

RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL PENSION FUND

FUNDING STRATEGY STATEMENT

Draft December 2016



This page intentionally blank

Rhondda Cynon Taf County Borough Council Pension Fund

Funding Strategy Statement

SECTION 1

Introduction

Overview

This Statement has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) (the LGPS Regulations). The Statement describes Rhondda Cynon Taf County Borough Council's strategy, in its capacity as Administering Authority (the Administering Authority), for the funding of the Rhondda Cynon Taf County Borough Council Pension Fund (the Fund).

As required by Administration Regulation 58(3), the Statement has been reviewed (and where appropriate revised) having regard to guidance published by CIPFA in September 2016.

Consultation

In accordance with Regulation 58(3), officers, elected members, and representatives of all employers participating within the Rhondda Cynon Taf County Borough Council Pension Fund, have been consulted on the contents of this Statement and their views have been taken into account in formulating the Statement. However, the Statement describes a single strategy for the Fund as a whole.

In addition, the Administering Authority has had regard to the Fund's Investment Strategy Statement published under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the Investment Regulations).

The Fund Actuary, Aon Hewitt, has also been consulted on the contents of this Statement.

Policy Purpose

The purpose of this Funding Strategy Statement is to document the process by which the Administering Authority:

- establishes a clear and transparent strategy, specific to the Fund, which will identify how employer's pension liabilities are best met going forward
- supports the regulatory requirement in relation to the

desirability of maintaining as nearly constant a primary contribution rate as possible

- enable overall employer contributions to be kept as constant as possible and (subject to the Administering Authority not taking undue risks and ensuring that the regulatory requirements are met) at reasonable cost to the taxpayers, scheduled, designating, and admitted bodies
- ensures that the regulatory requirements to set contributions so as to ensure the solvency and long-term cost efficiency of the Fund are met
- takes a prudent longer-term view of funding the Fund's liabilities.

Noting that whilst the funding strategy applicable to individual employers or categories of employers must be reflected in the Funding Strategy Statement, its focus should at all times be on those actions which are in the best long-term interests of the Fund.

**Links to
investment policy
set out in the
Investment
Strategy Statement**

The Authority has produced this Funding Strategy Statement having taken an overall view of the level of risk inherent in the investment policy set out in the Investment Strategy Statement and the funding policy set out in this Statement.

The Authority accepts that the outcome of formulating a strategic asset allocation needs to be consistent with achieving the solvency and deficit recovery targets and meeting obligations when they fall due.

Fixed interest and index-linked Government bonds are considered to provide an effectively guaranteed return if held to redemption (assuming the Government doesn't default). The Fund's asset allocation as set out in the Statement of Investment Principles or Investment Strategy Statement invests a significant proportion of the Fund in assets such as equities which are expected but not guaranteed to produce higher returns than Government bonds in the long term. The Administering Authority has agreed with the Fund Actuary that the funding target on the ongoing basis will be set by explicitly considering the expected return on the assets. The Administering Authority recognises that future investment returns are not guaranteed and that, in the absence of any other effects, if the expected returns are not achieved the solvency position of the Fund will deteriorate.

The funding strategy recognises the investment targets and the inherent volatility arising from the investment strategy, by being based on financial assumptions which take account of

the expected average return, and by including measures which can be used to smooth out the impact of such volatility.

The Administering Authority will continue to review both documents to ensure that the overall risk profile remains appropriate including, where appropriate, use of asset liability modelling or other analysis techniques.

Review of this Statement

The Administering Authority undertook its latest substantive review of this Statement in December 2016.

The Administering Authority will formally review this Statement as part of the triennial valuation as at 31 March 2019 unless circumstances arise which require earlier action.

The Administering Authority will monitor the funding position of the Fund on an approximate basis at regular intervals between valuations, and will discuss with the Fund Actuary whether any significant changes have arisen that require action.

SECTION 2

Aims and Purpose of the Fund

Purpose of the Fund

The purpose of the Fund is to invest monies in respect of contributions, transfer values and investment income to produce a Fund to pay Scheme benefits over the long term and in so doing to smooth out the contributions required from employers over the long term.

The Aims of the Fund

The main aims of the Fund are:

- 1. To comply with regulation 62 of the Local Government Pension Scheme Regulations 2013 and specifically to adequately fund benefits to secure the Fund's solvency while taking account of the desirability of maintaining as nearly constant a primary employer contribution rate as possible. The Fund should achieve and maintain solvency and long term cost efficiency (subject to the administering authority not taking undue risks), which should be assessed in light of the risk profile of the fund and the risk appetite of the administering authority and employers alike, at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies.**

The Administering Authority recognises that the requirement to keep employer primary contribution rates as nearly constant as possible can run counter to the following requirements:

- the regulatory requirement to secure solvency and long term cost efficiency,
- the requirement that the costs should be reasonable, and
- maximising income from investments within reasonable cost parameters (see later)

Producing low volatility in employer contribution rates requires material investment in assets, which 'match' the employer's liabilities. In this context, 'match' means assets that behave in a similar manner to the liabilities as economic conditions alter. For the liabilities represented by benefits payable by the Local Government Pension Scheme should there be no employers to fund the liabilities in the future, such assets would tend to comprise gilt edged investments.

Other classes of assets, such as stocks and property, are perceived to offer higher long-term rates of return, on average, and consistent with the requirement to maximise

the returns from investments the Administering Authority invests a substantial proportion of the Fund in such assets. However, these assets are more risky in nature, and that risk can manifest itself in volatile returns over short-term periods.

