

# FUNDING STRATEGY STATEMENT

## DYFED PENSION FUND

[APRIL 2021]

Carmarthenshire County Council

This Funding Strategy Statement has been prepared by Carmarthenshire County Council (the Administering Authority) to set out the funding strategy for the Dyfed Pension Fund (“the Fund”), in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

## EXECUTIVE SUMMARY

Ensuring that the Dyfed Pension Fund (the “Fund”) has sufficient assets to meet its pension liabilities in the long term is the fiduciary responsibility of the Administering Authority (Carmarthenshire County Council). The funding strategy adopted by the Dyfed Pension Fund will be critical in achieving this.

The purpose of this Funding Strategy Statement (“FSS”) is to set out a clear and transparent funding strategy that will identify how each Fund employer’s pension liabilities are to be met going forward.

The details contained in this Funding Strategy Statement will have a financial and operational impact on all participating employers in the Dyfed Pension Fund.

It is imperative therefore that each existing or potential employer is aware of the details contained in this statement.

Given this, and in accordance with governing legislation, all interested parties connected with the Dyfed Pension Fund have been consulted and given opportunity to comment prior to this Funding Strategy Statement being finalised and adopted. This statement takes into consideration all comments and feedback received.



### MEETING THE FUND’S SOLVENCY OBJECTIVE

The Administering Authority’s long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period. Contributions are set in relation to this objective which means that once 100% solvency is achieved, if the assumptions are borne out in practice, there would be sufficient assets to pay all benefits earned up to the valuation date as they fall due.

The general principle adopted by the Fund is that the assumptions used, taken as a whole, will be sufficiently prudent for this objective to be reasonably achieved in the long term at each valuation.

However, because financial and market conditions/outlook change between valuations, the assumptions used at one valuation may need to be amended at the next to meet the primary objectives. This in turn means that contributions will be subject to change from one valuation to another. This objective is considered on an employer specific level when setting individual contribution rates so each employer has the same fundamental objective in relation to their liabilities.

The funding strategy set out in this document has been developed alongside the Fund’s investment strategy on an integrated basis taking into account the overall financial and demographic risks inherent in the Fund to meet the objective for all employers over different periods. The funding strategy includes appropriate margins to allow for the possibility of adverse events (e.g. material reduction in investment returns, economic downturn and higher inflation

outlook) leading to a worsening of the funding position which would normally lead to volatility of contribution rates at future valuations if these margins were not included. This prudence is required by the Regulations and guidance issued by professional bodies and Government agencies to assist the Fund in meeting its primary solvency objective. The level of prudence has been quantified by the Actuary to provide protection against future adverse experience in the long term. Individual employer results will also have regard to their covenant strength and the investment strategy applied to the asset shares of those employers.



### LONG TERM COST EFFICIENCY

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency requires that any funding plan must provide equity between different generations of taxpayers. This means that the contributions must not be set at a level that is likely to give rise to additional costs in the future which fall on later generations of taxpayers or put too high a burden on current taxpayers. The funding parameters and assumptions e.g. deficit recovery period must have regard to this requirement which means a level of prudence is needed. Furthermore, the FSS must have regard to the desirability of maintaining as nearly constant a primary rate of contributions as possible.

When formulating the funding strategy, the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the "solvency" of the pension fund and "long term cost efficiency" of the Scheme so far as relating to the Fund.



### THE MCCLOUD JUDGMENT

The McCloud judgment in the LGPS refers to the legal decisions (initially by the Employment Appeal Tribunal and then ratified by the Court of Appeal) in the Sargeant/McCloud cases for the Fire and Judiciary pension arrangements. The Court ruled that transitional protections afforded to older members when these schemes were amended constituted unlawful age discrimination. Remedial action, in the form of benefit changes for these schemes, will therefore be required.

Although the above cases did not relate directly to the LGPS, the LGPS also put in place protections for older members as part of the reforms which came into effect from 2014. For the LGPS these took the form of an underpin, where older members would get the better of the benefits payable under the new and old schemes. The UK Government confirmed on 15 July 2019 that, alongside the process to remedy the Fire and Judiciary schemes, it will also bring forward proposals to address the issue for the other public service pension schemes, including the LGPS, although it is unclear at this stage what the exact extent will be of any required changes.

In carrying out the 2019 actuarial valuation a provision for the potential costs has been made. In particular it has been assumed that the eventual remedy will be that the underpin which applies to older members will also apply to younger members who joined the Fund before 1 April 2012 (the cut-off date for the protections to apply) in the same way as for older members. For formal presentation purposes, in line with guidance issued by the LGPS Scheme Advisory Board, the whole fund valuation result reported does not include the cost of McCloud. The costs have, however, been included within employer contribution plans.

## DEFICIT RECOVERY PLAN AND CONTRIBUTIONS



The solvency level of the Fund is 105% at the valuation date i.e. there is a small surplus of assets over liabilities (if the effect of the McCloud judgment were to be included then this solvency level would be slightly less, at 104%). However, for many employers in the Fund the funding level will be less than 100% - i.e. their assets within the Fund are less than their liabilities. In these cases, a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall. (In a similar manner, where an employer is in surplus it may in certain circumstances be appropriate to reduce the overall contributions payable to reflect this, by way of a “surplus offset”.)

Deficit contributions paid to the Fund by each employer will be expressed as £s amounts (flat or increasing year on year) and it is the Fund’s objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford given other competing cost pressures. This may result in some flexibility in recovery periods by employer which would be at the sole discretion of the Administering Authority. The recovery periods will be set by the Fund, although employers will be free to select any shorter deficit recovery period if they wish. Selected employers may also elect to make prepayments of contributions which could result in cash savings over the period of the valuation certificate.

The objective is to recover any deficit over a reasonable timeframe, and this will be periodically reviewed. Full details are set out in this FSS.

Subject to affordability and other considerations, the end point of individual employer recovery plans is expected to be maintained at this valuation, which means that recovery periods will normally be three years shorter than at the 2016 actuarial valuation. The target recovery period for employers at this valuation is therefore 11 years (3 years less than the corresponding target of 14 years from the previous valuation). In practice, individual employer circumstances could cause their recovery period to be different from this.

Over and above this, the Fund is now giving more recognition to the potential liabilities in the event that an employer will exit the Fund at some point. With this in mind, closed employers will normally have their contributions underpinned at existing levels. In addition, any employer in surplus on the ongoing actuarial valuation assumptions will not normally be allowed to use that surplus to offset its future contribution requirements to the Fund. These restrictions will not apply if the body has a surplus on its termination basis: in this event a surplus on the termination basis may be used to offset future contribution requirements.

In order to allow employers time to adjust their budgets, contributions for 2020/21 will normally be maintained at their existing levels, other than for the major scheduled bodies, before moving to the new rates in 2021/22. Where there is a material increase in contributions required at this valuation, in certain circumstances the Fund may agree to the increase being phased in over the period to 2022/23.



## ACTUARIAL ASSUMPTIONS

The actuarial assumptions used for assessing the funding position of the Fund and the individual employers, the “Primary” contribution rate, and any contribution variations due to underlying surpluses or deficits (i.e. the “Secondary” rate) are set out in Appendix A to this FSS.

The discount rate in excess of CPI inflation (the “real discount rate”) has been derived based on the expected return on the Fund’s assets based on the long term strategy set out in its Investment Strategy Statement (ISS). When assessing the appropriate prudent discount rate, consideration has been given to the level of expected asset returns in excess of CPI inflation (i.e. the rate at which the benefits in the LGPS generally increase each year).

The assumption for the long term expected future real returns has fallen since the last valuation. This is principally due to a combination of expectations for the returns on the Fund’s assets and the level of inflation in the long term. The assumption has therefore been adjusted so that in the Actuary’s opinion, when allowing for the resultant employer contributions emerging from the valuation, the Fund can reasonably be expected to meet the Solvency and Long Term Cost Efficiency objectives.

Taking into account the above the Fund Actuary is proposing that the long term real return over CPI inflation assumptions for determining the past service liabilities should be 1.70% per annum and 2.25% per annum for determining the future service (“primary”) contribution rate. This compares to 2.20% per annum and 2.75% per annum respectively at the last valuation.

The demographic assumptions are based on the Fund Actuary’s bespoke analysis for the Fund, also taking into account the experience of the wider LGPS where relevant.



## EMPLOYER ASSET SHARES

The Fund is a multi-employer pension scheme that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is necessary to make some approximations in the timing of cash flows and allocation of investment returns when deriving each employer’s asset share.

At each review, cash flows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation.

Other adjustments are also made on account of the funding positions of orphan bodies which fall to be met by all other active employers in the Fund. In addition, the asset shares may be restated for changes in data or other policies.



## FUND POLICIES

In addition to the information/approaches required by overarching guidance and Regulation, this statement also summarises the Fund’s practice and policies in a number of key areas:

### 1. Covenant assessment and monitoring

An employer’s financial covenant underpins its legal obligation and crucially the ability to meet its financial responsibilities to the Fund now and in the future. The strength of covenant to the Fund effectively underwrites the risks to which the Fund is exposed. These risks include underfunding, longevity, investment and market forces.

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital to the overall risk management and governance of the Fund. The employers’ covenants will be assessed and

monitored objectively in a proportionate manner, and an employer's ability to meet their obligations in the short and long term will be considered when determining its funding strategy.

After the valuation, the Fund will continue to monitor employers' covenants in conjunction with their funding positions over the inter-valuation period. This will enable the Fund to anticipate and pre-empt any material issues arising and thus adopt a proactive approach in partnership with the employer. More details are provided in the relevant appendix to this statement.

## 2. Admitting employers to the Fund

Various types of employers are permitted to join the LGPS under certain circumstances, and the conditions upon which their entry to the Fund is based on the Fund's separately maintained policy. Examples of new employers include:

- Scheme Employers
- Designated bodies - those that are permitted to join if they pass a resolution
- Admission bodies - usually arising as a result of an outsourcing or a transfer to an entity that provides some form of public service and their funding primarily derives from local or central government.

