DRAFT

FUNDING STRATEGY STATEMENT

SOUTH YORKSHIRE PENSION FUND

NOVEMBER 2019

South Yorkshire Pensions Authority

This Funding Strategy Statement has been prepared by South Yorkshire Pensions Authority (the Administering Authority) to set out the funding strategy for the South Yorkshire 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

It is the fiduciary responsibility of the Administering Authority (South Yorkshire Pensions Authority) to ensure that the South Yorkshire Pension Fund (the "Fund") has sufficient assets to meet its pension liabilities in the long term. The Funding Strategy adopted by the South Yorkshire Pension Fund will therefore be critical in achieving this statutory duty.

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 South Yorkshire 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 South Yorkshire 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 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.

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

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 and long term cost efficiency objectives.

The level of prudence has been quantified by the Actuary to show the level of contingency to provide protection against future adverse experience in the long term. Individual employer results will also have regard to their covenant strength. Broadly speaking the discount rate has been set so that there is approximately a 66% (or two-in-three) chance that the real returns achieved will be at least those assumed in the discount rate. The level of prudence will be reviewed each valuation taking into account the solvency and long term cost efficiency objectives for the Fund.

SOLVENCY AND LONG TERM COST 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 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 contribution 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.

DEFICIT RECOVERY PLAN AND CONTRIBUTIONS

As the solvency level of the Fund is 99% at the valuation date i.e. the assets of the Fund are less than the liabilities, a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall. At an individual employer level, there will be some instances where an employer's asset share is higher than the liabilities and therefore a surplus will exist. In such cases, a plan may need to be implemented to remove some, or all, of the surplus over an agreed timeframe, taking into account any increases to the Primary Rate which also emerge.

For those employers where a shortfall exists, 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. Employers may also elect to make prepayments of contributions which could result in a cash saving over the valuation certificate period.

The objective is to recover any deficit over a reasonable timeframe, and this will be periodically reviewed which in the long term provides equity between different generations of taxpayers whilst ensuring the deficit payments are eliminating a significant proportion of the capital element of the deficit, thereby reducing the interest cost. This will be periodically reviewed depending on the maturity profile of the Fund.

Subject to affordability considerations and individual employer circumstances, where a deficit exists and depending on the level of deficit, a guiding principle will be to maintain the total contributions at the prescribed monetary levels from the preceding valuation (including any indexation in these monetary payments over the recovery period). Contributions will only be reduced if the Fund deems this reasonable based on covenant and other risk factors. Full details are set out in this FSS.

Where there is a material increase in contributions required at this valuation, in certain circumstances the employer will be able to 'phase in' contributions over a period of 3 years in a pattern agreed with the Administering Authority and depending on the affordability of contributions as assessed in the covenant review of an employer. Employers will also be able to prepay deficit contributions if they have sufficient cash reserves to assist with affordability. Equally, certain employers will be able to align their contributions changes with their financial year if this does not end on 31 March.

The maximum recovery period for the Fund as a whole is 16 years at this valuation which is 3 years shorter than the average recovery period from the previous valuation. Subject to affordability and other considerations individual employer recovery periods would also be expected to reduce by a minimum of 3 years at this valuation.

The Government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. 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 notified to employers on this basis but also highlighting that the final costs may be significantly different. Employers will be able to <u>choose</u> to include these estimated costs over 2020/23 in their certified contributions. Alternatively, they will need to make allowance within their budgets and note that backdated contributions could be payable if the remedy is known before the next valuation.

[Drafting Note – This paragraph has been added following the guidance issued by the Scheme Advisory Board on 14 May 2019 concerning how to deal with the potential additional liabilities arising from the Cost Cap process and the McCloud and Sargeant age discrimination case (McCloud) (found here: http://www.lgpsboard.org/images/Other/Advice_from_the_SAB_on_McCloud_May_2019.pdf).This may need further adaptation once the outcome of the consultation is known. The Actuary will look at a potential cost to employers as part of the 2019 valuation process.]

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. included in 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 <u>in excess</u> 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 the returns on the Fund's assets and the level of inflation in the long term. Also, the Fund has implemented a number of risk management strategies since the last valuation and the expected volatility of returns has fallen i.e., provides more certainty to outcomes. This is also taken into account by the Actuary when proposing the assumptions and at this valuation means that the level of prudence has been reduced. 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 baseline past service liabilities should be 1.5% per annum and 2.35% per annum for determining the future service ("primary") contribution rate. This compares to 2.0% per annum and 2.75% per annum respectively at the last valuation.

Based on the assumptions being borne out in practice and the membership at the valuation date the aggregate projected expected return for the Fund as a whole over the 16 recovery period is a real return of CPI+1.75% per annum.

Alternative Funding Targets and Risk Management Framework

In the short to medium term, the Fund intends to implement a risk management strategy whereby employers will be categorised into different "investment" buckets. In such cases a different investment strategy would apply to the different groups of employers resulting in lower investment risk than the current whole fund strategy.

The Fund is therefore beginning to categorise employers in the following way. This will form the basis for any initial allocation into the different "investment" buckets.

Local Authorities – District Councils (including maintained schools), Police Fire, Combined Authority Group and SYPA. These employers either have the power to raise income through taxation or, in the case of SYPA, costs are entirely met by the Pension Fund.

Education Sector – F&HE Institutions and Academies. All these employers are ultimately funded by central government, although in different ways and with different forms of support. They do represent similar forms of risk although the likelihood of default can vary significantly between institutions.

