Staffordshire Local Government Pension Fund

Funding Strategy Statement

March 2011

1. Introduction

This is the Funding Strategy Statement (FSS) of the Staffordshire Local Government Pension Fund ("the Fund"), which is administered by Staffordshire County Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser and is effective from 31 March 2011.

1.1 Regulatory Framework

Employees' accrued benefits are guaranteed by statute. Employees' contributions are fixed in Local Government Pensions Scheme (LGPS) Regulations at a level which covers only part of the cost of accruing benefits. Employers pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers or pools of employers pay for their own liabilities.

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time.

In publishing the FSS the authority has to have regard to any guidance published by CIPFA and to the Statement of Investment Principles.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

1.2 Reviews of FSS

The FSS is reviewed in detail at least every three years as part of of the triennial valuation. This FSS is relevant for the 2010 valuation and is expected to remain unaltered until it is consulted upon prior to the next valuation in 2013. The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including; the Statement of Investment Principles, Governance and Communications strategies. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at
http://www.staffordshire.gov.uk/yourcouncil/humanresources/retirement/

If you have any other queries please contact John Wood, Head of Financial and Commercial Services in the first instance at e-mail address john.wood@staffordshire.gov.uk or on telephone number (01785 276335).

2. Purpose

2.1 Purpose of FSS

The Office of the Deputy Prime Minister (ODPM) (now the Department for Communities and Local Government (DCLG)) has stated that the purpose of the FSS is:

- *"to establish a* ***clear and transparent fund-specific strategy*** *which will identify how employers' pension liabilities are best met going forward;*
- *to support the regulatory framework to maintain* ***as nearly constant employer contribution rates as possible****; and*
- *to take a* ***prudent longer-term view*** *of funding those liabilities."*

These objectives are desirable individually, but may be mutually conflicting.

This statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered. The Fund:

- receives contributions from employees and employers, transfer payments from other funds as staff transfer their pension rights and income or capital growth from the Fund's investments;
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarised in Appendix A.

2.3 Aims of the Funding Policy

The objectives of the Fund's funding policy include the following:

- to ensure the long-term solvency of the Fund to ensure that sufficient funds are available to meet all pension liabilities as they fall due for payment;
- to ensure that employer contribution rates are stable;

- to minimise the long-term cost of the scheme by recognising the link between assets and liabilities and adopting an investment strategy that balances risk and return;

- to reflect the different characteristics of employing bodies in determining contribution rates where the Administering Authority considers it reasonable to do so;

- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations;

3. Solvency Issues and Target Funding Levels

3.1 Derivation of Employer Contributions

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the "*future service rate*"; plus

b) an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, "*past service adjustment*". If there is a surplus there may be a reduction in the employer's contribution rate if there is a deficit there will be an increase in the employer's contribution rate, with the surplus or deficit spread over an appropriate period. There is currently a deficit on the Fund (see 3.7.3 below for deficit recovery periods)

The Fund's actuary is required by the regulations to report the *Common Contribution Rate*[1], for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay.

The Fund's actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed "peculiar" to an individual employer[2]. It is the adjusted contribution rate which employers are actually required to pay. The sorts of peculiar factors which are considered are discussed in Section 3.5.

In effect, the *Common Contribution Rate* is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific spreading and phasing periods.

For some employers it may be agreed to pool contributions, see Section 3.7.9.

[1] See Regulation 77(4)
[2] See Regulation 77(6)

Details of the outcome of the Actuarial Valuation as at 31 March 2010 can be found in the formal valuation report dated March 2011, including an analysis at Fund Level of the *Common Contribution Rate*. Further details of individual employer contribution rates can also be found in the formal report.

Any costs of non ill-health early retirements may be paid by instalments shortly after the decision in accordance with the Administering body's requirements set out in 3.11.1 below

Note that following the 2004 Actuarial Valuation the maximum period over which the cost of 'strain' could be spread was reduced from 7 years to 5 years on advice from the actuary and this is kept under review at each valuation.

Employers' contributions are expressed as minima, with employers able to pay regular contributions at a higher rate. Employers should discuss with the Administering Authority before making one-off payments.

3.2 Solvency and Target Funding Levels

The Fund's actuary is required to report on the "solvency" of the whole fund at least every three years.