Certain employers may be required to provide a guarantee or alternative security before entry will be allowed, in accordance with the Regulations and Fund policies.

The key objective for the Fund is to only admit employers where the risk to the Fund is mitigated as far as possible.

## 3. Termination policy for employers exiting the Fund

When an employer ceases to participate within the Fund, it becomes an exiting employer under the Regulations. The Fund is then required to obtain an actuarial valuation of that employer's liabilities in respect of the benefits of the exiting employer's current and former employees, along with a termination contribution certificate.

The policy for employers who **do not have a guarantor** participating in the Fund:

Where there is no guarantor who would subsume the liabilities of the exiting employer, the Fund's policy is that a more prudent discount rate linked to corporate bond yields and a more prudent life expectancy assumption is used for assessing liabilities on termination. Any exit payments due should be paid immediately although instalment plans will be considered by the Administering Authority on a case by case basis. The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it.

Any exit credits (surplus assets over liabilities) will be paid from the Fund to the exiting employer following certification by the Actuary. The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it.

The policy for employers who **have a guarantor** participating in the Fund:

Where there is a **guarantor** who could subsume the liabilities, the termination position is assessed using an "ongoing" valuation basis, so consistent with the funding target assumptions.

The Fund's general policy is that recovery of deficit and surplus should be treated in a consistent manner. Therefore:

- Where all parties agree to such treatment, any deficit or surplus would normally be subsumed by the guarantor
- Otherwise, any surplus would normally be paid to the exiting employer, and any deficit would be paid immediately by the exiting employer if possible, and the guarantor otherwise, although instalment plans or temporary suspension of the payment may be considered by the Administering Authority on a case by case basis. Further details are set out in the Termination Policy in Appendix C.

The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it based on the advice of the Actuary and taking into account any separate contractual agreements that have been put in place between the exiting employer and the guarantor.

In practice, in the event of a surplus the Administering Authority will also have regard to the provisions of The Local Government Pension Scheme (Amendment) Regulations 2020 in determining the amount of any exit credit payable, and any such amount determined will be paid to the exiting employer within 6 months of cessation or such longer period as may be agreed in the individual case.

The policy for repayment of exit debts:

The default position for exit payments is that they are paid in full at the point of exit (adjusted for interest where appropriate). At the discretion of the administering authority, instalment plans over an agreed period or a Deferred Debt Agreement may be entered into. If an employer requests that an exit debt payment is recovered over a fixed period of time or that they wish to enter into a Deferred Debt Agreement with the Fund, they must make a request in writing covering the reasons for such a request. Any deviation from this position will be based on the Administering Authority's assessment of whether the full exit debt is affordable and whether it is in the interests of taxpayers to adopt either of the approaches. In making this assessment the Administering Authority will consider the covenant of the employer and also whether any security is required and available to back the arrangements. Further details are set out with in Appendix C.

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# 1

## INTRODUCTION

The Local Government Pension Scheme Regulations 2013 (“the 2013 Regulations”) and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 (“the 2014 Transitional Regulations”) and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (all as amended) (collectively, “the Regulations”) provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Dyfed Pension Fund the Administering Authority will prepare and publish its funding strategy;
- In preparing the FSS, the Administering Authority must have regard to:
  - the guidance issued by CIPFA for this purpose; and
  - the Investment Strategy Statement (ISS) for the Scheme published under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy set out in the FSS or the ISS.

### BENEFITS

The benefits provided by the Dyfed Pension Fund are specified in the governing legislation contained in the Regulations referred to above. Benefits payable under the Dyfed Pension Fund are guaranteed by statute and thereby the pensions promise is secure for members. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time facilitating scrutiny and accountability through improved transparency and disclosure.

The Fund is a defined benefit arrangement with principally final salary related benefits from contributing members up to 1 April 2014 and Career Averaged Revalued Earnings (“CARE”) benefits earned thereafter. There is also a “50:50 Scheme Option”, where members can elect to accrue 50% of the full scheme benefits in relation to the member only and pay 50% of the normal member contribution.

### EMPLOYER CONTRIBUTIONS

The required levels of employee contributions are specified in the Regulations. Employer contributions are determined in accordance with the Regulations (which require that an actuarial valuation is completed every three years by the Fund Actuary, including a rates and adjustments certificate specifying the “primary” and “secondary” rate of the employer’s contribution).

### PRIMARY RATE

The “Primary rate” for an employer is the contribution rate required to meet the cost of the future accrual of benefits, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer’s covenant.

The Primary rate for the whole fund is the weighted average (by payroll) of the individual employers' Primary rates.

## **SECONDARY RATE**

The "Secondary rate" is an adjustment to the Primary rate to reflect any past service deficit or surplus, to arrive at the rate each employer is required to pay. The Secondary rate may be expressed as a percentage adjustment to the Primary rate, and/or a cash adjustment in each of the three years beginning 1 April in the year following that in which the valuation date falls.

The Secondary rate is specified in the rates and adjustments certificate.

For any employer, the rate they are actually required to pay is the sum of the Primary and Secondary rates.

Secondary rates for the whole fund in each of the three years shall also be disclosed. These will be the calculated weighted average based on the whole fund payroll in respect of percentage rates and the total amount in respect of cash adjustments.

# 2

## PURPOSE OF THE FSS IN POLICY TERMS

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the Fund Actuary.

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and maintain sufficient assets in order for it to pay all benefits arising as they fall due.

The purpose of this Funding Strategy Statement is therefore:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward by taking a prudent longer-term view of funding those liabilities;
- to establish contributions at a level to "secure the solvency" of the pension fund and the "long term cost efficiency",
- to have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the Administering Authority to implement and maintain.

# 3

## AIMS AND PURPOSE OF THE FUND

### THE AIMS OF THE FUND ARE TO:

- manage employers' liabilities effectively and ensure that sufficient resources (i.e. liquid assets) are available to meet all liabilities as they fall due
- enable employer contribution rates to be kept at a reasonable and affordable cost to the taxpayers, scheduled, designating and admitted bodies, while achieving and maintaining fund solvency and long term cost efficiency, which should be assessed in light of the profile of the Fund now and in the future due to sector changes
- maximise the returns from investments within reasonable risk parameters taking into account the above aims.

### THE PURPOSE OF THE FUND IS TO:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses as defined in the Regulations.

# 4

## RESPONSIBILITIES OF THE KEY PARTIES

The efficient and effective management of the pension fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently. The key parties for the purposes of the FSS are the Administering Authority (and, in particular the Pensions Committee), the individual employers and the Fund Actuary and details of their roles are set out below. Other parties required to play their part in the fund management process are bankers, custodians, investment managers, auditors and legal, investment and governance advisors, along with the Local Pensions Board created under the Public Service Pensions Act 2013.

### KEY PARTIES TO THE FSS

The **Administering Authority** should:

- operate the pension fund
- collect employer and employee contributions, investment income and other amounts due to the pension fund as stipulated in the Regulations
- pay from the pension fund the relevant entitlements as stipulated in the Regulations
- invest surplus monies in accordance with the Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- take measures as set out in the Regulations to safeguard the fund against the consequences of employer default
- manage the valuation process in consultation with the Fund Actuary
- prepare and maintain a FSS and an ISS, both after proper consultation with interested parties, and
- monitor all aspects of the Fund's performance and funding, amending the FSS/ISS as necessary
- effectively manage any potential conflicts of interest arising from its dual role as both fund administrator and a scheme employer, and
- establish, support and monitor a Local Pension Board (LPB) as required by the Public Service Pensions Act 2013, the Regulations and the Pensions Regulator's relevant Code of Practice.

The **Individual Employer** should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations), unless they are a Deferred Employer
- pay all contributions, including their own as determined by the Fund Actuary, promptly by the due date
- develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain, and
- have regard to the Pensions Regulator's focus on data quality and comply with any requirement set by the Administering Authority in this context, and

- notify the Administering Authority promptly of any changes to membership which may affect future funding.
- Understand the pension impacts of any changes to their organisational structure and service delivery model
- Understand that the quality of the data provided to the Fund will directly impact on the assessment of the liabilities and contributions. In particular, any deficiencies in the data would normally result in the employer higher contributions than otherwise would be the case if the data was high of quality

The **Fund Actuary** should:

- prepare valuations including the setting of employers' contribution rates at a level to ensure fund solvency after agreeing assumptions with the Administering Authority and having regard to their FSS and the Regulations
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill health retirement costs etc
- provide advice and valuations on the termination of admission agreements
- provide advice to the Administering Authority on bonds and other forms of security against the financial effect on the Fund of employer default
- assist the Administering Authority in assessing whether employer contributions need to be revised between valuations as required by the Regulations
- advise on funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the ISS, and
- ensure the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to the Fund Actuary's role in advising the Fund.

The **Fund's Investment Manager(s)** should:

- invest funds given in accordance with the ISS and the Investment Management Agreement (IMA)
- meet investment performance targets and risk constraints, and
- comply with all the legislative, commercial and mandate requirements.

# 5

## SOLVENCY FUNDING TARGET

Securing the “solvency” and “long term cost efficiency” is a regulatory requirement. To meet these requirements, the Administering Authority’s long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the “funding target”) assessed on an ongoing past service basis including allowance for projected final pay where appropriate. In the long term, an employer’s total contribution rate would ultimately revert to its Primary rate of contribution.

### SOLVENCY AND LONG TERM EFFICIENCY

Each employer’s contributions are set at such a level to achieve full solvency in a reasonable timeframe. Solvency is defined as a level where the Fund’s liabilities i.e. benefit payments can be reasonably met as they arise.

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time.

When formulating the funding strategy, the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary’s Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the “solvency” of the pension fund and “long term cost efficiency” of the Scheme so far as relating to the Fund.

### DETERMINATION OF THE SOLVENCY FUNDING TARGET AND DEFICIT RECOVERY PLAN

The principal method and assumptions to be used in the calculation of the funding target are set out in **Appendix A**. The Employer Deficit Recovery Plans are set out in **Appendix B**.