Contractors – These employers can range from large multi-nationals to relatively small local businesses. Where contracts are let by a local authority there tends to be a guarantee, while the situation with contracts let by academies is more variable. However, in all cases the ultimate position is that the council or academy would need (at least in the short term) to take on any service (and hence pension liability) in the event of failure.

Others – While an extremely varied group this group probably presents the greatest likelihood of default (if possibly the least financial impact). In general, such employers have no or limited guarantees and therefore there is a danger that in the event of default liabilities will fall on the remaining employers.

If an employer is deemed to have a weaker covenant than others in the Fund, is planning to exit the Fund or would like to target a lower risk strategy, the Administering Authority has the discretion to move that employer (typically following discussions with the employer) into another strategy to protect the Fund as a whole. The current overall Fund investment strategy (as set out in the Investment Strategy Statement) will be known as the “higher risk investment strategy”. The investment strategy for each of the investment pots will be reviewed, following each actuarial valuation, as a minimum. The discount rate assumption that will be used for employers’ liabilities who fall into each category is linked directly to the relevant pot’s underlying assets allowing for the underlying level of risk associated.

Given that this risk management strategy will not be implemented before 1 April 2020, for the purpose of the 2019 actuarial valuation the setting of contribution rates to apply between 1 April 2020 and 31 March 2023, the Administering Authority will, depending on the circumstances of the employer, potentially apply a different funding target to certain employers in order to protect all stakeholders in the Fund i.e. to reflect different covenant / objectives etc. The different funding targets will be achieved by applying either a **5%** or **10%** loading to the employer’s baseline liabilities. In particular, where employers with a weaker covenant and in particular those with no guarantee have achieved a significant surplus based on a 100% funding target, a higher funding target will be set so as to deliver increased certainty that the employer will not fall into deficit in future.

Where a different funding target applies, this will be reflected in the employer’s deficit contributions / surplus offset over the period to 31 March 2023.

Demographic Assumptions

The demographic assumptions under all groups are based on the Fund Actuary’s bespoke analysis for the Fund, also taking into account the experience of the wider LGPS where relevant. For those employers terminating participation in the Fund, a more prudent mortality assumption will apply (see further comments below).

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 each employer's asset share.

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 shares, are allowed for when calculating asset shares at each valuation. Once the risk management strategy referred to above has been implemented, the investment return credited will depend on which bucket the employer's assets are in. In addition, the asset share may be restated for changes in data or other policies.

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.

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 **Appendix E** 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 and the approach taken is set out in **Appendix C**. Examples of new employers include:

- Mandatory Scheme Employers - for example new academies (see later section)
- Designated bodies - those that are permitted to join if they pass a resolution for example Town and Parish Councils.

- 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.
- [Employers may also join the Fund under the 'Deemed Employer' route. Further information on this is set out within **Appendix C**.]

[Drafting Note – This has been added following the consultation published by the MHCLG on 10 January 2019 (found here: https://www.gov.uk/government/consultations/local-government-pension-scheme-fair-deal-strengthening-pension-protection). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

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

In general, there will be a presumption against the admission of further, what were previously termed "Community Admission Bodies". Any such admission that is made will require a guarantee from a tax raising body.

Certain employers may be required to provide a guarantee (e.g. from a parent company) or alternative security before entry will be allowed, in accordance with the Regulations and Fund policies.

3. New academy conversions and multi-academy trusts

Current Fund policy regarding the treatment of schools when converting to academy status is for the new academy to inherit the school's share of the historic local authority deficit prior to its conversion. This deficit is calculated as the capitalised deficit funding contributions (based on the local authority deficit recovery period) the school would have made to the Fund had it not converted to academy status, subject to a minimum asset share of nil.

If the contribution rate for a local authority does not include any allowance for deficit funding contributions at the point at which a school converts to academy status, then no deficit will be allocated to the academy at the point of conversion.

In cases where numerous academies which participate in the Fund are in the same Multi-Academy Trust, the Fund's default position is that a combined funding position and average contribution requirements will apply (unless the Multi-Academy Trust requests separate contribution rates). Notwithstanding this, the Fund will continue to track the constituent academies separately on an approximate basis, in the interests of transparency and clarity around entry and exit of individual academies to the Trust in future.

The full policy is shown in **Appendix D.**

4. 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.

Where there is no guarantor who would subsume the liabilities of the exiting employer, the Fund's policy is that a discount rate linked to minimum risk investment returns (i.e. those that will be linked to any lower risk investment strategy subsequently implemented) and a more prudent longevity 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. Any exit credits (surplus assets over liabilities) will be paid from the Fund to the exiting employer within 3 months of completion of the cessation assessment by the Actuary. The Administering Authority will seek to modify this approach on a case by case basis if circumstances warrant it (for example, it may work with the outsourcing scheme employer to adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers).

This is subject to the exiting employer providing sufficient notice to the Fund of their intent to exit; any delays in notification will impact on the payment date. 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.

Where there is a **guarantor** who would subsume the assets and liabilities of the outgoing employer, the policy is that any deficit or surplus would be subsumed into the guarantor and taken into account at the following valuation. This is subject to agreement from all interested parties who will need to consider any separate agreements that have been put in place between the exiting employer and the outsourcing scheme employer.

If all parties do not agree then the surplus will be paid directly to the exiting employer within 3 months of cessation (despite any other agreements that may be in place). In maintaining a consistent approach, the Fund will seek to recover the deficit from the exiting employer in the first instance. However, if this is not possible, the deficit will be subsumed by the guarantor and all remaining assets and liabilities will then be subsumed by the guarantor.