This short-term volatility in investment returns can produce a consequent volatility in the measured funding position of the Fund at successive valuations, with knock on effects on employer contribution rates. The impact on employer rates is mitigated by use of a risk-based approach to setting the investment return assumption a smoothing mechanism which recognises the statutory nature of the Fund and its largest employers.

The Administering Authority recognises that there is a balance to be struck between the investment policy adopted, the smoothing mechanisms used at valuations, and the resultant smoothness of employer contribution rates from one valuation period to the next.

The Administering Authority also recognises that the position is potentially more volatile for Admission Bodies with short-term contracts where utilisation of smoothing mechanisms is less appropriate.

2. To ensure that sufficient resources are available to meet all liabilities as they fall due.

The Administering Authority recognises the need to ensure that the Fund has, at all times, sufficient liquid assets to be able to pay pensions, transfer values, costs, charges and other expenses. It is the Administering Authority's policy that such expenditure is met, in the first instance, from incoming employer and employee contributions to avoid the expense of disinvesting assets. The Administering Authority monitors the position on a monthly basis to ensure that all cash requirements can be met.

3. To manage employers' liabilities effectively.

The Administering Authority seeks to ensure that all employers' liabilities are managed effectively. In a funding context, this is achieved by seeking regular actuarial advice, ensuring that employers, Committee and Board members are properly informed, and through regular monitoring of the funding position.

4. To maximise the income from investments within reasonable risk parameters.

The Administering Authority recognises the desirability of maximising investment income within reasonable risk parameters. Investment returns higher than those available

on government stocks are sought through investment in other asset classes such as stocks and property. The Administering Authority ensures that risk parameters are reasonable by:

- restricting investments to the maximum percentages set out in the Investment Strategy Statement.
 - restricting investment to asset classes generally recognised as appropriate for UK pension funds.
 - analysing the potential risk represented by those asset classes in collaboration with the Fund's Actuary, Investment Advisors and Fund Managers.
-

SECTION 3

Responsibilities of the Key Parties

Responsibilities of the key parties

The three parties whose responsibilities to the Fund are of particular relevance are the Administering Authority, the Individual Employers and the Fund Actuary.

Their key responsibilities are set out below:

Administering Authority

The Administering Authority's key responsibilities are:

- 1. To operate the pension fund**
- 2. Collecting employer and employee contributions, investment income and other amounts due to the Fund as stipulated in LGPS regulations and, as far as the Administering Authority is able to, ensure these contributions are paid by the due date.**

Individual employers must pay contributions in accordance with Regulations 67 to 71 of the Regulations. The Administering Authority will ensure that all employers are aware of these requirements especially the requirement of the Pensions Act 1995 that members' contributions are paid by the 19th of the month following the month that it is paid by the member. The Administering Authority may charge interest on late contributions in accordance with Regulation 71 of the Regulations.

The Administering Authority will ensure that action is taken to recover assets from employers who have exited the Fund by

- requesting that the Fund Actuary calculates the deficit at the date of exit of the employer
- notifying the employer that it must meet any deficit calculated in the exit valuation.

- 3. Pay from the Fund the relevant entitlements as stipulated by LGPS Regulations.**
- 4. Invest surplus monies in accordance with the LGPS regulations.**

The Administering Authority will comply with Regulation 7(8) of the Investment Regulations.

- 5. Ensure that cash is available to meet liabilities as and when they fall due.**

The Administering Authority recognises this duty and

discharges it in the manner set out in the Aims of the Fund above.

6. Manage the valuation process in consultation with the Fund's actuary

The Administering Authority ensures it communicates effectively with the Fund Actuary to:

- agree timescales for the provision of information and provision of valuation results
- ensure provision of data of suitable accuracy
- ensure that the Fund Actuary is clear about the Funding Strategy Statement
- ensure that participating employers receive appropriate communication throughout the process
- ensure that reports are made available as required by Guidance and Regulation
- enable the Pension Committee and Board to review the valuation progress

7. Prepare and maintain a Investment Strategy Statement and a Funding Strategy Statement after due consultation with interested parties.

The Administering Authority will ensure that both documents are prepared and maintained in the required manner.

8. Monitor all aspects of the Fund's performance and funding and amend these two documents as required.

The Administering Authority monitors the investment performance and funding position of the Fund on a quarterly basis. The Investment Strategy Statement will be formally reviewed annually, and the Funding Strategy Statement every three years as part of the valuation cycle, unless circumstances dictate earlier amendment.

9. Effectively manage any potential conflicts of interest arising from its dual role as both Administering Authority and Scheme Employer.

**Individual
Employers**

Individual Employers will:

- Deduct contributions from employees' pay.
- Pay all ongoing contributions, including their employer contribution as determined by the Fund Actuary, promptly by the due date.