'Solvency" for ongoing employers is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund actuary's *ongoing funding basis*. This quantity is known as a funding level.

The Fund actuary agrees the financial and demographic assumptions to be used for each such valuation with the Administering Authority. The fund operates the same target funding level for all other employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see below). Please refer to paragraph 3.10 for the treatment of departing employers.

The overall solvency of the Fund at the 2010 valuation is 75% which compares with 89% at the 2007 valuation.

The ongoing funding basis has traditionally been used for each triennial valuation for all employers in the fund. The ongoing funding basis assumes a long-term participation in the Fund, and this basis is described in the next section.

In the circumstances where:

- the employer is an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and

- the admission agreement is likely to terminate, or the employer lose its last active member, within a timeframe considered by the Administering Authority to prompt a change in funding,

the Administering Authority may vary the discount rate used to set employer contribution rate. In particular contributions may be set for an employer to achieve full funding on a more prudent basis (eg using gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease.

3.3 Ongoing Funding Basis

(a) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the Club Vita's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with "medium cohort" and a 1% pa minimum underpin to future reductions in mortality rates.

The combined effect of the above changes from the 2007 valuation approach, is to add around one year of life expectancy on average. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members' benefits.

(b) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes allowance for an anticipated out-performance of returns from equities relative to Government bonds. There is, however, no guarantee that equities will out-perform bonds. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

It is therefore normally appropriate to restrict the degree of change to employers' contributions at triennial valuation dates.

Given the very long-term nature of the liabilities, a long term view of prospective returns from equities is taken.

For the purpose of the triennial funding valuation at 31 March 2010 and setting contribution rates effective from 1 April 2011, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.6% per annum greater than the return available from investing in government bonds at the time of the valuation (this is the same as that used at the 2007 valuation). The long term in this context would be 20 to 30 years or more. In the opinion of the Fund actuary, based on the current investment strategy of the Fund, an asset out-performance assumption (AOA) of 1.6% per annum is within a range that would be considered acceptable for the purposes of the funding valuation.

<u>(c) Salary growth</u>
Pay for public sector employees will be frozen by Government until 2012, with a flat increase of £250 being applied to all those earning less than £21,000 pa. Although this "pay freeze" does not officially apply to local government employers, it has been suggested that they are expected to show similar restraint in respect of pay awards. Based on an analysis of the membership in LGPS funds, the average expected increase in pensionable pay across all employees should be around 1% pa for the next two years. Therefore the salary increase assumption at the 2010 valuation has been set to 1% pa for 2010/11 and 2011/12. After this point, the assumption will revert back to RPI plus 1.5% pa, as adopted for the previous valuation.

<u>(d) Pension increases</u>
The Chancellor of the Exchequer announced in his Emergency Budget on 22 June 2010 that the consumer prices index (CPI) rather than the retail prices index (RPI) will be the basis for future increases to public sector pensions in deferment and in payment. This proposed change has been allowed for in the valuation calculations as at 31 March 2010.

At the previous valuation, we derived our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. At this valuation, we propose to adjust this market-derived rate downwards by 0.5% pa to allow for the "formula effect" of the difference between RPI and CPI. Basing pension increases on CPI rather than RPI will serve to reduce the value placed on the Fund's liabilities.

<u>(e) General</u>
The same financial assumptions are adopted for all employers for whom the ongoing basis is deemed to be appropriate. All employers have the same asset allocation: see 3.6.

The demographic assumptions vary by type of member and so reflect the different membership profiles of employers.

3.4 Future Service Contribution Rates

The future service element of the employer contribution rate is calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service.

The future service rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. Where it is considered appropriate to do so, the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a lower discount rate (most usually for Admission Bodies in the circumstances outlined in 3.2).

The approach used to calculate each employer's future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies that may have the power not to admit automatically all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

3.4.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* of valuation with a one year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise.

3.4.2 Employers that do not admit new entrants

Certain Admission Bodies have closed the scheme to new entrants. This is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as the membership ages.

To give more long term stability to such employers' contributions, the *Attained Age* funding method is normally adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both future service rates will include expenses of administration to the extent that they are borne by the Fund and include an allowance for benefits payable on death in service and ill health retirement.