The Fund will inform the guarantor of the exiting employer's request to receive the surplus before making payment of the exit credit. However, the Fund will not become embroiled in any disagreement over the refund of any surplus which is contrary to commercial agreements.

Ultimately the Fund will have to comply with the Regulations and therefore pay any exit credit. It is then up to the guarantor to contest the surplus payment citing the commercial contract in place and the desire for equal treatment in the event of a deficit.

In the event of parties unreasonably seeking to crystalise the exit credit on termination, the Fund will consider its overall policy and seek to recover termination deficits as opposed to allowing them to be subsumed with no impact on contribution requirements until the next assessment of the contribution requirements for the guarantor. Equally where a guarantor decides not to underwrite the residual liabilities the basis of assessment on termination will assume the liabilities are orphaned and thus the minimum risk basis will apply.

[An employer may continue to participate in the Fund with no contributing members and utilise the "Deferred Debt" Arrangements at the sole discretion of the Administering Authority which will be subject to a satisfactory covenant review on an ongoing basis. In this circumstance they will be treated as per any other participating employer in relation to overall funding strategy (including potentially requiring a final exit payment at some point) allowing for the covenant.]

[Drafting Note – This section has been adjusted following the consultation published by the MHCLG on 8 May 2019 (found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

5. Insurance arrangements

For certain employers, the Fund currently insures ill health retirement costs via an internal captive insurance arrangement which pools these risks for eligible employers. The captive arrangement will be operated as per the objectives set out in **Appendix F**.

CONTENTS

APPENDICES

1
INTRODUCTION

The Local Government Pension Scheme Regulations 2013 (as amended) ("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 South Yorkshire Pension Fund the Administering Authority will prepare and publish their 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 South Yorkshire Pension Fund are specified in the governing legislation contained in the Regulations referred to above. Benefits payable under the South Yorkshire 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 / EMPLOYEE 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 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 including ancillary, death in service and ill health benefits together with administration costs. It is expressed as a percentage of pensionable pay, 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 each employer is specified in the rates and adjustments certificate.

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 will be expressed as 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 for each employer 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 calculated as the total amount in respect of cash adjustments.

2

PURPOSE OF 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 actuary.

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then 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 are available to meet all liabilities as they fall due
- enable employer contribution rates to be kept at a reasonable and affordable cost to 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 investment 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, exit credits, 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 , 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 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's 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)
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- undertake administration duties in accordance with the Pension Administration Strategy.
- 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, additional pension contracts, 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 pensions 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 employer paying higher contributions than otherwise would be the case if the data was of high quality.

The **Fund Actuary** should:

- prepare valuations including the setting of employers' contribution rates at a level to ensure fund solvency and long term cost efficiency 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 to the Administering Authority and valuations on the termination of admission agreements including any exit credit payments.
- 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 the Administering Authority 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.

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 COST 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 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 and ancillary death in service and ill health benefits / ill-health premiums.
- the **Secondary rate**: a schedule of lump sum monetary amounts over 2020/23 in respect of an employer's surplus or deficit (including phasing adjustments).

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 review from 1 April 2023 based on the results of the 2022 valuation.

Where an employer is in a surplus position, the Secondary rate deduction from the Primary rate will be subject to a minimum threshold of £100, below which no deduction will be made.

DEFICIT 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 total contribution reductions to apply compared to the existing funding plan (allowing for indexation where applicable) where deficits remain unless there is compelling reason to do so.

- Subject to consideration of affordability, for scheduled and resolution bodies, and those admission bodies (not operating outsourced services) backed by a scheduled body guarantee, 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 (subject to a maximum of 16 years). This is to target full solvency over a similar (or shorter) time horizon. This is to maintain (as far as possible) equity between different generations of taxpayers and to protect the Fund against the potential for an unrecoverable deficit. The deficit recovery period will be set to at least cover the expected interest costs (actual interest costs will vary in line with investment performance) on the deficit.

- 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. The average recovery period adopted by all employers will be set out within the Actuary's report. Employers will be notified of their individual deficit recovery period as part of the provision of their individual valuation results.

- Those admission bodies operating outsourced services under a contract which expires within the maximum 16-year recovery period, the recovery period to apply will be the lifetime of the contract unless the body is in surplus (see comment below).

- Due to their weaker covenant, admission bodies not backed by a scheduled body guarantee will be subject to the same conditions as above but subject to a maximum recovery period of 11 years unless their defined (or expected) lifespan within the Fund is limited. Such known (or expected) events that could impact on their participation in the Fund should be notified to the administering authority by the body as soon as practically possible.

- 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.

- Where an employer is in a surplus position, the Secondary rate deduction from the Primary rate will be adjusted to such an extent that any surplus is used (i.e. run off) over the maximum 16-year period unless agreed otherwise with the administering authority e.g. where the employer's participation in the Fund is expected cease within the next three years.

  Such deductions will be subject to a minimum threshold of £100 p.a., below which no deduction will be made. The current level of contributions payable by the employer may also be phased down to the reduced level as appropriate.

- Where increases (or decreases) in employer contributions are required from 1 April 2020, following completion of the 2019 actuarial valuation, the increase (or decrease) from the rates of contribution payable in the year 2019/20 may be implemented in steps depending on affordability of contributions as determined by the administering authority. This will be notified to employers as part of the valuation process. It may be possible to have a different phasing pattern in certain circumstances subject to the agreement of the administering authority.