Underlying these assumptions are the following two tenets:

- that the Fund is expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

This allows the Fund to take a longer term view when assessing the contribution requirements for certain employers.

In considering this the Administering Authority, based on the advice of the Fund Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful potentially taking into account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2020 at the latest.

As part of each valuation separate employer contribution rates are assessed by the Fund Actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the distinct employers and employer groups in the Fund.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2019 actuarial valuation:

Individual employer contributions will be expressed and certified as two separate elements:

- the **Primary rate**: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits
- the **Secondary rate**: a schedule of lump sum monetary amounts over 2020/23 in respect of an employer's surplus or deficit

For any employer, the total contributions they are actually required to pay in any one year is the sum of the Primary and Secondary rates (subject to an overall minimum of zero). Both elements are subject to further review from April 2023 based on the results of the 2022 actuarial valuation.

## RECOVERY PLAN

It is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Administering Authority's view of the employer's covenant and risk to the Fund.

Recovery periods will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. This will determine the minimum contribution requirement and employers will be free to select any shorter deficit recovery period and higher contributions if they wish, including the option of prepaying the deficit contributions in one lump sum either on an annual basis or a one-off payment. This will be reflected in the monetary amount requested via a reduction in overall deficit contributions payable. The Administering Authority does retain ultimate discretion in applying these principles for individual employers on grounds of affordability and covenant strength.

The key principles when considering deficit recovery are as follows:

- The Fund does not believe it appropriate for monetary contribution reductions to apply compared to the existing funding plan (allowing for indexation of deficit contributions where applicable) where deficits remain unless there is a compelling reason to do so.
- Certain employers may follow a bespoke investment and funding strategy pertaining to their own circumstances determined by their risk and maturity characteristics. This will be documented separately.
- As a general rule the deficit recovery period will reduce by at least 3 years for employers at this valuation when compared to the preceding valuation. This is to target full solvency over a similar (or shorter) time horizon. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. Subject to affordability considerations and other factors, a bespoke period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Recovery Plan in **Appendix B**).

Application of these principles has resulted in the target recovery period of 11 years being adopted across Fund employers.

- Subject to affordability and other considerations, the end point of individual employer recovery plans is expected to be maintained at this valuation, which means that recovery periods will normally be three years shorter than at the 2016 actuarial valuation. The target recovery period for employers at this valuation is therefore 11 years (3 years less than the corresponding target of 14 years from the previous valuation). In practice, individual employer circumstances could cause their recovery period to be different from this.
- Over and above this, the Fund is now giving more recognition to the potential liabilities in the event that an employer will exit the Fund at some point. With this in mind, closed employers will normally have their contributions underpinned at existing levels. In addition, any employer in surplus on the ongoing actuarial valuation assumptions will not normally be allowed to use that surplus to offset its future contribution requirements to the Fund. These restrictions will not apply if the body has a surplus on its termination basis: in this event a surplus on the termination basis may be used to offset future contribution requirements.
- In order to allow employers time to adjust their budgets, contributions for 2020/21 will normally be maintained at their existing levels, other than for the major scheduled bodies, before moving to the new rates in 2021/22. Where there is a material increase in contributions required at this valuation, in certain circumstances the Fund may agree to the increase being phased in over the period to 2022/23. Employers should be aware that any stepping or deferral of increases may affect the contribution requirements arising at future valuations.

## CEASING PARTICIPATION IN THE FUND

On the cessation of an employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment.

The policy for employers who have a **guarantor** participating in the Fund is as follows:

The residual assets and liabilities and hence any surplus or deficit will transfer back to the guarantor. This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor.

Otherwise, in the event of a deficit, the Fund will seek to recover this from the exiting employer in the first instance. However, if this is not possible, then to maintain a consistent approach between treatment of surplus and deficit, the Fund will then seek to recover the deficit from the guarantor via an additional cash payment, unless otherwise agreed with the Administering Authority. In the event of a surplus the Administering Authority will have regard to the provisions of The Local Government Pension Scheme (Amendment) Regulations 2020 in determining the amount of any exit credit payable, and any such amount determined will be paid to the exiting employer within 6 months of cessation or such longer period as may be agreed in the individual case.

If requested, the Administering Authority will provide details of the information considered as part of the determination. A determination notice will be provided alongside the termination assessment from the Actuary. The notice will cover the following information and process steps:

1. Details of the employers involved in the process (e.g. the exiting employer and guarantor).
2. Details of the admission agreement, commercial contracts and any amendments to the terms that have been made available to the Administering Authority and considered as part of the decision making process. The underlying principle will be that if an employer is responsible for a deficit, they will be eligible for any surplus. This is subject to the information provided and any risk sharing arrangements in place.
3. The final termination certification of the exit credit by the Actuary.
4. The Administering Authority's determination based on the information provided.
5. Details of the appeals process in the event that a party disagrees with the determination and wishes to make representations to the Administering Authority.

The policy for employers who **do not** have a **guarantor** participating in the Fund is:

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 6 months of cessation or such longer period as may be agreed in the individual case).
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.
- The Administering Authority can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary. The termination policy is set out in Appendix C.

In all cases the Administering Authority reserves the right to apply a different approach at its sole discretion, taking into account the risk associated with an employer in proportion to the Fund as a whole. Any employer affected will be notified separately.

At the discretion of the Administering Authority, repayment plans over an agreed period or a Deferred Debt Agreement may be agreed subject to the Fund's policy in relation to flexibilities in recovering exit payments.

Further detail is available in the Termination Policy in **Appendix C**.

## FUNDING FOR NON-ILL HEALTH EARLY RETIREMENT COSTS

Employers are required to meet all costs of early retirement strain by immediate capital payments into the Fund, or in certain circumstances by agreement with the Fund, through instalments over a period not exceeding 3 years or if less the remaining period of the body's membership of the Fund.

## FUNDING FOR ILL HEALTH RETIREMENT COSTS

Should a member retire on ill health grounds, this will normally result in a funding strain for that employer (i.e. increased liability). The size of any funding strain will depend on how the cost of that ill health retirement compares with the expected cost built in the actuarial assumptions for that employer. The actual cost will also depend on the level of any benefit enhancements awarded (which depend on the circumstances of the ill health retirement) and also how early the benefits are brought into payment. Because the cost of an individual ill-health retirement can be substantial in relation to an employer's contribution requirements, the Fund has introduced a "captive" whereby the costs of

ill health retirements (other than for the five major scheduled employers) will be spread across a wider employer base. The treatment of any ill-health retirement strain cost emerging will therefore vary depending on the type of employer:

- For those employers who participate in the ill-health captive, any ill-health retirement strain cost emerging will be met by a contribution from the captive fund as part of the subsequent actuarial valuation (or termination assessment if sooner). No additional contributions will be due immediately from the employer although an adjustment to the “premium” payable may emerge following the subsequent actuarial valuation, depending on the overall experience of the captive fund.
- For those employers who do not participate in the ill-health captive, the “primary rate” payable over 2020/23 will include an allowance for ill-health retirement costs (alongside any allowance made for voluntary early retirements). Where ill-health retirement strain costs exceed an employer’s allowance over the inter-valuation period (or should an employer not have an allowance within their “primary rate”), the excess strain costs will be included in the employer’s deficit (and subsequent deficit contributions) at the 2022 valuation.

# 6

## LINK TO INVESTMENT POLICY AND THE INVESTMENT STRATEGY STATEMENT (ISS)

The results of the 2019 valuation show the liabilities to be 105% covered by the current assets (104% if the estimated effects of the McCloud judgment were to be allowed for), so there is a small surplus of existing assets over the past service liabilities.

In assessing the value of the Fund's liabilities in the valuation, allowance has been made for growth asset out-performance as described below, taking into account the investment strategy adopted by the Fund, as set out in the ISS.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is normally possible to construct a portfolio which represents the "minimum risk" investment position which would deliver a very high certainty of real returns above assumed CPI inflation. Such a portfolio would typically, in normal circumstances, consist of a mixture of long-term index-linked, fixed interest gilts and possible swaps.

Investment of the Fund's assets in line with this portfolio would minimise fluctuations in the Fund's funding position between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out this valuation it would not be appropriate to make any allowance for growth assets out-performance nor any adjustment to market implied inflation assumption due to supply/demand distortions in the bond markets. This would result in real return versus CPI inflation of negative 0.9% per annum at the valuation date. On this basis of assessment, the assessed value of the Fund's liabilities at the valuation would have been significantly higher, resulting in a funding level of 65%.

Departure from a minimum risk investment strategy, in particular to include growth assets such as equities, gives a better prospect that the assets will, over time, deliver returns in excess of CPI inflation and reduce the contribution requirements. The target solvency position of having sufficient assets to meet the Fund's pension obligations might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The current strategy is shown opposite.

	<b>Benchmark %</b>	<b>Range %</b>
US	8.0	3.0 - 13.0
Japan	4.00	0.0 - 9.0
Other regional	33.00	28.0 - 38.0
Global Equities	20.0	15.0 - 25.0
Fixed Income	10.0	5.0 - 15.0
Pan European Property	15.0	10.0 - 20.0
Infrastructure	5.0	3.5 - 6.5
Alternatives	5.0	3.5 - 6.5
<b>TOTAL</b>	<b>100.0</b>	

Based on the investment strategy in the ISS and the Actuary's assessment of the return expectations for each asset class, the overall best estimate average expected return is 2.7% per annum in excess of CPI inflation as at the valuation date. For the purposes of setting funding strategy however, the Administering Authority believes that it is appropriate to take a margin for prudence on these return expectations, and this is expected under the Regulations and guidance.

# 7

## IDENTIFICATION OF RISKS AND COUNTER-MEASURES

The funding of defined benefits is by its nature uncertain. Funding of the Scheme is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the Fund Actuary that the greatest risk to the funding level is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that assumed in the long term. The Actuary's formal valuation report includes a quantification of some of the major risk factors.

### FINANCIAL

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Market outlook moves at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- Future underperformance arising as a result of participating in the All Wales pool.
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.