- Develop a policy on certain discretions and exercise discretions within the regulatory framework.
 - Pay for added years in accordance with agreed arrangements.
 - Notify the Administering Authority promptly of all changes to membership, or other changes which affect future funding
 - pay any exit payments required in the event of their ceasing participation in the Fund
-

The Fund Actuary

The Fund Actuary will:

- prepare valuations including the setting of employers' contribution rates at a level to ensure solvency and long term cost efficiency after agreeing assumptions with the administering authority and having regard to the Funding Strategy Statement and the Regulations.
 - prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters.
 - provide advice and valuations on the exit of fund employers.
 - provide advice to the Administering Authority on bonds and other forms of security against the financial effect on the Fund of Employer's default
 - assist the Administering Authority in assessing whether employer contributions need to be revised between valuations as permitted or required by the regulations
 - ensure that the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to his role in advising the Fund.
-

SECTION 4

Funding Target, Solvency, Long Term Cost Efficiency and Notional Sub-Funds

Funding Principle	The Fund is financed on the principle that it seeks to provide funds sufficient to enable payment of 100% of the benefits promised.
Funding Targets and assumptions regarding future investment strategy	<p>The Funding Target is the amount of assets which the Fund needs to hold at any point in time such that the funds held, plus future anticipated investment returns on those funds, and taking into account the anticipated future experience of the membership and contributions due from the membership, meet the funding principle.</p> <p>Some comments on the principles used to derive the Funding Target for different bodies in the Fund are set out below.</p> <p>Scheduled Bodies and certain other bodies</p> <p>The Administering Authority will adopt a general approach in this regard of assuming indefinite investment in a broad range of assets of higher risk than low risk assets for Scheduled Bodies and certain other bodies which are, or can be treated as if they are long term in nature.</p> <p>The Administering Authority adopts a risk based approach to funding. In particular the discount rate (for most employers) has been set on the basis of the assessed likelihood of meeting the funding objectives. The Administering Authority has considered 3 key decisions in setting the discount rate:</p> <p>The long-term Solvency Target (i.e. the funding objective – where the Administering Authority wants the Fund to get to);</p> <p>The Trajectory Period (how quickly the Administering Authority wants the Fund to get there); and</p> <p>The Probability of Funding Success (how likely the Administering Authority wants it to be now that the Fund will actually achieve the Solvency Target by the end of the Trajectory Period).</p> <p>These three choices, supported by complex (stochastic) risk modelling carried out by the Fund Actuary, define the discount rate (investment return assumption) to be adopted and, by extension, the appropriate levels of employer contribution payable. Together they measure the riskiness (and hence also the degree of prudence) of the funding strategy. These are considered in more detail below.</p>

Admission Bodies and bodies closed to new entrants

For Admission Bodies the Administering Authority will have specific regard to the potential for participation to cease (or to have no contributing members), the potential timing of exit from the fund, and any likely change in notional or actual investment strategy as regards the assets held in respect of the Admission Body's liabilities at the date of cessation (i.e. whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities).

Orphan liabilities

These are liabilities with no access to funding from any employer in the Fund. To minimise the risk to other employers in the Fund the assets notionally related to these liabilities will be assumed to be invested in low risk investments. This is described in more detail later in this document.

Solvency and 'Funding Success'

The Fund's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term.

The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the liabilities assessed using appropriate actuarial methods and assumptions. The Administering Authority believes that its funding strategy will ensure the solvency of the Fund because employers collectively have the financial capacity to increase employer contributions should future circumstances require, in order to continue to target a funding level of 100%.

For Scheduled Bodies and Admission Bodies where a Scheme Employer of sound covenant has agreed to subsume its assets and liabilities following cessation, appropriate actuarial methods and assumptions are taken to be:

- the Projected Unit method of valuation; and
- assumptions such that, if the Fund had reached the Solvency Target, its financial position continued to be assessed by use of such methods and assumptions, and contributions were paid in accordance with those methods and assumptions, there would be a 70% chance that the Fund would be at least 100% funded after a period of 25 years.

This then defines the Solvency Target.

For Admission Bodies and other bodies whose liabilities are expected to be orphaned following cessation, a more prudent approach will be taken. The Solvency Target will be set by considering the valuation basis which would be adopted should the body leave the Fund. For most such bodies, the Solvency Target will be set commensurate with assumed investment in an appropriate portfolio of Government index linked and fixed interest bonds after cessation.

Probability of Funding Success

The Administering Authority considers funding success to have been achieved if the Fund, at the end of the Trajectory Period, has achieved the Solvency Target. The Probability of Funding Success is the assessed chance of this happening based on the level of contributions payable by members and employers and asset-liability modelling carried out by the Fund Actuary.

The discount rate, and hence the overall required level of employer contributions, has been set such that the Fund Actuary estimates there is around a 70% chance that the Fund would reach or exceed its Solvency Target after 25 years.

Funding Target

The Funding Target is the amount of assets which the Fund needs to hold at the valuation date to pay the liabilities at that date as indicated by the chosen valuation method and assumptions and the valuation data. The valuation calculations, including future service contributions and any adjustment for surplus or deficiency set the level of contributions payable and dictate the chance of achieving the Solvency Target at the end of the Trajectory Period (defined below). The key assumptions used for assessing the Funding Target are summarised in Appendix 1.

Consistent with the aim of enabling the primary rate of employers' contributions to be kept as nearly constant as possible, contributions are set by use of the Projected Unit valuation method for most employers. The Projected Unit method is used in the actuarial valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the future service contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period. The future service rate will be stable if the profile of the membership (age, gender etc) is stable.

For employers who no longer admit new members, the

Attained Age valuation method is normally used. This means that the contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.

Funding Targets and assumptions regarding future investment strategy

For Scheduled Bodies and Admission Bodies with a subsumption commitment from a Scheme Employer of sound covenant, the Administering Authority assumes indefinite investment in a broad range of assets of higher risk than risk free assets. This approach should lead to more stable employer contribution rates than adoption of the Projected Unit method for closed employers.