- Where increases in the primary rate and/or secondary rate contributions are to be phased in, the Administering Authority's policy is that any adjustment in 2020/21 should be rectified in 2022/23 i.e. so that the total level of primary and secondary rate contributions payable is the same over the three-year period.

- However, where a surplus exists or where there has been a reduction in contributions paid in respect of an employer's deficit at the valuation, the Fund would not consider it appropriate for any increase in contributions paid in respect of future accrual of benefits to be implemented in steps.

- For employers that do not have a financial year end of 31 March 2020 (e.g. 31 July 2020), the Fund can, at the employers request before 28th February 2020 allow the employer to continue to pay their current contribution plan until their financial year end date. The new contribution plan would then be implemented after this date (i.e. 1 August 2020 if the year-end is 31 July 2020)

Special circumstances to consider alternative deficit 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. All other things being equal this could result in a longer recovery period being acceptable to the Administering Authority, restricted to the maximum periods set out in Appendix B, although employers will still be expected to at least cover expected interest costs on the deficit.

- 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 evidence-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 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 principles, the Administering Authority, in consultation with the actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

Ill-Health Captive

- For those employers who are eligible for the ill-health captive arrangement, the contributions payable over the period 1 April 2020 to 31 March 2023 will be adjusted accordingly to reflect the premium charged to provide continued protection against the risks of excessive ill-health retirement costs emerging. Further details are provided in Appendix F of these adjustments.

Prepayment of Primary Rate and Secondary Rate Contributions

- For certain larger employers, subject to the agreement of the administering authority, the option to prepay Primary rate contributions may be made available. This option would be on the proviso that a “top-up” payment would be made by the employer prior to the end of the prepayment period in order to ensure that no underpayment emerges versus the minimum required by the valuation certificate.

- The facility to prepay secondary rate contributions where a deficit exists will be made available to all employers.

EMPLOYERS EXITING THE FUND

- Employers must notify the Fund as soon as they become aware of their planned exit date. Where appropriate, or at the request of the Scheme Employer, the Fund will review their certified contribution in order to target a fully funded position at exit. The costs of the contribution rate review will be payable by the employer or the outsourcing Scheme Employer (where necessary).

- 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. In such circumstances

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

- 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.

- If all parties do not agree then the surplus will be paid directly to the exiting employer within 3 months of completion of the cessation by the Actuary (despite any other agreements that may be in place). In maintaining a consistent approach, the Fund will seek to recover the deficit from the exiting employer in the first instance. However, if this is not possible, the deficit will be subsumed by the guarantor and all remaining assets and liabilities will then be subsumed by the guarantor.

- The Fund will inform the guarantor of the exiting employer’s request to receive the surplus before making payment of the exit credit. However, the Fund will not become embroiled in any disagreement over the refund of any surplus which is contrary to commercial agreements.

- Ultimately the Fund will have to comply with the Regulations and therefore pay any exit credit. It is then up to the guarantor to contest the surplus payment citing the commercial contract in place and the desire for equal treatment in the event of a deficit.

- In the event of parties unreasonably seeking to crystalise the exit credit on termination unreasonably the Fund will consider its overall policy and seek to recover termination deficits as opposed to allowing them to be subsumed with no impact on contribution requirements until the next assessment of the contribution requirements for the guarantor. Equally where a guarantor decides not to underwrite the residual liabilities then the basis on termination the basis of assessment will assume the liabilities are orphaned and the minimum risk basis of termination will apply.

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

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 3 months of completion of the cessation by the Actuary). This is subject to the exiting employer providing sufficient notice to the Fund of their intent to exit; any delays in notification will impact on the payment date.

- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as an immediate lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

- The Administering Authority also reserves the right to modify this approach on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary.

- Where an employer with no guarantor leaves the Fund and leaves liabilities with the Fund which the Fund must meet without recourse to that employer, the valuation of the termination payment will be calculated using a discount rate based on the minimum risk basis of termination.

Further details are set out in the termination policy is set out in Appendix C.

[Subject to sufficient financial covenant and at the sole discretion of the Administering Authority an employer may continue to participate in the Fund with no contributing members under the Deferred Debt arrangement.]

[Drafting Note – This has been added following the consultation published by the MHCLG on 8 May 2019 (found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

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.

ALTERNATIVE FUNDING TARGETS

In certain circumstances, as a pre-cursor to the Fund implementing a risk management framework involving investment buckets, a higher funding target may be adopted for certain employers as deemed appropriate by the Administering Authority. Initially this will be particularly applied to admitted body employers without a guarantor and will be used as a means of increasing the certainty of achieving or maintaining full funding.

The contribution rate for these employers will be determined to target a funding position of either 105% or 110% for the baseline liabilities. The principles around the recovery period will be as noted earlier after the change in funding target has been applied.

FUNDING FOR NON-ILL HEALTH EARLY RETIREMENT COSTS

All Employers are required to meet non ill-health early retirement strain costs arising on the grounds of redundancy / efficiency by immediate capital payments into 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. The treatment of any ill-health retirement strain cost emerging will vary depending on the type of employer:

- For those employers who participate in the ill-health insurance 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 don't participate in the ill-health captive, the "primary rate" payable over 2020/23 includes an allowance for ill-health retirement costs. Any ill-health retirement strain costs emerging will form part of the contribution rate assessment for the employer at the subsequent actuarial valuation (or termination assessment if sooner). No additional contributions will be due immediately from the employer.