3.5 Adjustments for Individual Employers

Adjustments to individual employer contribution rates are applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

The combined effect of these adjustments for individual employers applied by the Fund actuary relate to:

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (e.g. mix of members by age, gender, manual/non manual);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made;

over the period between each triennial valuation.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

The Fund actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation when calculating the share of the Fund assets attributable to each employer – see section 3.6 below, including, but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

3.6 Asset Share Calculations for Individual Employers

The Administering Authority does not account for each employer's assets separately. The Fund's actuary is required to apportion the assets of the whole fund between the employers at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund. The asset apportionment is capable of verification but not to audit standard.

The Administering Authority recognises the limitations in the process, but having regard to the extra administration cost of building in new protections, it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

3.7 Stability of Employer Contributions

3.7.1 General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of methods which the Administering Authority may permit, in order to improve the stability of employer contributions. These include, where circumstances permit:-

- capping of employer contribution rate changes within a pre-determined range ("stabilisation")
- the use of extended deficit recovery periods
- the phasing in of contribution rises or reductions
- the pooling of contributions amongst employers with similar characteristics
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

These and associated issues are covered in the remainder of 3.7.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement.

The Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis but will at all times be cognisant of its statutory obligations in regard to the securing the solvency of the Fund.

3.7.2 Stabilisation

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that the results of the modelling demonstrate that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" and are therefore paying less than their theoretical contribution rate should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

This stabilisation mechanism allows short term investment markets volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on all three of the following:

- net cash inflow
- investment strategy
- strength of employer covenant.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority (see below) and;
- there are no material events which cause the employer to become ineligible, eg significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring).

On the basis of extensive modelling (see 4.1.2),

- employer contribution increases each year are limited to 0.5% of salaries until 31 March 2014; and
- employer contribution reductions each year are limited to 2.0% of salaries until 31 March 2014.

The stabilisation criteria and limits are reviewed at the 31 March 2013 valuation, to take effect from 1 April 2014. This will take into account the maturing of the Fund's membership profile, the issues surrounding employer security, and other relevant factors.

At the 2010 valuation different stabilisation limits applied to certain bodies for historic reasons.

Eligible employers	Ineligible employers
Precepting bodies Police & Fire authorities Colleges & Universities	Community Admission Bodies Transferee Admission Bodies Health authorities Academies

3.7.3 Deficit Recovery Periods

The Administering Authority instructs the actuary to adopt specific deficit recovery periods for all employers when calculating their contributions.

The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table below.

Type of Employer	***Maximum*** **Length of Deficit Recovery Period**
Statutory bodies e.g. District Councils, Fire, Police, Probation.	20 years
Transferee Admission Bodies e.g. contractors	The period from the commencement date of revised contributions (April 2011 for the 2010 valuations) until the end of the Remaining Working Lifetime of employee members (subject to an acceptable covenant).
Bodies with either no or very few active members at this valuation	Deficit to be recovered by a fixed monetary amount over a period to be agreed with the body or its successor not to exceed 10 years.
All other types of employer	15 years

This *maximum* period is used in calculating each employer's *minimum* contributions. Employers may opt to pay higher regular contributions than these minimum rates. In any event, where stabilisation applies, the resulting employer contribution rate would be amended to comply with the stabilisation mechanism.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2011 for 2010 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.7.4 Deficit Recovery Payments

For employers where stabilisation is not being applied, the deficit recovery payments for each employer covering the three year period until the next valuation will often be set as a percentage of salaries. However, the Administering Authority reserves the right to amend these rates between valuations and/or to require these payments in monetary terms instead, for instance where:

- the employer is an admitted body with a relatively large deficit recovery contribution rate (eg 15% or more), in other words its payroll is a smaller proportion of its deficit than is the case for most other employers, or

- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or

- the employer has closed the Fund to new entrants.

3.7.5 Surplus Spreading Periods

As part of the overall Funding Strategy it was agreed to adopt a ‘stabilisation mechanism’ that limits increases and reductions in contribution rates for public sector bodies: see 3.7.2 above. Therefore any emerging surplus will not reduce their contributions outside the pre-determined range.

For Transferee Admission Bodies, the aim is to be 100% funded at cessation, and so the preferred approach would be to reduce contributions by spreading the surplus over the remaining contract term, although the approach taken may be discussed and agreed with the employer associated with the body.

