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60-second summary

Setting funding strategy at the 2023 valuation: Our recipe for success

Steven Scott
Senior Actuarial Consultant

The 2023 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 2023 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 2020 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 asset values have recovered strongly from the lows experienced at the 2020 valuation date, which coincided with the first wave of Covid-19. On top of this, liability values have fallen and employers may expect the combined effect of these factors to translate into lower contribution rates following the 2023 valuation.

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

As my colleague Robert Bilton set out in his 60-second summary, funding levels are at record highs. This may require Funds to consider surplus management for the first time. Existing funding plans have been designed with the explicit purpose of understanding uncertainty under a range of market conditions, including those prevailing at the 2023 valuation. As such, LGPS funds should not be reinventing the wheel at the 2023 valuation. Funding strategies already in place are fundamentally robust, and the 2023 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's 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 sets contribution rates at the valuation and the funding approach taken in other circumstances, ie new employers, transfers and exiting employers.

To fully utilise its potential, the FSS has to be the cornerstone of a successful consultation with employers. I would suggest the following improvements at the 2023 valuation:

1. **More accessible to employers:** A lot has been 'bolted on' to the FSS in recent years and a review at the 2023 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 (eg on cessations 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.

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T 020 7082 6000 | www.hymans.co.uk