FUNDING FOR DEATHS IN SERVICE

The financial impact of the benefits that become payable on the death of a member differ depending on whether the member dies before or after retirement.

The extent of any funding strain/profit which emerges on the death of a pensioner member (typically a profit) will be determined by the age of the pensioner at death and whether or not any dependants' benefits become payable.

In the event of a member dying whilst in active service, it is not certain that a funding profit would emerge. Whilst the Fund would no longer have to pay the accrued benefits at retirement for the deceased member, a lump sum death grant and also dependants' benefits would become payable instead. The dependants' benefits would also be based on the pensionable service that the member could have accrued had they remained in service until retirement.

Typically, the death of a young member with low pensionable service and dependants is likely to result in a large funding strain for the employer. However, the death of an older/long serving member with no dependants could actually result in a funding profit. Any funding strain or profit will emerge at the next actuarial valuation through increased/reduced deficit, except where the employer is in the termination process when it will be taken into account when the Actuary determines the termination position.

7

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

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 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 consist of a mixture of long-term index-linked gilts, fixed interest gilts and possible investment derivative contracts known as "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 or 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 minus 1% 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 c60%. This is a measure of the level of reliance on future investment returns.

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 overall strategic asset allocation is set out in the ISS and is as follows:

		Allocation %	Tolerance %
Bonds		**23.00**	
UK Index Linked		12.00	+/- 3.00
UK Buy and Maintain		5.00	+/- 2.00
Emerging Market High Return		3.00} 3.00} 6.00	} +/- 5.00
Quoted Equities		**50**	
UK		15.00	+/- 5.00
Overseas		35.00	+/- 5.00
	Developed Markets	27.125	+/- 5.00
	Emerging Markets	7.875	+/- 5.00
		35.00	
Illiquid Premium Private Equity Private Debt		 **7.00** **3.50**	 +/- 5.00 +/- 5.00
Infrastructure		**5.00**	+/- 5.00
Property		**10.00**	+/- 3.00
Cash		**1.50**	+/- 8.50
		100.00	

For the 2019 valuation, the investment return expectations as calculated by the Actuary equated to an overall best estimate average expected return of 2.65% per annum in excess of CPI inflation at the valuation date i.e. a 50/50 chance of achieving this real return 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. Broadly speaking the discount rate of CPI+1.5% p.a. has been set so that there is approximately a 66% (or two-in-three) chance that the returns achieved will be at least those assumed in the discount rate.

This margin however, has been reduced to take account of the risk management strategies implemented to reduce the volatility of returns within the investment strategy.

RISK MANAGEMENT STRATEGY

In the context of managing various aspects of the Fund's financial risks, the Administering Authority has implemented a number of risk management techniques. In particular:

- Equity Protection - the Fund has implemented protection against potential falls in the equity markets via the use of derivatives. The aim of the protection is to provide further stability in employer contributions (all other things equal) in the event of a significant equity market fall (although it is recognised that it will not protect the Fund in totality).

The principal aim of these risk management techniques is to effectively look to provide more certainty of real investment returns vs CPI inflation and/or protect against volatility in the termination position. It is designed to reduce risk and provide more stability/certainty of outcome for funding and ultimately employer contribution rates. The effect of these techniques has been allowed for in the 2019 actuarial valuation calculations and could have implications on future actuarial valuations and the assumptions adopted. Further details of the framework have been included in the ISS.

ALTERNATIVE INVESTMENT STRATEGIES

Within the next valuation cycle, the Fund will be considering the merits of implementing alternative investment strategies. Such strategies will have a lower level of growth assets compared with the current "higher risk" whole Fund strategy and will apply to certain employers in the Fund depending on their characteristics and objectives, as determined by the Administering Authority.

[Drafting Note – This paragraph has been added to enable the Fund to expand on the investment options that are offered to employers in the future if necessary. This would apply to employers who want to reduce/better manage their risk or if the Fund feels that they have insufficient covenant to continue with the risk associated with the higher risk investment strategy. Any options will be communicated to the Committee at that time. Once agreed, the Funding Strategy Statement will be updated to reflect this.]

The applicable investment strategy will be reflected in the relevant employer's notional asset share , funding basis and contribution requirements as assessed at subsequent actuarial valuations.

8

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 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 quantification of some of the major risk factors.

FINANCIAL

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Protection and risk management policies 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 larger asset pooling vehicle.
- 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. In addition, the implementation of a risk management framework to manage the key financial risks will help reduce risk over time.

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. The Fund’s ill health captive arrangement will also help to ensure that the eligible employers are not exposed to large deficits due to the ill health retirement of one or more of their members (see further information in **Appendix F**).

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 immediately 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 Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs (aside from ill-health retirement costs which are already insured for eligible employers) being insured with a third party or internally within the Fund. More detail on how the Fund currently insures ill health costs for eligible employers is set out in **Appendix F**.

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. Typically these would be via the Cost Management Process although in light of the McCloud discrimination case (see further comment in Section 9) there can be exceptional circumstances which give rise to unexpected changes in Regulations
- Changes to national pension requirements and/or HMRC Rules
- Political risk that the guarantee from the Department for Education for academies is removed or modified along with the operational risks as a consequence of the potential for a large increase in the number of academies in the Fund due to Government policy.