Any increase in employer contribution rates (as a result of these risks), may in turn impact on the service delivery of that employer and their financial position.

In practice the extent to which these risks can be reduced is limited. However, the Fund's asset allocation is kept under constant review and the performance of the investment managers is regularly monitored.

### DEMOGRAPHIC

The demographic risks are as follows:-

- Future changes in life expectancy (longevity) cannot be predicted with any certainty
- Potential strains from ill health retirements, over and above what is allowed for in the valuation assumptions
- Unanticipated acceleration of the maturing of the Fund resulting in materially negative cashflows and shortening of liability durations

Increasing longevity is something which government policies, both national and local, are designed to promote. It does, however, result in a greater liability for pension funds.

Ill health retirements can be costly for employers, particularly small employers where one or two costly ill health retirements can take them well above the “average” implied by the valuation assumptions. Increasingly we are seeing employers mitigate the number of ill health retirements by employing HR / occupational health preventative measures. These in conjunction with ensuring the regulatory procedures in place to ensure that ill-health retirements are properly controlled, can help control exposure to this demographic risk. As described above, for smaller employers the Fund has also implemented an internal “captive” approach to spreading the cost of ill-health retirements across a wider employer base. Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, **employing bodies should be doing everything in their power to minimise the number of ill-health retirements.** Early retirements for reasons of redundancy and efficiency do not affect the solvency of the Fund because they are the subject of a direct charge.

With regards to increasing maturity (e.g. due to further cuts in workforce and/or restrictions on new employees accessing the Fund), the Administering Authority regularly monitors the position in terms of cashflow requirements and considers the impact on the investment strategy.

## INSURANCE OF CERTAIN BENEFITS

The contributions for any employer may be varied as agreed by the Fund Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund.

## REGULATORY

The key regulatory risks are as follows:-

- Changes to Regulations, e.g. changes to the benefits package, retirement age, potential new entrants to scheme,
- Changes to national pension requirements and/or HMRC Rules

Membership of the Local Government Pension Scheme is open to all local government staff and should be encouraged as a valuable part of the contract of employment. However, increasing membership does result in higher employer monetary costs.

## GOVERNANCE

The Fund has done as much as it believes it reasonably can to enable employing bodies and scheme members (via their trades unions) to make their views known to the Fund and to participate in the decision-making process. This version of the FSS is being consulted on from December 2019 and the final Statement will be formally approved prior to 31 March 2020 in accordance with Council delegations.

Governance risks are as follows:-

- The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated
- Administering Authority unaware of structural changes in employer’s membership (e.g. large fall in employee numbers, large number of retirements) with the result that contribution rates are set at too low a level
- Administering Authority not advised of an employer closing to new entrants, something which would normally require an increase in contribution rates
- An employer ceasing to exist with insufficient funding or adequacy of a bond
- Changes to senior Fund Officers and the Panel membership.

For these risks to be minimised much depends on information being supplied to the Administering Authority by the employing bodies. Arrangements are strictly controlled and monitored, but in most cases the employer, rather than the Fund as a whole, bears the risk.

# 8

## MONITORING AND REVIEW

The Administering Authority has taken advice from the Fund Actuary in preparing this Statement, and has consulted with the employers participating in the Fund.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of the current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example, if there:

- has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- have been significant changes to the Scheme membership, or LGPS benefits e.g. resolution of the McCloud remedy
- have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy
- have been any significant special contributions paid into the Fund
- has been a change in Regulations or Guidance which materially impacts on the policies within the funding strategy.

When monitoring the funding strategy, if the Administering Authority considers that any action is required, the relevant employing authorities will be contacted. In the case of an employer who may exit the Fund, there is statutory provision for rates to be amended between valuations and this will be considered in conjunction with the employer affected and any associated guarantor of the employer's liabilities (if relevant).

### REVIEW OF CONTRIBUTIONS

In line with the Regulations, the Administering Authority has the ability to review employer contributions between valuations. The Administering Authority and employers now have the following flexibilities:

1. The Administering Authority may review the contributions of an employer where there has been a significant change to the liabilities of an employer.
2. The Administering Authority may review the contributions of an employer where there has been a significant change in the employer's covenant.
3. An employer may request a review of contributions from the Administering Authority if they feel that either point 1 or point 2 applies to them.

Consideration will be given to any risk sharing arrangements (e.g. cap and collar arrangements) when reviewing contribution rates. Further information is set out within the policy in Appendix E.

## THE MCCLOUD JUDGMENT

The cost management process was set up by HMT, with an additional strand set up by the Scheme Advisory Board (for the LGPS). The aim of this was to control costs for employers and taxpayers via adjustments to benefits and/or employee contributions.

As part of this, it was agreed that employers should bear the costs/risks of external factors such as the discount rate, investment returns and inflation changes, whereas employees should bear the costs/risks of other factors such as wage growth, life expectancy changes, ill health retirement experience and commutation of pension.

The outcomes of the cost management process were expected to be implemented from 1 April 2019, based on data from the 2016 valuations for the LGPS. This has now been put on hold due to age discrimination cases brought in respect of the firefighters and judges schemes, relating to protections provided when the public sector schemes were changed (which was on 1 April 2014 for the LGPS and 1 April 2015 for other Schemes).

The Government have confirmed that this judgment will result in a remedy being required for the LGPS. The Scheme Advisory Board issued guidance which sets out how the McCloud case should be allowed for within the 2019 valuation.

Therefore, the Fund has considered its policy in relation to costs that could emerge from the McCloud judgment in line with the guidance from the Scheme Advisory Board in conjunction with the Actuary. Whilst the remedy is not known and may not be known for some time, for the purpose of this valuation, when considering the appropriate contribution provision, we have assumed that the judgment would have the effect of removing the current age criteria applied to the underpin implemented in 2014 for the LGPS. This underpin therefore would apply to all active members as at 1 April 2012. The relevant estimated costs have been quantified and included within the contribution requirements quoted as part of the 2019 actuarial valuation for individual employers. For whole fund reporting purposes, in line with guidance issued by the LGPS Scheme Advisory Board, the McCloud costs have not been included within the disclosed funding level or primary contribution rate. The effects have, however, been separately quantified and are set out in the actuarial valuation report.

# APPENDIX A

## ACTUARIAL METHOD AND ASSUMPTIONS

### METHOD

The actuarial method to be used in the calculation of the solvency funding target 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. This method implicitly allows for new entrants to the scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted, which makes advance allowance for the anticipated future ageing and decline of the current closed membership group potentially over the period of the rates and adjustments certificate.

### FINANCIAL ASSUMPTIONS – SOLVENCY FUNDING TARGET

#### Investment return (discount rate)

The past service discount rate has been derived based on the expected return on the Fund assets based on the long term strategy set out in the Investment Strategy Statement (ISS). It includes appropriate margins for prudence. When assessing the appropriate discount rate consideration has been given to the returns in excess of CPI inflation (as derived below). The discount rate at the valuation has been derived based on an assumed return of 1.7% per annum above CPI inflation i.e. a real return of 1.7% per annum equivalent to a total discount rate of 4.1% per annum. This real return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics. The discount rate will be reviewed as a matter of course at the time of a formal valuation or a formal employer rate review.

For those employers who are funding on a corporate bond based the discount rate used will be linked directly to the yields available of corporate bond assets of an appropriate duration.

#### Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities, but subject to the following two adjustments:

- an allowance for supply/demand distortions in the bond market is incorporated, and
- an adjustment due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index

The overall reduction to RPI inflation to account for the above at the valuation date is 1.0% per annum. This adjustment to the RPI inflation assumption will be reviewed from the valuation date to take into account any reform in the RPI index, as announced by the Chancellor of the Exchequer. The change will then be implemented for the policies set out in this statement.

#### Salary increases

In relation to benefits earned prior to 1 April 2014, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% per annum over

the inflation (CPI) assumption as described above. This includes allowance for promotional increases.

### Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions where the LGPS is not required to provide full indexation). For members in pensionable employment, their CARE benefits are also indexed by CPI although this can be less than zero i.e. a reduction in benefits, whereas for pension increases this cannot be negative, as pensions cannot be reduced.

## DEMOGRAPHIC ASSUMPTIONS

### Mortality/Life Expectancy

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the Fund. The mortality tables used are set out below, with a loading reflecting Fund specific experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Fund Actuary. A specific mortality assumption has also been adopted for current members who retire on the grounds of ill health. For all members, it is assumed that the accelerated trend in longevity seen over recent time periods (as evidenced in the 2018 CMI analysis) will continue in the longer term and as such, the assumptions build in a level of longevity 'improvement' year on year in the future in line with the CMI 2018 projections and a long term improvement trend of 1.75% per annum.

We have set out the life expectancies at age 65 on the 2019 assumptions.

<u>Membership Category</u>	<u>Male Life Expectancy at 65</u>	<u>Female Life Expectancy at 65</u>
Pensioners	22.9	24.8
Actives aged 45 now	24.4	27.0
Deferreds aged 45 now	22.8	25.6

For example, a male pensioner, currently aged 65, would be expected to live to age 87.9, whereas a male active member aged 45 would be expected to live until age 89.4. This is a reflection of the expected improvement in life expectancy over the next 20 years in the assumptions above.

The mortality before retirement has also been adjusted based on LGPS wide experience.

### Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 per annum of pension given up.

### Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the incidence of ill health retirements, withdrawal rates and the proportions married/civil partnership assumption have been updated from those adopted for the last valuation. In addition, no allowance will be made for the future take-up of the 50:50 option (an allowance of 10% of current and future members (by payroll)

for certain employers was made at the last valuation). Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the contribution requirements for the next 3 years. Other assumptions are as per the last valuation.

### Expenses

Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by adding 0.5% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

### Discretionary Benefits

The costs of any discretion exercised by an employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation.

