SOUTH YORKSHIRE PENSIONS AUTHORITY

Agenda Item

Subject	**Setting the Framework for the 2025 Valuation**	**Status**	For Publication
Report to	Authority	**Date**	13th February 2025
Report of	Director		
Equality Impact Assessment	Not Required	Attached	No
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1 Purpose of the Report

1.1 To agree the framework for setting contribution rates and associated actuarial assumptions to be consulted on with employers as part of the 2025 valuation process.

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2 Recommendations

2.1 Members are recommended to:

a. Approve the framework set out in the body of the report for consultation with employers as part of consultation on the revised Funding Strategy Statement required as part of the valuation process.

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3 Link to Corporate Objectives

3.1 This report links to the delivery of the following corporate objectives:

Listening to our stakeholders

To ensure that stakeholders' views are heard within our decision making processes.

Investment Returns

To maintain an investment strategy which delivers the best financial return, commensurate with appropriate levels of risk, to ensure that the Fund can meet both its immediate and long-term liabilities.

Scheme Funding

To maintain a position of full funding (for the fund as a whole) combined with stable and affordable employer contributions on an ongoing basis.

Effective and Transparent Governance

To uphold effective governance showing prudence and propriety at all times.

The proposed rules for setting contribution rates and associated actuarial assumptions set out in this report are a key part of the valuation process and represent the key decisions which affect the level of contributions payable by employers. These decisions therefore impact on the level of investment return required in future and the overall level of scheme funding both contributing to the Authority's overall mission of providing a scheme that is affordable to employers. Setting out these proposals at an early stage in the valuation process ensures transparency and appropriate engagement with employers.

4 Implications for the Corporate Risk Register

4.1 The actions outlined in this report have implications for the risks included in the Corporate Risk Register related to affordability of contributions and the deliverability of investment returns. In addition, the successful delivery of actions to address various other risks such as those associated with data quality could materially impact the valuation outcomes at employer level.

5 Background and Options

5.1 The triennial actuarial valuation is the key event in the Authority's longer term business cycle and sets employer contribution rates for the coming three-year period, in this case from April 2026. Each valuation is undertaken in a specific economic and market context, the last one in 2022, for example being impacted by the post-covid market bounce and associated higher levels of inflation. This valuation which will be based on data in March 2025 will take place in the context of a fundamentally changed interest rate environment, somewhat lower levels of inflation and very significant pressure on the finances of all employers within the Fund together with very significant uncertainty over the future path of financial markets.

5.2 In setting contribution rates, the Authority needs to balance the interests of employers, both individually and collectively, and scheme members whose benefits are either in payment or fall due in the future. The over-riding responsibility of the Authority is to ensure that funds are available to pay pensions when they fall due. However, setting contribution rates at a level unaffordable to employers would clearly be counterproductive and this is where the Authority needs to balance the various competing interests.

5.3 The Authority is required in setting contribution rates to look to both affordability and stability over the long term. For many years contribution rates have been increasing to both address the deficit and ensure that the cost of future accrual is being fully met. The current estimated funding position clearly demonstrates that the deficit has been more than addressed, although future service contribution rates remain out of line with the long-term sustainable level.

5.4 The Authority also needs to be aware in setting contribution rates that the current favourable funding situation which developed very quickly during the latter part of 2022 could equally quickly reverse if market conditions change. Therefore, it may be appropriate to regard a part of the current surplus as a cushion against severe market movements thus providing a level of insurance against a return to a deficit position. The Authority also needs to consider that providing short-term relief to employers through a reduction in contributions might result in the need to raise contributions at a later stage when employers might be even less able than they are now to absorb any increase.

5.5 Given the very difficult situation faced by a significant proportion of employers and in particular the larger employers such as the local authorities this presents a difficult balancing act for the Authority, between the stability and affordability of contributions and long-term and short-term considerations.

5.6 As a starting point for the debate over the setting of contribution rates the Authority needs to view the primary rate and the repayment of surplus / recovery of deficit payments as a single amount, as this is the budgetary impact on employers. Thus, policy will assume that current contributions are affordable, given that they are being paid.

5.7 Policy will then need to move beyond this in several areas to protect the long-term interest of the Fund and scheme members, including:

- Defining a funding level target of more than 100% to create a cushion against significant negative market movements.
- Assuming an increased level of prudence in the setting of the discount rate (the assumed investment return) recognising the increased uncertainty over the level of future returns.
- Setting the rate of repayment of surplus (or the recovery of any remaining employer deficits) over a prudent period so that overall contributions are not artificially lowered in the short-term leading to budgetary difficulties when the repayment period ends.