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. So far as the revised Funding Strategy Statement is concerned,

- consultation took place with employers at the end of 2018 on a range of key issues and assumptions influencing the valuation process. These issues were also discussed at the 2018 Employer Forum.
- Copies of the draft Funding Strategy Statement were circulated to all employers during November 2019 for their comments and an invitation to comment was placed on the Fund's website.
- The Fund Actuary and Fund Officers presented details in relation to specific issues and changes at workshops for specific groups of employers and at the 2019 Employer Forum

The final Funding Strategy Statement was approved on 23rd January 2020Governance 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.
- Political risk that the academies guarantee from the Department for Education is removed, especially given the large increase in the number of academies in the Fund.

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 (e.g. with regular data reconciliations with employers), but in most cases the employer, rather than the Fund as a whole, bears the risk.

PENSIONS AUTHORITY

South Yorkshire Pensions Authority, as the Administering Authority for South Yorkshire Pension Fund, has responsibility and accountability for overseeing the Fund.

Full details of the business of the authority including the meeting dates of the various Boards, minutes and agenda's, the contact details of the current Members and links to live webcasting of meeting can be accessed through the Authority's website https://www.sypensions.org.uk/Home/About-Us

PENSIONS ADMINISTRATION STRATEGY

The Pensions Administration Strategy (PAS) sets out clear standards of service to members by defining employer and Fund responsibilities in administering the Scheme and sets out the requirements for the two-way flow of information. The employer should notify the administering authority of the following events.

- Structural change in employer's membership e.g. large fall in employee numbers or large number of retirements.
- A closure in accessibility of the scheme to new entrants.
- An employer ceasing to exist.

The strategy has been developed and adopted in consultation and agreement with the participating Fund Employers and is provided for through statute by Regulation 59 of the Local Government Pension Scheme Regulations 2013 (as amended). It sets out, amongst other things, how the

Administering Authority, SYPA, will administer the Pension Scheme and Fund on behalf of Employing Organisations, and their Scheme Members, participating in the South Yorkshire Pension Fund, its requirements for employers in terms of the timely and accurate provision of information pertinent to the administration of the Scheme and Fund, and the penalties to be applied to those employing organisations failing to meet their duties, responsibilities and obligations as detailed within the strategy document.

The strategy has been developed and adopted in consultation to improve the overall standard of administration of the Scheme and the Fund and is intended to apply in a spirit of partnership working and co-operation where every assistance, tool, facility, system, training and guidance will be provided where possible to enable employers to improve administrative performance and meet the requirements of the strategy. Any penalties and censures carried within the strategy are not intended to apply as a first resort but rather as a last resort following a period of time and opportunity given for improvement to any organisation struggling to meet its obligations.

LOCAL PENSION BOARD

The Pension Board was established in April 2015 in accordance with the Public Service Pensions Act 2013, the national statutory governance framework delivered through the LGPS Regulations and guidance as issued by the Scheme Advisory Board.

The Board seeks to assist the South Yorkshire Pensions Authority to maintain effective and efficient administration and governance. The LPB comprises both Scheme members, retired and active, together with employer representatives. Employer representation is not restricted to the four large local Councils.

It meets quarterly and all Board Members have undertaken training and have established a work programme that will enable them to meet their obligations to ensure that the Fund complies with the relevant codes of practice and current legislation.

The Board is now supported by an Independent Adviser in order to ensure that it can provide effective challenge to the Authority and its officers.

9
MONITORING AND REVIEW

The Administering Authority has taken advice from the 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 statutory actuarial valuation and every review of employer rates or interim 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 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
- 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.

When monitoring the funding strategy, if the Administering Authority considers that any action is required, the relevant employers will be contacted. In the case of admitted bodies, 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 or request a full interim valuation. If considered appropriate, the Fund will carry out an interim valuation or a review of contributions for a specific employer or employer(s), if there:

1. has been a significant change in market conditions and/or deviation in the progress of the Funding Strategy,
2. has been a material change in an employer's covenant assessed in line with the policy in Appendix E.
3. the employer has notified the Fund of their intention to exit within the next 3 years. Employers must notify the Fund as soon as they become aware of their planned exit date.
4. has been a deviation in the progress of the funding strategy for the employer.
5. have been significant changes to the Scheme membership, or LGPS benefits.
6. has been a change in employer status.
7. have been any significant special contributions paid into the Fund.
8. have been significant statutory or regulatory changes.

In the normal course of events, contributions will only be reviewed for statutory or tax raising employers as part of a full actuarial valuation (statutory or interim valuation).

In exceptional circumstances, not envisaged in the Funding Strategy Statement, the Fund can apply for a direction from the Secretary of State to carry out an interim valuation. The Secretary of State would also have a power to require interim valuations of the Fund either on representation from the Fund, scheme employers or of his own volition.

Where the contribution review is triggered by an employer request (e.g. points 2, 3, 4, 5, 6 and 7 above), the costs associated with the review will be met by the employer(s) concerned.

COST MANAGEMENT THE McCLOUD JUDGMENT

The cost management process was set up by the Government, 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.

The potential impact of the judgement (based on the information available at the time) has been quantified and communicated to employers as part of the 2019 valuation. This has been assessed by 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. In effect this represents a worst case scenario in relation to those who were active as at 1 April 2012 (i.e. ignoring new joiners) and is therefore a prudent estimate of the impact. Employers will be able to choose to pay these estimated costs over 2020/23 in their certified contributions. Alternatively, they will need to make provision within their budgets.
If a definitive judgment is made before the 2022 valuation then for employers who chose not to incorporate the impact in their contributions backdated contributions will be collected immediately. The mechanism to achieve this has been set out in the Actuary’s certificate. For other employers any difference between the contributions collected and the actual cost will be adjusted in the 2022 valuation.