## METHOD AND ASSUMPTIONS USED IN CALCULATING THE COST OF FUTURE ACCRUAL (OR “PRIMARY RATE”)

The future service liabilities are calculated using the same assumptions as the funding target except that a different financial assumption for the discount rate is used. A critical aspect here is that the Regulations state that contributions are set at such a level to achieve: full solvency in a reasonable timeframe, and long term cost-efficiency. Long term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. The Regulations also state that the Fund Actuary should have regard to the *desirability* of keeping the “Primary Rate” (which is the future service rate) as stable as possible. All of these requirements need to be taken into account when setting the assumptions.

As future service contributions are paid in respect of benefits built up in the future, the Primary Rate should take account of the market conditions applying at future dates, not just the date of the valuation, thus it is justifiable to use a slightly higher expected return from the investment strategy. In addition the future liabilities for which these contributions will be paid have a longer average duration than the past service liabilities as they relate to active members only.

The financial assumptions in relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real discount rate of 2.25% per annum above the long term average assumption for consumer price inflation of 2.4% per annum. This leads to a discount rate of 4.65% per annum.

## EMPLOYER ASSET SHARES

The Fund is a multi-employer pension scheme that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is necessary to make some approximations in the timing of cashflows and allocation of investment returns when deriving the employer asset share.

In attributing the overall investment performance obtained on the assets of the Scheme to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Scheme as a whole unless agreed otherwise between the employer and the Fund at the sole discretion of the Administering Authority.

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation.

Other adjustments are also made on account of the funding positions of orphan bodies which fall to be met by all other active employers in the Fund.

**SUMMARY OF KEY WHOLE FUND ASSUMPTIONS USED FOR CALCULATING FUNDING TARGET AND COST OF FUTURE ACCRUAL (THE “PRIMARY RATE”) FOR THE 2019 ACTUARIAL VALUATION**

<b>Long-term yields</b>	
Market implied RPI inflation	3.40% p.a.
<b>Solvency Funding Target financial assumptions</b>	
Investment return/Discount Rate	4.10% p.a.
CPI price inflation	2.40% p.a.
Long Term Salary increases	3.90% p.a.
Pension increases/indexation of CARE benefits	2.40% p.a.
<b>Future service accrual financial assumptions</b>	
Investment return/Discount Rate	4.65% p.a.
CPI price inflation	2.40% p.a.
Long Term Salary increases	3.90% p.a.
Pension increases/indexation of CARE benefits	2.40% p.a.

**Life expectancy assumptions**

The post retirement mortality tables adopted for this valuation are set out below:

<u>Current Status</u>	<u>Retirement Type</u>	<u>Mortality Table</u>
<b><u>Annuitant</u></b>	<u>Normal Health</u>	<u>94% S3PMA CMI 2018 [1.75%]</u> <u>92% S3PFA M CMI 2018 [1.75%]</u>
	<u>Dependant</u>	<u>124% S3PMA CMI 2018 [1.75%]</u> <u>94% S3DFA CMI 2018 [1.75%]</u>
	<u>Ill Health</u>	<u>116% S3IMA CMI 2018 [1.75%]</u> <u>134% S3IFA CMI 2018 [1.75%]</u>
	<u>Future Dependant</u>	<u>123% S3PMA CMI 2018 [1.75%]</u> <u>109% S3DFA CMI 2018 [1.75%]</u>
<b><u>Active</u></b>	<u>Normal Health</u>	<u>100% S3PMA CMI 2018 [1.75%]</u> <u>91% S3PFA M CMI 2018 [1.75%]</u>
	<u>Ill Health</u>	<u>116% S3IMA CMI 2018 [1.75%]</u> <u>140% S3IFA CMI 2018 [1.75%]</u>
<b><u>Deferred</u></b>	<u>All</u>	<u>124% S3PMA CMI 2018 [1.75%]</u> <u>109% S3PFA M CMI 2018 [1.75%]</u>
<b><u>Future Dependant</u></b>	<u>Dependant</u>	<u>127% S3PMA CMI 2018 [1.75%]</u> <u>117% S3DFA CMI 2018 [1.75%]</u>

Other demographic assumptions are set out in the Fund Actuary's formal report.

## APPENDIX B – EMPLOYER RECOVERY PLANS

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period. On an individual employer basis it is very rare for the assets to equal the past service liabilities, so a deficit recovery plan needs to be adopted such that additional contributions are paid into the Fund to meet the shortfall, or adjustments made to run off the surplus (where appropriate).

Deficit contributions paid to the Fund by each employer will be expressed as £s amounts and it is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Administering Authority's view of the employer's covenant and risk to the Fund.

Recovery periods will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. **This will determine the minimum contribution requirement although employers will be free to select any shorter deficit recovery period and/or pay higher contributions if they wish.**

The determination of the recovery periods is summarised in the table below:

Category	Target Deficit Recovery Period	Derivation
Unitary Authorities, and Police & Crime Commissioner	14 years	3 years less than at the 2016 valuation
Mid and West Wales Fire Authority	14 years	Currently in surplus and chosen to smooth the contribution outcome
Open Employers	Normally 11 years	3 years less than at the 2016 valuation
Closed Employers	Minimum of 11 years and the average future working lifetime of the membership	Target recovery period reduced by 3 years but also ensuring consistency of overall contributions versus those on the existing recovery plan
Employers with a limited participation in the Fund	Determined on a case by case basis	Normally the length of expected period of participation in the Fund

In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:

- The size of the funding shortfall;
- The business plans of the employer;
- The assessment of the financial covenant of the Employer, and security of future income streams;
- Any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.

For any employers assessed to be in surplus, their individual contribution requirements will be adjusted to such an extent that any surplus is unwound over an 11 year period unless agreed with the Administering Authority (if surpluses are sufficiently large, contribution requirements will be set to a minimum nil total amount). The current level of contributions payable by the employer may also be phased down to the reduced level as appropriate.

Over and above this, the Fund is now giving more recognition to the potential liabilities in the event that an employer will exit the Fund at some point. With this in mind, closed employers will normally have their contributions underpinned at existing levels. In addition, any employer in surplus on the ongoing actuarial valuation assumptions will not normally be allowed to use that surplus to offset its future contribution requirements to the Fund. These restrictions will not apply if the body has a surplus on its termination basis: in this event a surplus on the termination basis may be used to offset future contribution requirements.

### **Other factors affecting the Employer Recovery Plans**

As part of the process of agreeing funding plans with individual employers, the Administering Authority will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities.

It is acknowledged by the Administering Authority that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Administering Authority therefore would be willing to use its discretion to accept an evidenced based affordable level of contributions for the organisation for the three years 2020/2023. Any application of this option is at the ultimate discretion of the Fund officers and Section 151 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.

For those bodies identified as having a weaker covenant, the Administering Authority will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans. As a minimum, the annual deficit payment must meet the on-going interest costs to ensure, everything else being equal, that the deficit does not increase in monetary terms.

Notwithstanding the above, the Administering Authority, in consultation with the Fund Actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

# APPENDIX C – TERMINATION POLICY, FLEXIBILITIES FOR EXIT PAYMENTS AND DEFERRED DEBT AGREEMENTS

## INTRODUCTION

This document details the Fund's policy on the methodology for assessment of termination payments in the event of the cessation of an employer's participation in the Fund, repayment plans and Deferred Debt Agreements (DDA). It supplements the general policy of the Fund as set out in the FSS.

## TERMINATION ASSESSMENT OF AN EMPLOYER'S RESIDUAL PENSION OBLIGATIONS AND METHOD TO CALCULATE BOND/ FINANCIAL GUARANTEES

### ASSUMPTIONS TO ADOPT FOR THE TERMINATION ASSESSMENT

On the cessation of an employer's participation in the Fund where an employer becomes an exiting employer, the Actuary will be asked to make a termination assessment. Depending on the circumstances of the termination this assessment may incorporate a more cautious basis of assessment of the final liabilities for the employer. Typically this will be where the employer does not have a guarantor in the Fund who has agreed to subsume the orphaned liabilities from the exiting employer.

Where it may be appropriate to use a more cautious basis, the discount rate assumption used will be derived to be consistent with a lower risk investment strategy based on corporate bond yields of an appropriate duration. This is subject to the financial assumptions used being no less cautious than the equivalent valuation assumptions updated appropriately based on the advice of the actuary. The Administering Authority retains the discretion to adopt a different approach (e.g. one based on a "minimum risk" approach) for any particular employer related to the size of the risk and the employer will be notified of this accordingly.

In addition to using a more cautious discount rate, the Actuary will also use a more prudent mortality assumption when assessing the size of the liabilities for termination purposes. In particular, the Actuary will assume a higher improvement rate for future life expectancy than is used for ongoing funding purposes. Where it is appropriate to apply a more cautious assumption, the Actuary will assume that the accelerated trend in longevity seen in recent years will continue in the longer term. The assumption, therefore, will build in a level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a long term improvement trend of 2% per annum for males and females.

The appropriate method adopted depends on the characteristics of the exiting body (and in particular whether there is another employer in the Fund who is prepared to act as sponsor for any residual liabilities) and the risk in the context of the potential impact on other employers' contributions. This is because where liabilities are "orphaned" all employers have to cover any deficits (or surpluses) that arise in relation to these liabilities via their contribution rates at each valuation.

In summary, depending on the employer type, participation basis and covenant there are three alternative approaches to value liabilities on termination and to assess bond requirements:-

1. Assessing the final termination liabilities using assumptions consistent with the most recent valuation basis adjusted as necessary to reflect the expected return outlook in relation to the investment strategy which supports the exiting employer's liabilities. These assumptions will be reviewed on an ongoing basis to allow for changed in market conditions along with any structural or legislative changes. In particular, since the valuation date it has been announced that RPI inflation will be reformed to be in line with the CPIH inflation measure from 2030. This therefore needs to be reflected when deriving an updated market estimate of the CPI inflation. For example, when assessing a termination position from 25 November 2020 we will adjust the market RPI inflation to arrive at the CPI inflation assumption by deducting 0.6% per annum as opposed to the 1.0% per annum at the valuation date when assessing an employers termination position. This assumption will be kept under review over time.
2. Assessing the final liabilities using a discount rate which is linked to a lower risk investment strategy, so that the calculation of the liabilities will be based on corporate bonds of appropriate duration to the liabilities. In addition, the Actuary will apply the more prudent mortality assumption as described above. The assumptions adopted will also be reviewed on an ongoing basis and updated for any market developments, including any structural or legislative changes such as the reform of RPI.
3. Assessing the final liabilities using a discount rate which is based on a "minimum risk" approach where the discount rate will be based on government gilt yields of appropriate duration to the liabilities and a more prudent mortality assumption as above (again the assumptions adopted will also be reviewed on an ongoing basis and updated for any market developments, including any structural or legislative changes such as the reform of RPI). Typically this will be applied to an employer who would have a material effect on the Fund on exit by leaving significant residual orphan liabilities.