For any other employers deemed to be in surplus the preferred approach would be to maintain contributions at the future service level. However, reductions **may** be permitted to reduce contributions below the cost of accruing benefits, by spreading the surplus element over the maximum periods shown above for deficits in calculating their **minimum** contributions.

To help meet the stability requirement, employers outside the stabilisation mechanism may prefer not to take such reductions.

3.7.6 *Phasing in of Contribution Rises*

With the exception of Transferee Admission Bodies employers may be permitted to phase in contribution rises as follows:

- for major tax raising bodies up to 6 years

- bodies who have no active members at this valuation will not be phased but are subject to the special arrangement referred to in table 3.7.3 above

- all other bodies 3 years, subject to the Administering Authority being satisfied as to the strength of the employer’s covenant

3.7.7 Phasing in of Contribution Reductions

Any contribution reductions will be subject to the 'stabilisation mechanism' set out in 3.7.2 above for public sector bodies. Other bodies including Transferee Admission Bodies can take the reduction with immediate effect, subject to paragraph 3.7.5 above.

3.7.8 The Effect of Opting for Longer Spreading or Phasing-In

Employers which are permitted and elect to use a longer deficit spreading period than was used at the 2007 valuation or to phase-in contribution changes will be assumed to incur a greater loss of investment returns on the deficit by opting to defer repayment. Thus, deferring paying contributions will lead to higher contributions in the long-term.

3.7.9 Pooled Contributions

3.7.9.1 Smaller Employers

With the advice of the Actuary the Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service.

Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not usually permitted to participate in a pool. Transferee Admission Bodies are usually also ineligible for pooling.

Smaller admitted bodies may be pooled with the letting employer, as per 3.8 (i) below.

Employers who are permitted to enter (or remain in) a pool at the 2010 valuation will be advised of their contribution rate and that it is subject to a pooling arrangement unless they seek in writing to be excluded from the pool.

3.7.9.2 Other Contribution Pools

Schools generally are also pooled with their funding Council. However there may be exceptions for specialist or independent schools such as Academies.

From time to time the Administering Authority may set up pools for employers with similar characteristics.

Those employers that have been pooled are identified in the Rates and Adjustments Certificate.

3.7.10 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority. Such flexibility includes a reduced rate of contribution, an extended deficit recovery period, or permission to join a pool with another body (eg the Local Authority). Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan;
- whether the admission agreement is likely to be open or closed to new entrants.

3.8 New Admission Bodies

Employers which 'outsource' have flexibility in the way that they can deal with the pension 'risk'. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor.

i) Pooling
Under this option the contractor is pooled with the letting employer letting the contract. In this case, the contractor pays the same rate as the letting employer , which is may be under the stabilisation approach.

ii) Employer retains pre-contract risks
Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor's contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) Fixed contribution rate agreed
Under this option the contractor pays a fixed contribution rate and doesn't pay any cessation deficit.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from;

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above;
- redundancy and early retirement decisions.

Transferee Admission Bodies will normally be required to provide some form of security, such as a guarantee from the letting employer or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract
- allowance for the risk of asset underperformance
- allowance for the risk of a fall in gilt yields
- allowance for the possible non-payment of employer and member contributions to the Fund.
- the current deficit.

The security will be reassessed on an annual basis.

The Administering Authority will only consider requests from Community Admission Bodies (or other similar bodies, such as section 75 NHS partnerships) to join the Fund if they are sponsored by a Scheduled Body with tax raising powers, guaranteeing their liabilities and also provide a form of security if requested.

The above approaches reduce the risk, to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies.

3.9 Regular Reviews

The Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals. These intervals may be annual, in the case of Admission Bodies and/or in the last few years of the employer's contract. Such reviews may be triggered by significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions payable (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), an increased level of security or guarantee, or some combination of these.

3.10 Admission Bodies Ceasing

Admission Agreements for Transferee Admission Bodies are assumed to expire at the end of the contract.

Admission Agreements for other employers are generally assumed to be open-ended but can be terminated at any point subject to the terms of the agreement.