For Admission Bodies and other bodies whose liabilities are expected to be orphaned on cessation, the Administering Authority will have regard to

- the potential for participation to cease (or for the body to have no contributing members),
- the type of service being provided by the employer (eg statutory or not), and the covenant of the employer,
- the potential timing of exit from the Fund,
- any likely change in notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date of cessation (i.e. whether the liabilities will become 'orphaned' or a guarantor exists to subsume the notional assets and liabilities).

The Fund is deemed to be fully funded when the assets are equal to or greater than 100% of the Funding Target, where the funding target is assessed based on the sum of the appropriate funding targets across all the employers/groups of employers.

Other Aspects of Funding Strategy

Recovery Periods

Where a valuation reveals that the Fund is in surplus or deficiency against the Funding Target, employer contribution rates will be adjusted to target restoration of full funding over a period of years (the Recovery Period). The Recovery Period applicable for each participating employer is set by the Fund Actuary in consultation with the Administering Authority and the employer, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.

The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefit payments over long periods of time. For employers of sound covenant, and in the context of the LGPS as a statutory scheme the Administering Authority is prepared to agree to Recovery Periods which are longer than the average future working lifetime of the membership of that employer. The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible. However, the Administering Authority also recognises the risk in relying on long recovery periods and has agreed with the Fund Actuary a limit of 23 years. The Administering Authority's policy is to agree Recovery Periods with each employer which are as short as possible within this framework.

For employers whose participation in the fund is for a fixed period it is unlikely that the Administering Authority and Fund Actuary would agree to a Recovery Period longer than the remaining term of participation.

Grouping

In some circumstances it may be desirable to group employers within the Fund together for funding purposes (ie to calculate employer contribution rates). Reasons might include reduction of volatility of contribution rates for small employers, facilitating situations where employers have a common source of funding or accommodating employers who wish to share the risks related to their participation in the Fund.

The Administering Authority recognises that grouping can give rise to cross subsidies from one employer to another over time. The Administering Authority's policy is to consider the position carefully at each valuation and to notify each employer that is grouped that this is the case, and which other employers it is grouped with. If the employer objects to this grouping, it will be offered its own contribution rate. For employers with more than 50 contributing members, the Administering Authority would look for evidence of homogeneity between employers before considering grouping. For employers whose participation is for a fixed period grouping is unlikely to be permitted.

All employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service – in other words, the cost of such benefits is shared across the employers in the Fund. Such lump sum benefits can cause funding strains which could be significant for some of the smaller employers without insurance or sharing of risks. The Fund, in view of its size, does not see it

as cost effective or necessary to insure these benefits externally and this is seen as a pragmatic and low cost approach to spreading the risk.

Currently there are two groups of employers in the Fund pooled together for funding and contribution purposes. One group is funded on the same funding target as the main scheduled bodies, and the other on the Orphan Admission Bodies funding target. All risks are shared within these groups apart from the payment of deficit contributions.

Where employers are grouped together entirely for funding purposes, this will only occur with the consent of the employers involved.

Stepping

Again, consistent with the aim to keep employer contributions as nearly constant as possible, the Administering Authority will consider, at each valuation, whether new contributions should be payable immediately, or should be reached by a series of steps over future years. The Administering Authority will discuss with the Fund Actuary the risks inherent in such an approach, and will examine the financial impact and risks associated with each employer.

Where employer contributions are being stepped up, the Administering Authority's policy is that in the normal course of events no more than three equal annual steps will be permitted. Where stepping is agreed the Administering Authority will ensure that the employer recognises that this is a mechanism by which contributions can be smoothed and that it represents a deferral of costs rather than a reduction, i.e. by paying less in the short term higher contributions are likely to be required in the longer-term.

Where employer contributions are being stepped down, the Administering Authority's policy is that in the normal course of events six equal annual steps will be used. Where the expected remaining time till the employer exits the Fund is such that a shorter period is appropriate, or in exceptional circumstances, a shorter stepping period with a bespoke stepping pattern may be permitted.

Long term cost efficiency

In order to ensure that measures taken to maintain stability of employer contributions are not inconsistent with the statutory objective for employer contributions to be set so as to ensure the long-term cost efficiency of the Fund, the Administering Authority has assessed the actual contributions payable by considering:

- The implied average deficit recovery period, allowing for

the stepping of employer contribution changes;

- The investment return required to achieve full funding over the recovery period; and
- How the investment return compares to the Administering Authority's view of the expected future return being targeted by the Fund's investment strategy.

Inter-valuation funding calculations

In order to monitor developments, the Administering Authority may from time to time request informal valuations or other calculations. Generally, in such cases the calculations will be based on an approximate roll forward of asset and liability values, and liabilities calculated by reference to assumptions consistent with the most recent preceding valuation. Specifically, it is unlikely that the liabilities would be calculated using individual membership data, and nor would the assumptions be subject to the same level of review as occurs at formal triennial valuations.

Notional Sub-Funds for individual employers

Notional sub-funds

In order to establish contribution rates for individual employers or groups of employers it is convenient to notionally subdivide the Fund as a whole between the employers (or group of employers where grouping operates), as if each employer had its own notional sub-fund within the Fund.

This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, nor ownership of any particular assets or groups of assets by any individual employer or group.

Roll-forward of sub-funds

The notional sub-fund allocated to each employer will be rolled forward allowing for all cashflows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income allocated as set out below. In general no allowance is made for the timing of contributions and cashflows for each year are assumed to be made half way through the year with investment returns assumed to be uniformly earned over that year. However, where significant one-off employer contributions have been paid, allowance is made for the timing of such contributions.