## APPROACH TO ADOPT FOR EACH EMPLOYER TYPE

The approach to be adopted would be varied dependent on whether there is a guarantor who participates in the Fund who would be prepared to assume responsibility for the liabilities and the type of participation as follows:-

### (I) ADMISSION BODIES PARTICIPATING BY VIRTUE OF A CONTRACTUAL ARRANGEMENT

For employers that are guaranteed by a guarantor (usually the original employer or letting authority), the Fund's default policy at the point of cessation is for the guarantor to subsume the residual assets, liabilities and any surplus or deficit. This is subject to the agreement of all parties involved (i.e. the Fund, the exiting employer and the guarantor) who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor. In some instances an exit debt may be payable by an employer before the assets and liabilities are subsumed by the guarantor, this will be considered on a case-by-case basis. No payment of an exit credit will be payable unless representation is made as set out below.

If there is any dispute, then the following arrangements will apply:

- In the case of a surplus, in line with the amending Regulations (The Local Government Pension Scheme (Amendment) Regulations 2020) the parties will need to make

representations to the Administering Authority if they believe an Exit Credit should be paid outside the policy set out above, or if they dispute the determination of the Administering Authority. The Fund will notify the parties of the information required to make the determination on request.

- If the Fund determines an Exit Credit is payable then they will pay this directly to the exiting employer within 6 months of completion of the final cessation by the Actuary.
- In the case of a deficit, in order to maintain a consistent approach, the Fund will seek to recover this from the exiting employer in the first instance although if this is not possible then the deficit will be recovered from the guarantor either as a further contribution collection or at the next valuation depending on the circumstances.

If requested, the Administering Authority will provide details of the information considered as part of the determination. A determination notice will be provided alongside the termination assessment from the Actuary. The notice will cover the following information and process steps:

1. Details of the employers involved in the process (e.g. the exiting employer and guarantor).
2. Details of the admission agreement, commercial contracts and any amendments to the terms that have been made available to the Administering Authority and considered as part of the decision making process. The underlying principle will be that if an employer is responsible for a deficit, they will be eligible for any surplus. This is subject to the information provided and any risk sharing arrangements in place.
3. The final termination certification of the exit credit by the Actuary.
4. The Administering Authority's determination based on the information provided.
5. Details of the appeals process in the event that a party disagrees with the determination and wishes to make representations to the Administering Authority.

In some instances, the outgoing employer may only be responsible for part of the residual deficit or surplus as per the separate risk sharing agreement. The default is that any surplus would be retained by the Fund in favour of the outsourcing employer/guarantor unless representation is made by the relevant parties in line with the Regulations as noted above. For the avoidance of doubt, where the outgoing employer is not responsible for any costs under a risk sharing agreement then no exit credit will be paid as per the Regulations unless the Fund is aware of the provisions of the risk sharing agreement in any representation made and determines an exit credit should be paid.

Where the guarantor will absorb the residual assets and liabilities, it is the view of the Actuary that the ongoing valuation basis (adjusted as necessary as described above) should be adopted for the termination calculations. This is the way the initial admission agreement would typically be structured i.e. the admission would normally be fully funded based on liabilities assessed on the valuation basis.

If a guarantor deviates from the policy to subsume the residual assets, liabilities and any surplus or deficit, for future termination events the Fund will not normally allow the guarantor to subsume any residual deficits. In such cases they would normally require the exiting employer to pay off the deficit as a single lump sum.

If the guarantor refuses to take responsibility for the liabilities then the residual deferred pensioner and pensioner liabilities should be assessed on the more cautious basis. In this situation the size of the termination payment would also depend on what happened to the active members and if

they all transferred back to the original Scheme Employer (or elsewhere) and aggregated their previous benefits. As the transfer would normally be effected on a "fully funded" valuation basis the termination payment required would vary depending on the circumstances of the case. Where this occurs the exiting employer would then be treated as if it had no guarantor as per the policy below.

## (II) OTHER EMPLOYERS WITH A GUARANTOR IN THE FUND

The approach for these will be the same as (i) above and will depend on whether the guarantor is prepared to accept responsibility for residual liabilities.

## (III) EMPLOYERS WITH NO GUARANTOR IN THE FUND

These are cases where the residual liabilities would be "orphaned" within the Fund, although it is possible that a bond would be in place. The termination calculation would be on the more cautious basis as noted in 2. above although the approach in 3. above could apply at the discretion of the Administering Authority.

The actuarial valuation and the revision of any Rates and Adjustments Certificate in respect of the outgoing employer must be produced by the Actuary at the time when the employer exits the Fund; the policy will always be subject to change in the light of changing economic circumstances and legislation.

The policy for such employers will be:

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 6 months of completion of the cessation by the Actuary or such longer period as may be agreed in the individual case).
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

The above funding principles will also impact on the **bond requirements** for bodies. The purpose of the bond is that it should cover any unfunded liabilities arising on termination that cannot be reclaimed from the outgoing body.

## ALLOWING FOR THE MCCLOUD JUDGMENT IN TERMINATION VALUATIONS

The Government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment, however the final remedy is not currently known with any certainty although it is expected to be similar to the allowance made in employer rates at this valuation. Where a surplus or deficit is being subsumed, no allowance will be made for McCloud within the calculations and the impact will be considered at the next contribution rate review. However, if a representation is made to the Administering Authority in relation to an Exit Credit then a reasonable estimate for the potential cost of McCloud will need to be included.

Where a surplus or deficit isn't being subsumed, McCloud will be allowed for as a matter of policy.

The allowance will be calculated in line with the treatment set out in this Funding Strategy Statement for all members of the outgoing employer using the termination assessment assumptions. For the avoidance of doubt, there will be no recourse for an employer with regard to McCloud, once the final termination has been settled and payments have been made. Once the remedy is known, any calculations will be performed in line with the prevailing regulations and guidance in force at the time.

## **POLICY IN RELATION TO THE FLEXIBILITY FOR EXIT DEBT PAYMENTS AND DEFERRED DEBT AGREEMENTS (DDA)**

The Fund's policy for termination payment plans is as follows:

1. The default position is for exit payments to be paid immediately in full unless there is a risk sharing arrangement in place with a guaranteeing Scheme employer in the Fund whereby the exiting employer is not responsible for any exit payment. In the case of an exit credit the determination process set out above will be followed.
2. At the discretion of the administering authority, instalment plans over an agreed period or a Deferred Debt Agreement (DDA) will only be agreed subject to the policy in relation to any flexibility in recovering exit payments.

As set out above, the default position for exit payments is that they are paid in full at the point of exit (adjusted for interest where appropriate). If an employer requests that an exit debt payment is recovered over a fixed period of time or that they wish to enter into a DDA with the Fund, they must make a request in writing covering the reasons for such a request. Any deviation from this position will be based on the Administering Authority's assessment of whether the full exit debt is affordable and whether it is in the interests of taxpayers to adopt either of the approaches. In making this assessment the Administering Authority will consider the covenant of the employer and also whether any security is required and available to back the arrangements.

Any costs (including necessary actuarial, legal and covenant advice) associated with assessing this will be borne by the employer and will be invoiced to the employer by the Fund or included in the contribution plan or exit debt payment (depending on the circumstances).

The following policy and processes will be followed in line with the principles set out in the statutory guidance dated 2 March 2021.

## **POLICY FOR SPREADING EXIT PAYMENTS**

The following process will determine whether an employer is eligible to spread their exit payment over a defined period.

1. The Administering Authority will request updated financial information from the employer including management accounts showing expected financial progression of the organisation and any other relevant information to use as part of their covenant review. If this information is not provided then the default policy of immediate payment will be adopted.
2. Once this information has been provided, the Administering Authority (in conjunction with the Fund Actuary, covenant and legal advisors where necessary) will review the covenant of the employer to determine whether it is in the interests of the Fund to allow them to spread the exit debt over a period of time. Depending on the length of the period and also the size of the

outstanding debt, the Fund may request security to support the payment plan before entering into an agreement to spread the exit payments.

3. This could include non-uniform payments e.g. a lump sum up front followed by a series of payments over the agreed period. The payments required will include allowance for interest on late payment.
4. The initial process to determine whether an exit debt should be spread may take up to 6 months from receipt of data so it is important that employers who request to spread exit debt payments notify the Fund in good time
5. If it is agreed that the exit payments can be spread then the Administering Authority will engage with the employer regarding the following:
  - a. The spreading period that will be adopted (this will be subject to a maximum of 5 years).
  - b. The initial and annual payments due and how these will change over the period
  - c. The interest rates applicable and the costs associated with the payment plan devised
  - d. The level of security required to support the payment plan (if any) and the form of that security e.g. bond, escrow account etc.
  - e. The responsibilities of the employer during the exit spreading period including the supply of updated information and events which would trigger a review of the situation
  - f. The views of the Actuary, covenant, legal and any other specialists necessary
  - g. The covenant information that will be required on a regular basis to allow the payment plan to continue.
  - h. Under what circumstances the payment plan may be reviewed or immediate payment requested (e.g. where there has been a significant change in covenant or circumstances)
6. Once the Administering Authority has reached its decision, the arrangement will be documented and any supporting agreements will be included.

## **EMPLOYERS PARTICIPATING WITH NO CONTRIBUTING MEMBERS**

As opposed to paying the exit debt an employer may participate in the Fund with no contributing members and utilise the “Deferred Debt Agreements” (DDA) at the sole discretion of the Administering Authority. This would be at the request of the employer in writing to the Administering Authority.

