Lancashire County Pension Fund ("the Fund") – 2025 Valuation

Summary of main Funding Strategy Statement (FSS) changes

Introduction
As part of each valuation the Fund is required to review the FSS. For 2025 the Scheme Advisory Board have produced updated guidance that the Fund is required to comply with. As such the format, layout and ordering of the FSS has changed significantly from 2022. In particular, the updated version of the FSS incorporates all relevant Fund policies within it.

Key changes
The key drivers of employer contribution rates are the:
- “real discount rate” – the assumed investment return above inflation
- “funding buffer” – an element of the funding surplus that is retained in the Fund to increase future contribution stability
- recovery period – the period over which any deficit or surplus above the buffer is removed via contribution adjustments

Real discount rates
The proposed real discount rates have increased compared to the 2022 valuation.

- The real past service rate (used to set the funding level and secondary contributions) has increased from 1.4% p.a. to 2.65% p.a. above inflation.
- The real future service rate (used to set primary contributions) has increased from 1.9% p.a. to 2.25% p.a.

  A different rate is applied for future service to reflect the regulatory requirement to keep primary contributions as stable as possible. Additionally, the contributions will be paid and invested in the future and so do not need to be tied to current market conditions to the same degree.

The increases reflect the changes in market conditions and economic outlook since 2022, in particular an increase in long-term expected investment returns driven by the increase in bond yields / interest rates. As a result, although the absolute values are materially higher than 2022, the level of prudence within the assumptions has also increased.

Funding buffer
The purpose of the buffer is to increase contribution stability, it can be used to prevent / limit contribution increases at future valuations if the Fund’s position were to worsen. The proposed funding buffer is increased from 10% to 20%. This means that the first 20% of surplus will be retained in the Fund, compared to the first 10% at 2022.

Surplus recovery / spread period

The impact on contributions of returning surplus above the buffer to employers will be based on a 20-year recovery / spread period compared to a 16-year period at the 2022 valuation. This increase is designed to further promote contribution rate stability, as longer periods result in more stable contributions.

Expected impact of changes to assumptions
The above parameters should be considered in combination relative to their impact on contribution rates. Overall, the result of the changes are:

- A material increase in prudence (i.e. an increase in the likelihood that the contributions are sufficient to pay benefits in future). All of the parameter changes noted above act to increase the level of prudence.
- A material reduction in the Fund's overall contribution rate, meaning a significant reduction in overall employer cash contributions.

In setting these parameters, with advice from the Fund actuary, the Fund has sought to balance the budgetary requirements and challenges of the current employers with the Fund's obligation to protect future employers and taxpayers who will inherit responsibility for payment of the benefits. This includes modelling of potential future outcomes to ensure the chance of significant contribution increases in future (which could be severely damaging / unaffordable to employers) is suitably low.

Details of the 2025 funding position and the average employer contribution rate will be available following the employer presentations on 8th and 9th October 2025.

Other changes
Demographic assumptions
The assumptions have been updated to reflect the latest Fund experience and national trends in life expectancy and other demographic factors. Whilst changes to the life expectancy assumptions serve to slightly reduce liabilities / primary contribution rates, the impact of changes to other demographic assumptions is marginal.

Redundancy strain costs
When a member over the age of 55 is made redundant they are entitled to payment of their benefits immediately without any reduction. This creates a "strain" within the Fund – the actuarial estimate of the cost of paying the benefits earlier than the member's retirement age – which is currently paid up front by the employer.

Following employer requests and prior consultation, the intention is that in future certain employers will have the option of setting aside an element of their surplus as a reserve to fund these redundancy strains. For these employers no strain payments would be due across the period covered by the contribution certificate (2026/29) as long as the total strain amount remained less than the reserve (with any excess above the reserve being paid as usual).

The option will be limited to employers with a surplus above the buffer, and also to larger employers (as strains tend to be rare amongst smaller employers, and when small employers do see strains the cost is less likely to be covered by the reserve). The level of the reserve will be based on recent experience, so as to fund the typical level of redundancy strains without encouraging an increase in such cases.

However, the Fund would have discretion to increase the reserve in specific cases where appropriate.

Employer risk policy
The employer risk policy covers the treatment of employers who do not have taxpayer backing (“Category B” employers). It specifically addresses the risk that they leave the Fund with an exit debt they are unable to pay, leaving a debt to the Fund. When Category B employers exit their liabilities are “orphaned” – i.e. become the responsibility of the Fund as a whole (meaning each employer in the Fund takes on a proportional share). To protect against this, the employer risk policy allows the Fund to set more prudent assumptions for these employers and limits on access to surplus (where there is a termination debt), resulting in higher contributions that act to reduce the potential exit debt, unless they can provide a bond / other security to protect against the risk.

At the 2022 valuation, having reviewed the level of risk, a discount rate 0.25% lower than for “Category A” taxpayer backed employers was applied. At 2025, the proposal is that this gap is reduced to 0%. Additionally, the improvement in termination debts means access to surplus. The net result will be the same treatment as for Category A employers is applied in the vast majority of cases. This reflects a material reduction in the risk posed by these employers at 2025, due to:

- strong Fund performance and changes in market conditions meaning the size of the potential exit debts – and so the potential risk – has materially reduced.
- material increases in prudence of the standard assumptions at 2025 (as noted above), meaning the need for additional protection is reduced.

Termination policy – approach to exiting Category B employers
When Category B employers exit the Fund, to protect the other employers in the Fund, their final position is assessed using more prudent assumptions that result in higher liabilities and so a lower surplus refund / higher deficit payment (than under standard “ongoing” assumptions). These assumptions are linked to market yields at the point of exit (subject to certain underpins), to estimate the “market value” of the risk being transferred to the Fund.

As part of the review, it is proposed that the “discount rate” (assumed future investment return) is updated to be based on the yield on Government bonds (gilts), rather than corporate bonds. The corporate bond approach was designed to avoid potentially unaffordable exit costs that would have arisen if gilts were referenced. The shift in bond yields since 2022 means the cost of a gilt-based exits has reduced materially, and so this compromise is no longer required. A move to reference Government bonds in the termination assumptions will provide greater protection to the Fund and is more in line with the actual market value of the liabilities (e.g. what an insurer would charge to take on the risk).

Termination policy – Fund expenses
The termination policy has been updated to include allowance for an estimate of the future administrative expenses incurred by the Fund in relation to administering the benefits of the exiting employer’s former members following exit.

Multi Academy Trusts (MATs)
Where MATs have multiple academies in the Fund, currently each one is treated as a separate employer, with their own assets, liabilities and contributions rates. Following a high-level consultation, the Fund will offer the option for MATs to pay a single pooled rate in respect of all their Fund academies (although the assets and liabilities will still be tracked separately to allow for such eventualities as when an academy transfers between MATs).