Notwithstanding the provisions of the Admission Agreement, the Administering Authority considers any of the following as triggers for the termination of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund;
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

If an Admission Body's admission agreement is terminated, the Administering Authority will instruct the Fund actuary to carry out a termination valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

The approach adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

(a) For Transferee Admission Bodies, the assumptions applying at the contract end would normally be those used for an ongoing valuation to be consistent with those used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

(b) For non Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers.

The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future. Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in 3.3. Where such a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis" with no allowance for potential future investment outperformance and with an allowance for further future improvements in life expectancy. This could give rise to significant payments being required.

(c) For Admission Bodies with guarantors, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee.

Under (a) and (b), any shortfall would usually be levied on the departing Admission Body as a lump sum payment unless there are alternative sources of funds such as guarantees or bonds in place.

In the event that the Fund is not able to recover the required payment in full directly from the Admission Body or from any bond, indemnity or guarantor, then:

(i) in the case of Transferee Admission Bodies the Awarding Authority will be liable for future deficits and contributions arising. At its absolute discretion, the Administering Authority may agree to recover any outstanding amounts via an increase in the Awarding Authority's contribution rate over an agreed period, outside any stabilisation mechanism in place.

(ii) in the case of other Admission Bodies where there is no guarantor, the unpaid amounts fall to be shared amongst all of the employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date

As an alternative to (ii) above, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on ongoing suitably amended valuation basis: deficit recovery payments would be derived from this cessation amount. This approach would be monitored as part of each triennial valuation and the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

3.11 Early Retirement Costs

3.11.1 Non Ill Health retirements

The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health. Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining the age at which the valuation assumes that benefits are payable.

With the agreement of the Administering Authority the payment can be spread as follows:

Major Employing bodies	- up to 5 years
Community Admission Bodies	- up to 3 years
Academies	- up to 3 years
Transferee Admission Bodies	- payable immediately.

However, due to the current difficult economic conditions and cuts in budgets, the Administering Authority may permit alternative repayment terms for a temporary period: for the most secure employers only (i.e. those who are precepting and eligible for the stabilisation mechanism), the Fund will allow the option of repayment of early retirement strain costs over a longer period. In practice this will be effected by:

- assessing at the end of each financial year the additional liabilities arising from early retirements in that year,
- converting these into an additional contribution rate expressed as a percentage of payroll (based on a 20 year deficit recovery period). This is paid in addition to the stabilised contribution rate.

It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire. The additional costs of premature retirement are calculated by reference to these ages (NB the relevant age may be different for different periods of service, following the benefit changes from April 2008).

3.11.2 Ill health monitoring

Admitted Bodies will usually have an 'ill health allowance'; Scheduled Bodies may have this also, depending on their agreement terms with the Administering Authority. Under these circumstances, the Fund monitors each employer's, or pool of employers, ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis as apply for non ill-health cases. Details will be included in each separate Admission Agreement.

3.11.3 Ill health insurance

If an employer provides satisfactory evidence to the Administering Authority of a current insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged;

- there is no need for monitoring of allowances.

The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

4. Funding Strategy and Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice.

4.1 Funding Strategy

The Funding Strategy is intended to achieve the Fund's objectives set out in 2.3 above. The key problem is that the key objectives often conflict. For example, minimising the long term cost of the scheme (i.e. keeping employer rates affordable) is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down fairly frequently in fairly large moves). This conflicts with the objective to have stable contribution rates.

4.1.1 Key Objectives

The Actuary has developed four key measures which captures the essence of the Fund's objectives;

A) Affordability – how much can employer's afford

B) Stability – employers should not see significant moves in their contribution rates to provide a more stable budgeting environment

C) Prudence - the fund should have a reasonable expectation of being fully funded in the long term

D) Stewardship – the assumptions used should be sustainable in the long term.

4.1.2 Asset Liability Modelling

The Actuary was able to model the impact of these four key areas using a range of investment mixes and explicitly capping the increase in contribution rates at 0.5% of salaries per annum.

The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes (“stabilisation”) struck an appropriate balance between the above objectives, in particular between the need for stability of contributions and meeting the Administering Authority’s aims of prudent stewardship of the Fund. Whilst the current stabilisation mechanism is to remain in place until 2014, it was noted that this will need to be reviewed following the 2013 valuation.

4.2 Investments

The Administering Authority will determine the detailed asset allocation consistent with the overall asset allocation determined as part of the funding strategy. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (SIP).