The following process will determine whether the Fund and employer will enter into such an arrangement:

1. The Administering Authority will request updated financial information from the employer including management accounts showing expected financial progression of the organisation. If this information is not provided then a DDA will not be entered into by the Administering Authority
2. Once this information has been provided, the Administering Authority will firstly consider whether it would be in the best interests of the Fund and employers to enter into such an arrangement with the employer. This decision will be based on a covenant review of the

employer to determine whether the exit debt that would be required if the arrangement was not entered into is affordable at that time (based on advice from the Actuary, covenant and legal advisor where necessary).

3. The initial process to determine whether a DDA should apply may take up to 3 months from receipt of the required information so an employer who wishes to request that the Administering Authority enters into such an arrangement needs to make the request in advance of the potential exit date.
4. If the Administering Authority's assessment confirms that the potential exit debt is not affordable, the Administering Authority will engage in discussions with the employer about the potential format of a DDA using the template Fund agreement which will be based on the principles set out in the Scheme Advisory Board's separate guide. As part of this, the following will be considered and agreed:
  - What security the employer can offer whilst the employer remains in the Fund. In general the Administering Authority won't enter into such an arrangement unless they are confident that the employer can support the arrangement on an ongoing basis. Provision of security may also result in a review of the recovery period and other funding arrangements.
  - Whether an upfront cash payment should be made to the Fund initially to reduce the potential debt.
  - What the updated secondary rate of contributions would be required up to the next valuation.
  - The financial information that will be required on a regular basis to allow the employer to remain in the Fund and any other monitoring that will be required.
  - The advice of the Actuary, covenant, legal and any other specialists necessary.
  - The responsibilities that would apply to the employer while they remain in the Fund.
  - What conditions would trigger the implementation of a revised deficit recovery plan and subsequent revision to the secondary contributions (e.g. provision of security).
  - The circumstances that would trigger a variation in the length of the DDA (if appropriate), including a cessation of the arrangement e.g. where the ability to pay contributions has weakened materially or is likely to weaken in the next 12 months. Where an agreement ceases an exit payment (or credit) could become payable. Potential triggers may be the removal of any security or a significant change in covenant assessed as part of the regular monitoring.
  - Under what circumstances the employer may be able to vary the arrangement e.g. a further cash payment or change in security underpinning the agreement.

The Administering Authority will then make a final decision on whether it is in the best interests of the Fund to enter into a DDA with the employer and confirm the terms that are required.

5. For employers that are successful in entering into a DDA, contribution requirements will continue to be reviewed as part of each actuarial valuation or in line with the DDA in the interim if any of the agreed triggers are met.

6. The costs associated with the advice sought and drafting of the DDA will be borne by the employer and will be invoiced to the employer by the Fund or included in the contribution plan (depending on the circumstances).

# APPENDIX D – COVENANT ASSESSMENT AND MONITORING POLICY

An employer's covenant underpins its legal obligation and ability to meet its financial responsibilities now and in the future. The strength of covenant depends upon the robustness of the legal agreements in place and the likelihood that the employer can meet them. The covenant effectively underwrites the risks to which the Fund is exposed, including underfunding, longevity, investment and market forces.

An assessment of employer covenant focuses on determining the following:

- > Type of body and its origins
- > Nature and enforceability of legal agreements
- > Whether there is a bond in place and the level of the bond
- > Whether a more accelerated recovery plan should be enforced
- > Whether there is an option to call in contingent assets
- > Is there a need for monitoring of ongoing and termination funding ahead of the next actuarial valuation?

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital.

## RISK CRITERIA

The assessment criteria upon which an employer should be reviewed could include:

- Nature and prospects of the employer's industry
- Employer's competitive position and relative size
- Management ability and track record
- Financial policy of the employer
- Profitability, cashflow and financial flexibility
- Employer's credit rating
- Position of the economy as a whole

Not all of the above would be applicable to assessing employer risk within the Fund; rather a proportionate approach to consideration of the above criteria would be made, with further consideration given to the following:

- The scale of obligations to the pension scheme relative to the size of the employer's operating cashflow
- The relative priority placed on the pension scheme compared to corporate finances
- An estimate of the amount which might be available to the scheme on insolvency of the employer as well as the likelihood of that eventuality.

## ASSESSING EMPLOYER COVENANT

The employer covenant will be assessed objectively and its ability to meet their obligations will be viewed in the context of the Fund's exposure to risk and volatility based on publically available information and/or information provided by the employer. The monitoring of covenant strength along with the funding position (including on the termination basis) enables the Fund to anticipate and pre-empt employer funding issues and thus adopt a proactive approach. In order to objectively monitor the strength of an employer's covenant, adjacent to the risk posed to the Fund, a number of fundamental financial metrics will be reviewed to develop an overview of the employer's stability and a rating score will be applied using a Red/Amber/Green (RAG) rating structure.

In order to accurately monitor employer covenant, it will be necessary for research to be carried out into employers' backgrounds and, in addition, for those employers to be contacted to gather as much information as possible. Focus will be placed on the regular monitoring of employers with a proactive rather than reactive view to mitigating risk.

The covenant assessment will be combined with the funding position to derive an overall risk score. Action will be taken if these metrics meet certain triggers based on funding level, covenant rating and the overall risk score

## FREQUENCY OF MONITORING

The funding position and contribution rate for each employer participating in the Fund will be reviewed as a matter of course with each triennial actuarial valuation. However, it is important that the relative financial strength of employers is reviewed regularly to allow for a thorough assessment of the financial metrics. The funding position will be monitored (including on the termination basis) by officers based upon advice provided by the Fund Actuary.

## COVENANT RISK MANAGEMENT

The focus of the Fund's risk management approach is the identification and treatment of the risks. It will be a continuous and evolving process which runs throughout the Fund's strategy. Mechanisms that will be explored with certain employers, as necessary, will include but are not limited to the following:

1. Parental Guarantee and/or Indemnifying Bond
2. Transfer to a more prudent actuarial basis and investment strategy (e.g. the termination basis)
3. A higher funding target, shortened recovery periods and increased cash contributions
4. Managed exit strategies
5. Contingent assets and/or other security such as escrow accounts.

# APPENDIX E – REVIEW OF EMPLOYER CONTRIBUTIONS BETWEEN VALUATIONS

In line with the Regulations that came into force on 23rd September 2020, the Administering Authority has the ability to review employer contributions between valuations. The Administering Authority and employers now have the following flexibilities:

1. The Administering Authority may review the contributions of an employer where there has been a significant change to the liabilities of an employer.
2. The Administering Authority may review the contributions of an employer where there has been a significant change in the employer's covenant.
3. An employer may request a review of contributions from the Administering Authority if they feel that either point 1 or point 2 applies to them. The employer would be required to pay the costs of any review following completion of the calculations and is only permitted to make a maximum of one request between actuarial valuation dates (except in exceptional circumstances and at the sole discretion of the Administering Authority).

Where the funding position for an employer significantly changes solely due to a change in assets (or changes in actuarial assumptions), the Regulations do not allow employer contributions to be reviewed outside of a full valuation. However changes in assets would be taken into account when considering if an employer can support its obligations to the Fund after a significant covenant change (see 2. above).

The Administering Authority will consult with the employer prior to undertaking a review of their contributions including setting out the reason for triggering the review.

For the avoidance of doubt, any review of contributions may result in no change and a continuation of contributions as per the latest actuarial valuation assessment. In the normal course of events, a rate review would not be undertaken close to next actuarial valuation date, unless in exceptional circumstances. For example:

- A contribution review due to a change in membership profile would not be undertaken in the 6 months leading up to the next valuation Rates and Adjustments Certificate.
- However, where there has been a material change in covenant, a review will be considered on a case by case basis to determine if a contribution review should take place and when any contribution change would be implemented. This will take into account the proximity of the actuarial valuation and the implementation of the contributions from that valuation.

## SITUATIONS WHERE CONTRIBUTIONS MAY BE REVIEWED

Contributions may be reviewed if the Administering Authority becomes aware of any of the following scenarios. Employers will be notified if this is the case. Consideration will also be given to the impact that any employer changes may have on the other employers and on the Fund as a whole, when deciding whether to proceed with a contribution review.

### 1) Significant changes in the employer's liabilities

This includes but is not limited to the following scenarios:

- a) Significant changes to the employer's membership which will have a material impact on their liabilities, such as:
  - i. Restructuring of an employer
  - ii. A significant outsourcing or transfer of staff to another employer (not necessarily within the Fund)
  - iii. A bulk transfer into or out of the employer
  - iv. Other significant changes to the membership for example due to redundancies, significant salary awards, material ill health retirements (for employers not using the ill-health captive arrangement) or, large numbers of withdrawals
- b) Two or more employers merging including insourcing and transferring of services
- c) The separation of an employer into two or more individual employers

In terms of assessing the triggers under a) above, the Administering Authority will only consider a review if the change in liabilities is expected to be more than 5% of the total liabilities. In some cases this may mean there is also a change in the covenant of the employer.

Any review of the rate will normally only take into account the impact of the change in liabilities (including, if relevant, any underfunding in relation to pension strain costs) both in terms of the Primary and Secondary rate of contributions.

### 2) Significant changes in the employer's covenant

This includes but is not limited to the following scenarios:

- a) Provision of, or removal of, or impairment of, security, bond, guarantee or some other form of indemnity by an employer against their obligations in the Fund. For the avoidance of doubt, this includes provision of security to any other pension arrangement which may impair the security provided to the Fund.
- b) Material change in an employer's immediate financial strength or longer-term financial outlook (evidence should be available to justify this) including where an employer ceases to operate or becomes insolvent.
- c) Where an employer exhibits behaviour that suggests a change in their ability and/or willingness to pay contributions to the Fund.

In some instances, a change in the liabilities will also result in a change in an employer's ability to meet its obligations.

Employers will be required to agree to notify the Administering Authority of any material changes in relation to a) or b) above.