Further adjustments are made for:

- A notional deduction to meet the expenses paid from the

Fund in line with the assumption used at the previous valuation.

- Allowance for death in service lump sum benefits shared across all employers in the Fund (see above)
- Allowance for any known material internal transfers in the Fund (cashflows will not exist for these transfers). The Fund Actuary will assume an estimated cashflow equal to the value of the liabilities determined consistent with the Funding Target transferred from one employer to the other unless some other approach has been agreed between the two employers.
- An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund which will take into account any gains or losses related to the orphan liabilities.

In some cases information available will not allow for such cashflow calculations. In such a circumstance:

- Where, in the opinion of the Fund Actuary, the cashflow data which is unavailable is of low materiality, estimated cashflows will be used
- Where, in the opinion of the Fund Actuary, the cashflow data which is unavailable is material, the Fund Actuary will instead use an analysis of gains and losses to roll forward the notional sub-fund. Analysis of gains and losses methods are less precise than use of cashflows and involve calculation of gains and losses relative to the surplus or deficiency exhibited at the previous valuation. Having established an expected surplus or deficiency at this valuation, comparison of this with the liabilities evaluated at this valuation leads to an implied notional asset holding.
- Analysis of gains and losses methods will also be used where the results of the cashflow approach appears to give unreliable results perhaps because of unknown internal transfers.

Attribution of investment income

Where the Administering Authority has agreed with an employer that it will have a tailored asset portfolio notionally allocated to it, the assets notionally allocated to that employer will be credited with a rate of return appropriate to the agreed notional asset portfolio.

Where the employer has not been allocated a tailored notional portfolio of assets, the assets notionally allocated to that employer will be credited with the rate of return earned

by the Fund assets as a whole, adjusted for any return credited to those employers for whom a tailored notional asset portfolio exists.

SECTION 5

Special Circumstances related to Admission

Interim reviews for Admission Bodies

Regulation 64(4) of the Regulations provides the Administering Authority with a power to carry out valuations in respect of employers that are likely to become exiting employers, and for the Actuary to certify revised contribution rates, between triennial valuation dates.

The Administering Authority's overriding objective at all times in relation to participating employers is that, where possible, there is clarity over the Funding Target for that body, and that contribution rates payable are appropriate for that Funding Target. However, this is not always possible as any date of exit may be unknown (for example, participation may be assumed at present to be indefinite), and also because market conditions change daily.

The Administering Authority's general approach in this area is as follows:

- Where the date of exit is known, and is more than 3 years hence, or is unknown and assumed to be indefinite, interim valuations will generally not be carried out at the behest of the Administering Authority.
- For Transferee and Schedule 2 Part 3 (1)(d) Admission Bodies falling into the above category, the Administering Authority sees it as the responsibility of the relevant Scheme Employer to instruct it if an interim valuation is required. Such an exercise would be at the expense of the relevant Scheme Employer unless otherwise agreed.
- A material change in circumstances, such as the date of exit becoming known, material membership movements or material financial information coming to light may cause the Administering Authority to informally review the situation and subsequently formally request an interim valuation.
- For admissions due to cease within the next 3 years, the Administering Authority will keep an eye on developments and may see fit to request an interim valuation at any time.

Notwithstanding the above guidelines, the Administering Authority reserves the right to request an interim valuation of any employer at any time in accordance with Regulation 64(4).

Guarantors

Some Admission Bodies may participate in the Fund by virtue of the existence of a Guarantor. The Administering Authority maintains a list of employers and their associated Guarantors. The Administering Authority, unless notified otherwise, sees the duty of a Guarantor to include the following:

- If an Admission Body ceases and defaults on any of its financial obligations to the Fund, the Guarantor is expected to provide finance to the Fund such that the Fund receives the amount certified by the Fund Actuary as due, including any interest payable thereon.
- If the Guarantor is an employer in the Fund and is judged to be of suitable covenant by the Administering Authority, the Guarantor may defray some of the financial liability by subsuming the residual liabilities into its own pool of Fund liabilities. In other words, it agrees to be a source of future funding in respect of those liabilities should future deficiencies emerge.
- During the period of participation of the Admission Body a Guarantor can at any time agree to the future subsumption of any residual liabilities of an Admission Body. The effect of that action would generally be to reduce the Funding Target for the Admission Body, which would probably lead to reduced contribution requirements.

Bonds and other securitization

Schedule 2 Part 3 of the Regulations creates a requirement for a new admission body to carry out, to the satisfaction of the Administering Authority (and Scheme Employer in case of an Admission Body admitted under Schedule 2 Part 3 (1)(d) Regulations), an assessment taking account of actuarial advice, of the level of risk arising on premature termination of the provision of service or assets by reason of insolvency, winding up or liquidation of the admission body.

Where the level of risk identified by the assessment is such as to require it, the Admission Body shall enter into an indemnity or bond with an appropriate party.

Where, for any reason it is not desirable for an Admission Body to enter into an indemnity bond, the Admission Body is required to secure a guarantee in a form satisfactory to the Administering Authority as set out in Schedule 2 Part 3 paragraph (8).