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out after each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund’s liability profile. Following the 2010 valuation, it was agreed that up to 10% of the Fund’s assets would be gradually moved into “alternative” risk-reducing assets, as and when suitable opportunities arise. This change would remain consistent with the stabilisation mechanism described above.

The same investment strategy is currently followed for all employers. The Administering Authority does not currently have the facility to operate different investment strategies for different employers.

4.3 Consistency with Funding Basis

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund, the asset outperformance assumption is within a range that would be considered acceptable for the purposes of the funding valuation and consistent with the requirement to take a “prudent longer-term view” of the funding of liabilities (see para 2.1).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers’ contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.4 Balance between Risk and Return

The balance between risk and reward has been considered as part of the consultation on the funding strategy and has been informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

4.5 Intervaluation Monitoring of Funding Position

The Administering Authority monitors investment performance and monitors the relative funding position relative to the growth in the liabilities.   It reports back to employers through the Employer's Consultative Forum.

5. Key Risks & Controls

5.1 Types of Risk

The Administering Authority's has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

5.2 Financial Risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.	*Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.* *Analyse progress at three yearly valuations for all employers.* *Inter-valuation roll-forward of liabilities between valuations at whole fund level.*
Inappropriate long-term investment strategy.	*Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes. Chosen option consider to provide the best balance.*
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	*Inter-valuation monitoring, as above.* *Some investment in bonds helps to mitigate this risk.*
Active investment manager under-performance relative to benchmark.	*Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.*

5.2 Financial Risks Continued

Risk	Summary of Control Mechanisms
Pay and price inflation significantly more than anticipated.	*The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.* *Inter-valuation monitoring, as above, gives early warning.* *Some investment in bonds also helps to mitigate this risk.* *Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.*
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	*An explicit stabilisation mechanism has been agreed as part of the funding strategy.*

5.3 Demographic Risks

Risk	Summary of Control Mechanisms
Pensioners living longer.	*Set mortality assumptions with some allowance for future increases in life expectancy.* *The Fund Actuary has direct access to the experience of over 50 funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the Valuation.*
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	*Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.*

5.3 Demographic Risks Continued

Risk	**Summary of Control Mechanisms**
Deteriorating patterns of early retirements	*Employers are charged the extra cost of non ill-health retirements following each individual decision.* *Employer ill health retirement experience is monitored.* *Government changes to regulations to increase the minimum pension age from 50 to 55 and to have a normal retirement age of 65 by abolishing the 'rule of 85'.*
Reductions in payroll causing insufficient deficit recovery payments	*In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:* *For employers in the stabilisation mechanism, may be brought out of that mechanism to permit appropriate contribution increases (see second bullet point under 3.7.2).* *For other employers, review of contributions is permitted in general between valuations (see 3.9) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.*

5.4 Regulatory Risks

Risk	Summary of Control Mechanisms
Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees	*The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.*
Changes to national pension requirements and/or HMRC rules e.g. changes arising from the Hutton Review of public sector pensions.	*The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.* *The results of the Hutton review are not expected to affect the Fund until after the 2013 valuation, and so will be incorporated at that time. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.*

5.5 Governance Risks

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	*The Administering Authority has a close relationship with employing bodies and communicates required standards eg for submission of data.* *The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations* *Deficit contributions may be expressed as monetary amounts.*
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.	*The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.*
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: • *Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see 3.7.10).* • *Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.* • *Vetting prospective employers before admission.* • *Where permitted under the regulations requiring a bond to protect the scheme from various risks.* • *Requiring new Community Admission Bodies to have a guarantor.* • *Reviewing bond or guarantor arrangements at regular intervals (see 3.9).* • *Reviewing contributions if thought appropriate (see 3.9 and 3.7.4).*

Appendix A

Responsibilities of Key Parties

The Administering Authority should:-

- collect employer and employee contributions;
- invest surplus monies in accordance with the regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the fund's actuary;
- prepare and maintain a FSS and a SIP, after consultation; and
- monitor all aspects of the fund's performance and funding and amend FSS/SIP

The Individual Employer should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- exercise discretions 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
- notify the administering authorities promptly of all changes to membership or, as may be proposed, which affect future funding.

The Fund actuary should:-

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS; and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

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