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 AND COST OF FUTURE ACCRUAL

Investment return (discount rate) – Solvency Funding Target

The 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 1.5% per annum above CPI inflation i.e. a real return of 1.5% per annum and a total discount rate of 3.9% per annum. This real return will be reviewed from time, to time, typically at the time of a formal valuation or bond review 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.

For those employers for whom the Administering Authority deems an alternative funding target should apply, a 5% or 10% loading will be applied to the baseline liabilities determined using the discount rate above, as deemed appropriate.

Investment return (discount rate) – Cost of Future Accrual

The future service liabilities are calculated using the same assumptions as the solvency funding target except that a different financial assumption for the discount rate is used. A critical aspect here is that the Regulations state the desirability of keeping the "Primary Rate" (which is the future service rate) as stable as possible so this needs 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 based on an overall assumed real discount rate of 2.35% per annum above the long term average assumption for consumer price inflation of 2.4% per annum. This leads to a discount rate of 4.75% per annum.

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 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 average reduction to the assumption to long term RPI inflation to arrive at the CPI inflation assumption at the valuation date is 1.0% per annum. The CPI inflation assumption at the valuation date is 2.4% per annum.

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 1.25% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint for employers The default assumption is for pay growth of 3% (covering both headline increases and incremental drift) each year from the valuation date up to 31st March 2023 although employers will be able to opt for the long-term assumption only should they wish.

Application of bespoke salary increase assumptions as put forward by individual employers will be at the ultimate discretion of the Administering Authority but as a minimum must be reasonable and practical. Employers will need to provide clear evidence that justifies any bespoke assumptions (for example a long-term pay agreement) To the extent that experience differs to the assumption adopted, the effects will emerge at the next actuarial valuation.

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 scheme. 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 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 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.

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

Commutation

Based on scheme specific analysis undertaken over a long period, it has been assumed that, on average, retiring members will commute pension up to 90% of the maximum tax-free cash available at retirement (allowing for any standard 3/80ths cash sum that may be payable). 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 p.a. 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 remain in line with the assumptions adopted for the last valuation. In addition, no allowance will be made for the future take-up of the 50:50 option. Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate 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

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. In addition, the asset share may be restated for changes in data or other policies.

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

Long-term yields	
Market implied RPI inflation	[3.40%] p.a.
Solvency Funding Target financial assumptions	
Investment return/Discount Rate	[3.90%] p.a.
CPI price inflation	[2.40%] p.a.
Long Term Salary increases*	[3.65%] p.a.
Pension increases/indexation of CARE benefits	[2.40%] p.a.
Future service accrual financial assumptions	
Investment return/Discount Rate	[4.75%] p.a.
CPI price inflation	[2.40%] p.a.
Long Term Salary increases*	[3.65%] p.a.
Pension increases/indexation of CARE benefits	[2.40%] p.a.

* in addition to this, an allowance for further short-term pay restraint may be made. This will be in the range of 2% per annum to 3% per annum for 4 years to 31 March 2023 depending on an employer's circumstances.

Life expectancy assumptions

The post retirement mortality tables adopted for this valuation, along with sample life expectancies, are set out below:

-Post retirement mortality tables

Current Status	Retirement Type	Mortality Table
Annuitant	Normal Health	101% S3PMA_CMI_2018 [1.75%] 88% S3PFA_M_CMI_2018 [1.75%]
	Dependant	133% S3PMA_CMI_2018 [1.75%] 89% S3DFA_CMI_2018 [1.75%]
	Ill Health	125% S3IMA_CMI_2018 [1.75%] 122% S3IFA_CMI_2018 [1.75%]
	Future Dependant	128% S3PMA_CMI_2018 [1.75%] 107% S3DFA_CMI_2018 [1.75%]
Active	Normal Health	109% S3PMA_CMI_2018 [1.75%] 90% S3PFA_M_CMI_2018 [1.75%]
	Ill Health	125% S3IMA_CMI_2018 [1.75%] 139% S3IFA_CMI_2018 [1.75%]
Deferred	All	131% S3PMA_CMI_2018 [1.75%] 105% S3PFA_M_CMI_2018 [1.75%]

Future Dependant	Dependant	137% S3PMA_CMI_2018 [1.75%] 113% S3DFA_CMI_2018 [1.75%]

-Life expectancies at age 65

Membership Category	Male Life Expectancy at 65	Female Life Expectancy at 65
Pensioners	22.4	25.6
Actives aged 45 now	23.8	27.5
Deferreds aged 45 now	22.4	26.4

Further detail and other demographic assumptions are set out in the Actuary's formal report.

APPENDIX B – EMPLOYER DEFICIT / SURPLUS RECOVERY PLANS

As the assets of the Fund are less than the liabilities at the effective date, a deficit recovery plan needs to be adopted such that additional contributions are paid into the Fund to meet the shortfall.

Deficit contributions paid to the Fund by each employer will be expressed as £s amounts and will increase at 2.4% p.a. (unless agreed with the Administering Authority). 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 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 principles used to determine the recovery periods is summarised in the table below. These will be used to derive the minimum contributions payable subject to reasonable affordability and covenant assessment. In some cases, the actuary may recommend a higher deficit contribution for 2020/23.