The Administering Authority's approach in this area is as follows:

- a) In the case of Transferee Admission Bodies and Admission Bodies admitted under Schedule 2 Part 3

(1)(d) of the Regulations and other Admission Bodies where a Scheme Employer acts as guarantor, and so long as the Administering Authority judges the relevant Scheme Employer to be of sufficiently sound covenant, any bond exists purely to protect the relevant Scheme Employer or Guarantor on default of the Admission Body. As such, the Administering Authority's policy is that the relevant Scheme Employer or Guarantor should decide the level of required bond (to the satisfaction of the Administering Authority). The Administering Authority will be pleased to supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer which would satisfy the Administering Authority, but this should not be construed as advice to the relevant Scheme Employer on this matter. The Administering Authority notes that levels of required bond cover can fluctuate and recommends that relevant Scheme Employers review the required cover regularly, at least once a year.

- b) In the case of Admission Bodies as described in a) above, where the Administering Authority does not judge the relevant Scheme Employer to be of sufficiently strong covenant, the Administering Authority will set a level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed that is satisfied with the level of bond cover. The Administering Authority notes that levels of required bond cover can fluctuate and will require the relevant Scheme Employer to jointly review the required cover with it regularly, at least once a year.
- c) For all other Admission Bodies, the Administering Authority will set the required level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed the level of bond cover. The Administering Authority notes that levels of required bond cover can fluctuate and will review the required cover regularly, at least once a year.

Subsumed liabilities

Where an employer is ceasing participation in the Fund such that it will no longer have any contributing members, it is possible that another employer in the Fund agrees to provide a source of future funding in respect of any emerging deficiencies in respect of those liabilities.

In such circumstances the liabilities are known as subsumed liabilities (in that responsibility for them is subsumed by the accepting employer). For such liabilities the Administering Authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of

the liabilities of the accepting employer. Generally this will mean assuming continued investment in more risky investments than Government bonds.

Orphan liabilities

Where an employer is ceasing participation in the Fund such that it will no longer have any contributing members, unless any residual liabilities are to become subsumed liabilities, the Administering Authority will act on the basis that it will have no further access for funding from that employer once any cessation valuation, carried out in accordance with Regulation 64, has been completed and any sums due have been paid. Residual liabilities of employers from whom no further funding can be obtained are known as orphan liabilities.

The Administering Authority will seek to minimise the risk to other employers in the Fund that any deficiency arises on the orphan liabilities such that this creates a cost for those other employers to make good the deficiency. To give effect to this, the Administering Authority will seek funding from the outgoing employer sufficient to enable it to match the liabilities with low risk investments, generally Government fixed interest and index linked bonds.

To the extent that the Administering Authority decides not to match these liabilities with Government bonds of appropriate term then any excess or deficient returns will be added to or deducted from the investment return to be attributed to the employer's notional assets.

Liabilities in the Fund which are already orphaned will be assumed to be 100% funded on the appropriate funding target at each triennial valuation. This will be achieved by the Actuary notionally re-allocating assets within the Fund as required.

Exit of employers

Where an employer exits the Fund, an exit valuation will be carried out in accordance with Regulation 64. That valuation will take account of any activity as a consequence of cessation of participation regarding any existing contributing members (for example any bulk transfer payments due) and the status of any liabilities that will remain in the Fund.

In particular, the exit valuation will distinguish between residual liabilities which will become orphan liabilities, and liabilities which will be subsumed by other employers. For orphan liabilities the Funding Target in the cessation

valuation will anticipate investment in low risk investments such as Government bonds. For subsumed liabilities the cessation valuation will anticipate continued investment in assets similar to those held in respect of the subsuming employer's liabilities.

Regardless of whether the residual liabilities are orphan liabilities or subsumed liabilities, the departing employer will be expected to make good the funding position revealed in the exit valuation. In other words, the fact that liabilities may become subsumed liabilities does not remove the possibility of an exit payment being required unless another employer agrees to make good any deficit.

SECTION 6

Identification of risks and counter measures

Approach

The Administering Authority seeks to identify all risks to the Fund and to consider the position both in aggregate and at an individual risk level. Those risks most likely to impact on the funding strategy are investment risk, liability risk, liquidity/maturity risk, regulatory/compliance risk, employer risk and governance risk.

The Administering Authority will monitor the risks to the Fund, and will take appropriate action to limit the impact of these both before, and after, they emerge wherever possible. The Administering Authority will ensure that funding risks are included within their overarching risk management framework and strategy, linking to their risk register and risk management policy as appropriate and includes defining a role for the Local Pension Board within this framework.

Investment Risk

This covers items such as the performance of financial markets and the Fund's investment managers, asset reallocation in volatile markets, leading to the risk of investments not performing (income) or increasing in value (growth) as forecast. Examples of specific risks would be:

- assets not delivering the required return (for whatever reason, including manager underperformance)
- systemic risk with the possibility of interlinked and simultaneous financial market volatility
- insufficient funds to meet liabilities as they fall due
- inadequate, inappropriate or incomplete investment and actuarial advice is taken and acted upon
- counterparty failure

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income - yield curve, credit risks, duration risks and market risks
- alternative assets – liquidity risks, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risk
- macroeconomic risks

The Fund mitigates these risks through diversification, permitting investment in a wide variety of markets and assets, and through the use of specialist managers with differing mandates in addition to the internal investment management

team, which has a wide variety of experience within its members.

The performance of both markets and managers is reviewed regularly by the Investment Advisory Panel, which has the appropriate skills and training required to undertake this task.

Liability risk

The main risks include interest rates, pay and price inflation, changing retirement patterns and other demographic risks.

The Administering Authority will ensure that the Fund Actuary investigates these matters at each valuation and reports on developments. The Administering Authority will agree with the Fund Actuary any changes which are necessary to the assumptions underlying the measure of solvency to allow for observed or anticipated changes.

