steps during 2023 and 2024 to be ready to implement in time for the next actuarial valuation.

If you'd like to understand more, you can of course get in touch with your usual Hymans contact who'll be happy to help.

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