5.8 In practical terms this can be expressed as:

- The Authority will seek to maintain an overall funding level of 120% to provide a cushion against future market volatility. This is roughly the funding level at the 2022 valuation and should cover all but the most extreme scenarios.
- The Authority will set a discount rate based on an 80% probability of success (the level of prudence), which has the consequential effect of minimising regret risk (the likelihood of contributions having to be increased from the level set out in the plan).
- The Authority will over the 2025 valuation period seek to move employers to the long term sustainable primary contribution rate, or as close to it as practically possible.
- The Authority will set a floor level for the combination of primary and secondary contributions of 15% of pay. This is to avoid the total amount being paid into the Fund being reduced to artificially low levels and serves to support stability in contribution rates over a longer period. There are a small number of employers with existing combined contribution rates of less than 15% which will need to be examined on a case-by-case basis.
- As a consequence of the combination of the above surpluses will be repaid to employers evenly over a period such that the combination of primary and

secondary combinations remains stable at the level set from April 2026 for as long as possible. The minimum period over which contributions will be repaid will be 15 years.

- For employers with a surplus but a funding level less than 120% no surplus will be repaid.
- For contractors in surplus, the surplus will be repaid over the remaining life of the contract, and this may result in no contributions being payable over the valuation period. This is to avoid the creation of additional surpluses which could become repayable as exit credits, and if risk sharing arrangements are in place with the contracting employer this will result in a further benefit to the contracting employer in reduced contract costs.

5.9 There are several other policy considerations on which the Authority needs to decide prior to consultation with employers. These are:

- Treatment of Multi-Academy Trusts (MAT's) – Previously MAT's have been allowed to either operate a single contribution rate or to maintain individual rates for each school. The way in which MAT's are evolving and the DfE's desire to create more standardisation of Academy contribution rates make the option of retaining rates for each school increasingly difficult. Therefore, it is proposed to enforce the pooling of contribution rates for all MAT's. This is likely to reduce or eliminate the remaining deficits and will simplify several administrative processes.
- Given the small number and diverse nature of the so-called Resolution bodies within the Fund (largely Parish and Town Councils) it is proposed not to mandate the pooling of contribution rates for these bodies.
- The Combined Authority is examining the option of setting a single rate across the new Combined Authority Group by pooling the MCA with the Chief Constable and it is proposed that, if requested by the Combined Authority that this is agreed.
- It is not proposed to change the scope of the ill health captive arrangement which is used for managing the impact of ill health retirement costs on smaller employers. This will continue to apply to:
    - Academies and MAT's
    - Contractors
    - Resolution Bodies
    - Community Admissions

5.10 The Authority also needs to consider various key assumptions which will feed into the valuation process and which the actuary advises on. These are always subject to some change as actuarial models take in new information. However, as the starting point for the process the following are proposed:

- Long-Term Inflation – 2.3%
- Future Pay Awards – 2.9% (As the proportion of benefits covered by the CARE scheme becomes greater this is becoming a less important factor but does remain significant for the larger employers with greater longevity in the Fund.)
- Investment Returns (also known as the Discount Rate) – Will depend on the allowance for prudence set by the Authority. Initial modelling based on an 80% level of prudence gives an assumed return of 5.4% pa.

- Longevity – Scheme specific allowance based on latest Club Vita tables and the most up to date version of the CMI longevity improvements model, published by the actuarial profession.

5.11 All of the above lead to the following proposed rules for the setting of contribution rates for different groups of employers. The rules are different for the different groups because of either their different starting points and/or the level of variation within the group and the different timescales for their participation in the Fund.

Employer Group	Target Funding Level	Surplus Repayment/ Deficit Recovery Period	Notes
Councils/ MCA / Police / Fire / F&HE	120%	Minimum of 15 Years	Target 120% funding level and distribute surplus above this back to the employer. Colleges are already treated in the same way as the most secure employers therefore there is no funding impact from the DfE guarantee. A floor will be applied to ensure total contributions payable do not fall below 15% of pay to support longer term stability. This may result in a longer repayment period for some employers.
Other Scheduled Bodies	120%	Minimum of 15 Years	Treated as for Councils etc with the same floor arrangement in place.
Academies	120%	Minimum of 15 Years	If the Funding Level is greater than 120% then distribute the surplus over a minimum of 15 years with the same floor arrangement as for Councils etc. If the Funding Level is less than 120% then the required primary rate will be set as a floor.
Resolution Bodies (Town and Parish Councils)	120%	Minimum of 15 Years	Target 120% funding level and distribute surplus above this back to the employer as for Councils. Same floor arrangement to apply as for Councils etc.
Contractors (non-pass through)	100% (no explicit buffer as	Contract Period	If the Funding Level is greater than 120% and the contract period is less than 3 years