The Fund Actuary will also provide quarterly funding updates to assist the Administering Authority in its monitoring of the financial liability risks. The Administering Authority will, as far as practical, monitor changes in the age profile of the Fund membership early retirements, redundancies and ill health early retirements and, if any changes are considered to be material, ask the Fund Actuary to report on their effect on the funding position.

If significant liability changes become apparent between valuations, the Administering Authority will notify all participating employers of the anticipated impact on costs that will emerge at the next valuation and consider whether to require the review of the bonds that are in place for Admission Bodies.

If significant demographic changes become apparent between valuations, the Administering Authority will notify all participating employers of the anticipated impact on costs that will emerge at the next valuation and will review the bonds that are in place for Transferee Admitted Bodies.

Liquidity and Maturity risk

This is the risk of a reduction in cash flows into the Fund, or an increase in cash flows out of the Fund, or both, which can be linked to changes in the membership and, in particular, a shift in the balance from contributing members to members drawing their pensions. Changes within the public sector and to the LGPS itself may affect the maturity profile of the LGPS and have potential cash flow implications. For example,

- budget cuts and headcount reductions could reduce the active (contributing) membership and increase the number of pensioners through early retirements;

- an increased emphasis on outsourcing and other alternative models for service delivery may result in falling active membership (e.g. where new admissions are closed),
- public sector reorganisations may lead to a transfer of responsibility between different public sector bodies, (e.g. to bodies which do not participate in the LGPS),
- scheme changes and higher member contributions in particular may lead to increased opt-outs;
- a high take-up of the 50/50 option will reduce member contributions to the Fund

The Administering Authority seeks to maintain regular contact with employers to mitigate against the risk of unexpected or unforeseen changes in maturity leading to cashflow or liquidity issues.

Regulatory and compliance risk

Regulatory risks to the scheme arise from changes to general and LGPS specific regulations, taxation, national changes to pension requirements, or employment law. The Government is also carrying out a review of the structure of the LGPS.

The Administering Authority will keep abreast of all the proposed changes. The Administering Authority will normally respond to consultations on these matters where they have an impact on the Fund and ask the Fund Actuary to assess the possible impact on costs of the change. It would encourage employers, who frequently have a greater interest in proposed changes, to respond independently.

Employer risk

These risks arise from the ever-changing mix of employers, from short-term and ceasing employers, and the potential for a shortfall in payments and/or orphaned liabilities.

The Administering Authority maintains a knowledge base on its employers, their basis of participation and their legal status (e.g. charities, companies limited by guarantee, group/subsidiary arrangements) and uses this information to inform the FSS.

Liquidity and maturity risk

The LGPS is going through a series of changes, each of which will impact upon the maturity profile of the LGPS and have potential cash flow implications. The increased emphasis on outsourcing and other alternative models for service delivery, which may result in the following

- active members leaving the LGPS

- transfer of responsibility between different public sector bodies
- scheme changes which might lead to increased opt-outs
- spending cuts and their implications.

All of these may result in workforce reductions that will reduce membership, reduce contributions and prematurely increase retirements in ways that may not have been taken into account in previous forecasts.

The Administering Authority's policy is to require regular communications between itself and employers and to ensure regular reviews of maturity at overall Fund and employer level where material issues are identified.

Governance risk

This covers the risk of unexpected structural changes in the Fund membership (for example the closure of an employer to new entrants or the large scale withdrawal or retirement of groups of staff), and the related risk of the Administering Authority not being made aware of such changes in a timely manner.

The Administering Authority's policy is to require regular communication between itself and employers, and to ensure regular reviews of such items as bond arrangements, financial standing of non-tax raising employers and funding levels.

Particular examples are set out below:

Early retirement strain payments

No allowance is made for the additional value of the benefits when a member is made redundant or leaves on the grounds of efficiency. To counter the potential 'strain' (or cost) emerging at the next valuation early retirement strain payments are required from the employer to the Fund to meet this additional cost over a period of no longer than 3 years.

Employers with small and declining number of contributing members

The Administering Authority's view is that employers with no contributing members cannot be charged contributions under Regulation 67. There is a risk of an employer ceasing to pay contributions with a deficit in the Fund, and being unable to pay the exit payment under Regulation 64.

The Administering Authority will monitor employers with declining membership to ensure that funding is close to 100% on the solvency measure by the time the last member leaves service and this may affect the funding strategy accordingly.

Bodies ceasing to exist with unpaid deficiency

Some employers can cease to exist and become insolvent leaving the employers in the Fund open to the risk of an unpaid deficit. For Transferee Admission Bodies and Admission Bodies admitted under Schedule 2 Part 3 (1)(d), any such deficit will be met by the relevant Scheme Employer and there is therefore little risk to other employers in the Fund (provided of course that the relevant Scheme Employer is itself regarded to be of good covenant).

Other employers are more problematic and the Administering Authority will as far as practicable look to reduce risks by use of bond arrangements or ensuring there is a guarantor to back the liabilities of the body.

Recovery period risk

The Administering Authority recognises that permitting surpluses or deficiencies to be eliminated over a Recovery Period rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements. The Administering Authority will discuss the risks inherent in each situation with the Fund Actuary and to limit the Recovery Period where appropriate. Details of the Administering Authority's policy are set out earlier in this Statement.

Stepping risk

The Administering Authority recognises that permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient in the early years of the process. The Administering Authority will discuss the risks inherent in each situation with the Fund Actuary and limit the number of permitted steps as appropriate. Details of the Administering Authority's policy are set out earlier in this Statement.