Additional information will be sought from the employer in order to determine whether a contribution review is necessary. This may include annual accounts, budgets, forecasts and any specific details of restructure plans. As part of this, the Administering Authority will take advice from the Fund Actuary, covenant, legal and any other specialist adviser.

In this instance, any review of the contribution rate would include consideration of the updated funding position both on an ongoing and termination basis and would usually allow for changes in asset values when considering if the employer can meet its obligations on both an ongoing and termination basis (if applicable). This could then lead to the following actions (see further comments below):

- the contributions changing or staying the same depending on the conclusion and/or;
- security to improve the covenant to the Fund and/or;
- if appropriate, a change in the investment strategy via the employer investment pot.

## PROCESS AND POTENTIAL OUTCOMES OF A CONTRIBUTION REVIEW

Where one of the listed events occurs, the Administering Authority will enter into discussion with the employer to clarify details of the event and any intention to review contributions. Ultimately, the decision to review contributions as a result of the above events rests with the Administering Authority after, if necessary, taking advice from their Actuary, legal or a covenant specialist advisors.

This also applies where an employer notifies the Administering Authority of the event and requests a review of the contributions. The employer will be required to agree to meet any professional and/or administration costs associated with the review. The employer will be required to outline the rationale and case for the review through a suitable exchange of information prior to consideration by the Administering Authority.

The Administering Authority will consider whether it is appropriate to use updated membership data within the review (e.g. where the change in membership data is expected to have a material impact on the outcome) and whether any supporting information is required from the employer.

As well as revisiting the employer's contribution plan, as part of the review it is possible that other parts of the funding strategy will also be reviewed where the covenant of the employer has changed, for example the Fund will consider:

- Whether the Primary contribution rate should be adjusted to allow for any profile change
- Whether the Secondary contribution rate should be adjusted including whether the length of the recovery period adopted at the previous valuation remains appropriate. The remaining recovery period from the last valuation would be the maximum period adopted (except in exceptional and justifiable circumstances and at the sole discretion of the Administering Authority on the advice of the Actuary).

The review of contributions may take up to 3 months from the date of confirmation to the employer that the review is taking place, in order to collate the necessary data.

Any change to an employer's contributions will be implemented at a date agreed between the employer and the Fund. The Schedule to the Rates and Adjustment Certificate at the last valuation will be updated for any contribution changes. As part of the process the Administering Authority will consider whether it is appropriate to consult any other Fund employers prior to implementing the revised contributions. Circumstances where the Administering Authority may consider it appropriate to do so include where there is another employer acting as guarantor in the Fund, then the guarantor would be consulted on as part of the contribution review process.

The Administering Authority will agree a proportionate process for periodical ongoing monitoring and review following the implementation of the revised contribution plan. The Employer will be required to provide information to the Fund to support this, which will depend in part of the reasons for triggering the contribution review.

# APPENDIX F - GLOSSARY

**Actuarial Valuation:** an investigation by the Fund Actuary into the ability of the Fund to meet its liabilities. For the LGPS the Fund Actuary will assess the funding level of each participating employer and agree contribution rates with the Administering Authority to fund the cost of new benefits and make good any existing deficits as set out in the separate Funding Strategy Statement. The asset value is based on market values at the valuation date.

**Administering Authority:** the council with a statutory responsibility for running the Fund and that is responsible for all aspects of its management and operation.

**Admission bodies:** A specific type of employer under the Local Government Pension Scheme (LGPS) who do not automatically qualify for participation in the Fund but are allowed to join if they satisfy the relevant criteria set out in the Regulations.

**Benchmark:** a measure against which fund performance is to be judged.

**Best Estimate Assumption:** an assumption where the outcome has a 50/50 chance of being achieved.

**Bonds:** loans made to an issuer (often a government or a company) which undertakes to repay the loan at an agreed later date. The term refers generically to corporate bonds or government bonds (gilts).

**Career Average Revalued Earnings Scheme (CARE):** with effect from 1 April 2014, benefits accrued by members in the LGPS take the form of CARE benefits. Every year members will accrue a pension benefit equivalent to 1/49th of their pensionable pay in that year. Each annual pension accrued receives inflationary increases (in line with the annual change in the Consumer Prices Index) over the period to retirement.

**Contingent Assets:** assets held by employers in the Fund that can be called upon by the Fund in the event of the employer not being able to cover the debt due upon termination. The terms will be set out in a separate agreement between the Fund and employer.

**Covenant:** the assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term or affordability constraints in the short term.

**CPI:** acronym standing for "Consumer Prices Index". CPI is a measure of inflation with a basket of goods that is assessed on an annual basis. The reference goods and services differ from those of RPI. These goods are expected to provide lower, less volatile inflation increases. Pension increases in the LGPS are linked to the annual change in CPI.

**CPIH:** an alternative measure of CPI which includes owner/occupiers' housing costs and Council Tax (which are excluded from CPI).

**Deferred Debt Agreement (DDA):** A written agreement between the Administering Authority and an exiting Fund employer for that employer to defer their obligation to make an exit payment and continue to make contributions at the assessed Secondary rate until the termination of the DDA.

**Deferred Employer:** An employer that has entered into a DDA with the Fund.

**Deficit:** the extent to which the value of the Fund's past service liabilities exceeds the value of the Fund's assets. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions).

**Deficit recovery period:** the target length of time over which the current deficit is intended to be paid off. A shorter period will give rise to a higher annual contribution, and vice versa.

**Discount Rate:** the rate of interest used to convert a cash amount e.g. future benefit payments occurring in the future to a present value.

**Employer's Future Service Contribution Rate (Primary Rate):** the contribution rate payable by an employer, expressed as a % of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses.

**Employing bodies:** any organisation that participates in the LGPS, including admission bodies and scheme employers.

**Equities:** shares in a company which are bought and sold on a stock exchange.

**Fund Actuary / Actuary:** an individual appointed by the Administering Authority who is a Fellow of the Institute and Faculty of Actuaries and is suitably authorised and experienced to perform an LGPS actuarial valuation.

**Funding or solvency Level:** the ratio of the value of the Fund's assets and the value of the Fund's liabilities expressed as a percentage.

**Funding Strategy Statement:** this is a key governance document that outlines how the Administering Authority will manage employer's contributions and risks to the Fund.

**Investment Strategy:** the long-term distribution of assets among various asset classes that takes into account the Funds objectives and attitude to risk.

**Government Actuary's Department (GAD):** the GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

**Guarantee / guarantor:** a formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's covenant to be as strong as its guarantor's.

**Minimum risk funding basis:** more cautious funding basis than the existing valuation basis. The relevant discount rate used for valuing the present value of liabilities is based on the yields from Government Bonds or Swaps.

**Letting employer:** an employer that outsources part of its services/workforce to another employer, usually a contractor. The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer.

**Liabilities:** the actuarially calculated present value of all benefit entitlements i.e. scheme cashflows of all members of the Fund, built up to date or in the future. The liabilities in relation to the benefit entitlements earned up to the valuation date are compared with the present market value of Fund assets to derive the deficit and funding/solvency level. Liabilities can be assessed on different set of actuarial assumptions depending on the purpose of the valuation.

**LGPS:** the Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements.

**Mandatory scheme employers:** Employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Scheme Employers. For example, these include councils, colleges, universities and academies.

**Maturity:** a general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.

**Members:** The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).

**Orphan liabilities:** liabilities in the Fund for which there is no sponsoring employer within the Fund. Ultimately orphan liabilities must be underwritten by all other employers in the Fund.

**Percentiles:** relative ranking (in hundredths) of a particular range. For example, in terms of expected returns a percentile ranking of 75 indicates that in 25% of cases, the return achieved would be greater than the figure, and in 75% cases the return would be lower.

**Phasing/stepping of contributions:** when there is an increase/decrease in an employer's long term contribution requirements, the increase in contributions can be gradually stepped or phased in over an agreed period. The phasing/stepping can be in equal steps or on a bespoke basis for each employer.

**Pooling:** employers may be grouped together for the purpose of calculating contribution rates, (i.e. a single contribution rate applicable to all employers in the pool). A pool may still require each individual employer to ultimately pay for its own share of deficit, or (if formally agreed) it may allow deficits to be passed from one employer to another.

**Prepayment:** the payment by employers of contributions to the Fund earlier than that certified by the Fund Actuary. The amount paid will be reduced in monetary terms compared to the certified amount to reflect the early payment.

**Present Value:** the value of projected benefit payments, discounted back to the valuation date.

**Profile:** the profile of an employer's membership or liability reflects various measurements of that employer's members, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc.

**Prudent Assumption:** an assumption where the outcome has a greater than 50/50 chance of being achieved i.e. the outcome is more likely to be overstated than understated. Legislation and Guidance requires the assumptions adopted for an actuarial valuation to be prudent.

**Rates and Adjustments Certificate:** a formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal valuation. This is completed by the Fund Actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.

**Real Return or Real Discount Rate:** a rate of return or discount rate net of (CPI) inflation.

**Recovery Plan:** a strategy by which an employer will make up a funding deficit over a specified period of time ("the recovery period"), as set out in the Funding Strategy Statement.

**Scheduled bodies:** types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).

**Scheme Employers:** employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Scheme Employers.

**Section 13 Valuation:** in accordance with Section 13 of the Public Service Pensions Act 2014, the Government Actuary's Department (GAD) have been commissioned to advise the Department for Communities and Local Government (DCLG) in connection with reviewing the 2016 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

**Solvency Funding Target:** an assessment of the present value of benefits to be paid in the future. The desired funding target is to achieve a solvency level of a 100% i.e. assets equal to the accrued liabilities at the valuation date assessed on the ongoing concern basis.

**Valuation funding basis:** the financial and demographic assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is consistent with an expected rate of return of the Fund's investments. This

includes an expected out-performance over gilts in the long-term from other asset classes, held by the Fund.

**50/50 Scheme:** in the LGPS, active members are given the option of accruing a lower personal benefit in the 50/50 Scheme, in return for paying a lower level of contribution.