	aiming for full funding at cessation)		then allow surplus spreading, which may result in a nil contribution rate. If the Funding Level is greater than 120% and the contract period is greater than three years, then floor at the primary rate. If the Funding Level is between 100% and 120% then floor at the primary rate subject to adjustments to minimise the likelihood of paying an exit credit.
Contractors (pass through)	As for the contracting employer	As for the contracting employer	Arrangements as for the contracting employer.
Community Admission Bodies with full guarantee	100% on least risk basis (90% lower bound) (no explicit buffer – aiming for no debt at cessation)	Future Working Life or 15 years (if future working life is more than 15 years)	Target 100% Funding Level and distribute surplus above this back to the employer over the repayment period.
Community Admission Bodies with partial or no guarantee	100% on least risk basis (95% upper bound) (no explicit buffer – aiming for no debt at cessation)	Future Working Life or 15 years (if future working life is more than 15 years)	Target 100% Funding Level on a least risk basis (95% probability). Surplus above this to be paid back to the employer over the repayment period, which could lead to nil rates.

5.12 The different expression of the policy for Community Admission Bodies and Contractors reflects the fact that these employers have a limited "life expectancy" within the Fund and the approach while utilising a similar level of prudence expresses this in a slightly different way focussed on achieving full funding at the point of cessation and minimising any exit credit (or payment) that might become due at cessation. As indicated above where current contribution rates are below the proposed floor the position will be considered on a case-by-case basis.

5.13 Initial engagement around this strategy has been undertaken with larger employers including the larger Multi-Academy Trusts, and a verbal update will be provided on the feedback received. Further engagement with all employers is necessary to ensure that the requirements of the relevant regulation to consult are met.

5.14 The broad plan for the valuation process is set out below. The intention is to deliver the valuation significantly ahead of the statutory deadline of March 31st, 2026, ensuring that employers have earlier access to information and an effective consultation on key parts of the process. A project team to deliver the valuation process have been identified and appropriate project management arrangements are in place internally with appropriate liaison with the actuary built into this process. In addition, other work within Pensions Administration, such as work to address backlogs is currently being focussed on areas which will affect data quality for the valuation, such as reducing the number of unprocessed leavers and outstanding deferments, so that the results can be as clean as possible.

Month	Activity
February 2025	Trial run data extract including McCloud data. Initial engagement with larger employers and Multi-Academy Trusts.
March 2025	Authority approves initial framework for the valuation including policies for setting contribution rates
April 2025	Complete Pensions Increase process. Provide actuary with cash flow data.
May 2025	Complete CARE revaluation so that data reflects the updated value of benefits.
June 2025	Complete data cleansing and validation Authority approves draft Funding Strategy Statement and Pensions Administration Strategy for consultation with stakeholders.
July 2025	Submit final data to Actuary
September 2025	Results received from Actuary and communicated to employers alongside formal consultation on the Funding Strategy Statement and Pensions Administration Strategy.
October 2025	Completion of employer consultation
November 2025	Employers certify acceptance of contribution rates and submit revised employer discretions policies.
December 2025	Authority Meeting – Approval of the Rates and Adjustments Certificate, Funding Strategy Statement and revised Pensions Administration Strategy
February 2026	Authority Meeting – Reserve date for approval of the Rates and Adjustments Certificate etc.
March 2026	Statutory Deadline

5.15 This valuation reflects a fundamental change in the overall funding position, and it will be important to maintain ongoing dialogue with employers throughout the process and the plan set out above provides for this as well as for an earlier conclusion to the process than has been customary.

6 <u>Implications</u>

6.1 The proposals outlined in this report have the following implications:

Financial	Funding for the valuation process is identified within the budget.
Human Resources	Training requirements for staff involved in the valuation process for the first time have been identified and are being addressed.
ICT	None directly.
Legal	None
Procurement	Delivery of the valuation is being undertaken through the contract for actuarial services which was awarded following a compliant procurement process.

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Background Papers	
Document	**Place of Inspection**