APPENDIX 1

Actuarial Valuation as at 31 March 2016

Method and assumptions used in calculating the funding target

The actuarial method to be used is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service.

Principal assumptions

Investment return (discount rate)

The discount rate for the 2016 valuation is 4.5% p.a. for the periods pre and post retirement with the exception of Admission Bodies which will ultimately give rise to Orphan liabilities where the discount rate is 4.1% in service (equivalent to the yield on long-dated fixed interest gilts at a duration appropriate for the Fund's liabilities plus an asset out-performance assumption of 2.0%) and 2.5% (left service), which is intended to be equivalent to the yield on long-dated fixed interest gilts at the valuation date but which has, in the interests of affordability and stability of employer contributions, been increased by 0.4% in light of the Actuary's view of the possible future increase in gilt yields. For certain Admission Bodies which have previously been assumed to have a subsumption commitment but where it now seems possible they would leave orphaned liabilities on exit, at the discretion of the Administering Authority, the discount rate is 4.1% left service.

Inflation (Retail Prices Index (RPI) and Consumer Prices Index (CPI) inflation)

The RPI inflation assumption is taken to be the Capital Market Assumption at the valuation date as produced by Aon Hewitt Limited. In formulating the Capital Market Assumption, both consensus forecasts and the inflation risk premium are considered.

The CPI inflation assumption at the valuation date is set as RPI inflation less 1.1%.p.a. The deduction has been set having regard to the estimated difference between RPI and CPI arising from the difference in the calculation approach between the two indices. This estimate (and hence the assumed difference between CPI and RPI) will vary from time to time.

Salary increases

The assumption for real salary increases (salary increases in excess of consumer price inflation) will be determined by an allowance of 1.25% p.a. over the consumer price inflation assumption as described above.

Pension increases

Increases to pensions are assumed to be in line with the inflation (CPI) assumption as determined above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

Mortality

Post-retirement Mortality

Base Rates

Normal Health: Standard SAPS S2 Normal Health tables, year of birth base rates, adjusted by a scaling factor.

Ill-health: Standard SAPS S2 Ill-health tables, year of birth base rates adjusted by a scaling factor.

Scaling Factors

Rates adjusted by scaling factors as dictated by Fund experience

Males (normal health)	100%
Females (normal health)	100%
Males (ill-health)	105%
Females (ill-health)	105%

Future improvement to base rates

An allowance for improvements in line with the CMI 2014, for men or women as appropriate, with a long term rate of improvement of 1.50% p.a.

Pre-retirement mortality

Males: As for normal health retirements but with a 65% scaling factor
 Females: As for normal health retirements but with a 65% scaling factor

Early retirements

Members who are protected in respect of their Rule of 85 Age following the benefit changes introduced in 2008 (i.e. those members who joined the Fund before 1 October 2006 and who would be aged over 60 on 31 March 2016) will be assumed to retire at the Rule of 85 Age or age 60 if higher with no reduction to accrued benefits.

Members joining on or after 1 April 2014 are assumed to retire at their normal retirement age (which is aligned with state pension age).

All other members assumed to retire at age 65.

Withdrawals

Allowance is made for withdrawals from service. On withdrawal, members are assumed to leave a deferred pension in the Fund and are not assumed to exercise their option to take a transfer value.

Retirement due to ill health

Allowance is made for retirements due to ill health. Proportions assumed to fall into the different benefit tiers applicable after 1 April 2008 are:

Tier 1 (upper tier)	80%
Tier 2 (middle tier)	15%
Tier 3 (lower tier)	5%

Family details

A man is assumed to be 3 years older than his spouse, civil partner or cohabitee. A woman is assumed to be 3 years younger than her spouse, civil partner or cohabitee.

80% of non-pensioners are assumed to be married / cohabitating at retirement or earlier death.

80% of pensioners are assumed to be married / cohabitating at age 65.

Commutation

Each member is assumed to take cash such that the total cash received (including statutory 3N/80 lump sum) is 80% of the permitted maximum amount permitted of their past service pension entitlements.

Take up of 50/50 scheme

All members are assumed to remain in the scheme which they are in at the valuation date.

Promotional salary increases

Allowance is made for age-related promotional increases.

Expenses

0.5% of Pensionable Pay added to the cost of future benefit accrual.

Method and assumptions used in calculating the cost of future accrual

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target.

For most employers, the actuarial method to be used is the Projected Unit method with a one year control period. For employers who do not permit new employees to join the Fund, the actuarial method to be used is the Attained Age method. Under both funding methods the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service.

Summary of key whole Fund principal financial assumptions used for calculating funding target and cost of future accrual (the “normal cost”) for the 2013 actuarial valuation

Discount rate (in service)	4.5% for Scheduled, Resolution and Bodies with subsumption guarantees 4.1 % (Orphan Admission Bodies)
Discount rate (left service)	4.5% Scheduled, Resolution and Bodies with subsumption guarantees 2.5% (Orphan Admission Bodies) 4.1% (transitional basis used in exceptional circumstances where it is unclear whether a formal subsumption commitment exists and where the employer has historically been set a subsumption funding target)
Rate of general pay increases	3.25%
Rate of price inflation (RPI)	3.1%
Rate of price inflation (CPI)	2.0%
Rate of pension increases (on benefits in excess of GMPs)	2.0%
Rate of pension increases on post-88 GMPs	1.8%
Rate of deferred pension increases	2.0%
Rate of GMP increases in deferment	3.25%