Category	Maximum Deficit Recovery Period	Derivation
District Councils	16 years	Determined by reducing the period from the preceding valuation by at least 3 years
Other Tax-raising Scheduled and Designating Bodies	16 years	Determined by reducing the period from the preceding valuation by at least 3 years and to ensure, where appropriate, total contributions do not reduce versus the current contributions from the existing recovery plan.
Academies and Multi-Academy Trusts	16 years	Determined by reducing the period from the preceding valuation by at least 3 years and to ensure, where appropriate, total contributions do not reduce versus the current contributions from the existing recovery plan.
Higher and Further Education Bodies (Universities and Colleges)	16 years	Determined by reducing the period from the preceding valuation by at least 3 years and to ensure, where appropriate, total contributions do not reduce versus the current contributions from the existing recovery plan.
Community Admission Bodies (guaranteed by another Scheme Employer within the Fund)	16 years	Determined by reducing the period from the preceding valuation by at least 3 years and to ensure, where appropriate total contributions do

		not reduce versus the current contributions from the existing recovery plan.
Community Admission Bodies (with no guarantee),	11 years	Determined by reducing the period from the preceding valuation by at least 3 years (unless the expected participation in the Fund is known and is shorter) and to ensure, where appropriate, total contributions do not reduce versus the current contributions from the existing recovery plan.
Transferee Admission Bodies (guaranteed by the letting Scheme Employers)	16 years	Deficit recovery period to be limited to the lifetime of the contract. For those employers in surplus, the maximum recovery period may apply unless the contract is expected to expire in the next three years.

The recovery period adopted for individual employers has been notified to them along with their individual valuation results.

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.

The objective is to recover any deficit over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the total contributions at the expected monetary levels from the preceding valuation (allowing for any indexation in these monetary payments over the recovery period).

For any employers assessed to be in surplus, their individual contribution requirements may be adjusted to such an extent that any surplus is unwound over a maximum 16 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.

Other factors affecting the Employer Deficit Recovery Plans

As part of the process of agreeing funding plans with individual employers and managing risk in the intervaluation period, the Administering Authority will exceptionally consider the use of contingent assets (for example a charge on a property) 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. All other things equal this could result in a longer recovery period being acceptable to the Administering Authority, restricted to a maximum period of 16 years, although employers will still be expected to at least cover expected interest costs on the deficit.

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 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 actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

APPENDIX C - ADMISSIONS AND TERMINATION POLICY

ENTRY TO THE FUND

MANDATORY SCHEME EMPLOYERS

Certain employing bodies are required to join the scheme under the Regulations. These bodies include tax raising bodies, those funded by central government (academies and colleges) and universities (reliant on non-government income). Academies also fall under this category.

DESIGNATING BODIES

Designating bodies are permitted to join the scheme if they pass a resolution to this effect. Designating bodies, other than connected entities, are not required under the Regulations to provide a guarantee. These bodies usually have tax raising powers and include Parish and Town Councils.

ADMISSION BODIES

An admitted body is an employer which, if it satisfies certain regulatory criteria, can apply to participate in the Fund. If its application is accepted by the administering authority, it will then have an "admission agreement". In accordance with the Regulations, the admission agreement sets out the conditions of participation of the admitted body including which employees (or categories of employees) are eligible to be members of the Fund.

Admitted bodies can join the Fund if

- They provide a service for a scheme employer as a result of an outsourcing (formerly known as Transferee Admission Bodies)
- They provide some form of public service and their funding in most cases derives primarily from local or central government. In reality they take many different forms but the one common element is that they are "not for profit" organisations (formerly known as Community Admission Bodies).

Admitted bodies may only join the Fund if they are guaranteed by a scheme employer. When the agreement or service provision ceases, the Fund's policy is that in all cases it will look to recover any outstanding deficit from the outgoing body unless appropriate instruction is received from the outsourcing employer or guaranteeing employer, in which case the assets and liabilities of the admission body will in revert to the outsourcing scheme employer or guaranteeing employer.

[JOINING THE FUND VIA THE 'DEEMED EMPLOYER' ROUTE

This is an alternative route to the admitted body route for achieving pension protection. It relates to employers which have employees working for a third party but fall under the deemed employer for the purposes of the Regulations.

It will be the outsourcing Scheme Employer's choice, when initially putting the contract out to tender, whether the Admission Agreement or Deemed Employer approach will be used. The outsourcing scheme employer will be also known as the deemed employer with regard to this admitted body.

If the Deemed Employer route is chosen, the admitted body will not join the Fund and will instead be grouped/pooled with the original scheme employer. This may be used when a pass through arrangement has been agreed.

The Fund's policy will be dependent on the deemed employer's policy and approach to dealing with these outsourcings. This makes it imperative that each outsourcing scheme employer has a clear policy on the treatment of each type of admitted body. The Fund also requires an agreement (similar to the admission agreement) with the admitted body to ensure their duties are fulfilled e.g. payment of contributions.]

[Drafting Note – This has been added following the consultation published by the MHCLG on 10 January 2019 (found here: https://www.gov.uk/government/consultations/local-government-pension-scheme-fair-deal-strengthening-pension-protection). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

CONNECTED ENTITIES

Connected entities by definition have close ties to a scheme employer given that a connected entity is included in the financial statements of the scheme employer.

Although connected entities are "Designating Bodies" under the Regulations, they have similar characteristics to admitted bodies (in that there is an "outsourcing employer"). However, the Regulations do not strictly require such bodies to have a guarantee from a scheme employer.

However, to limit the risk to the Fund, the Fund will require that the scheme employer provides a guarantee for their connected entity, in order that the ongoing funding basis will be applied to value the liabilities.

CHILDREN'S CENTRE TRANSFER TO ACADEMY TRUSTS

Local education authorities have an obligation to provide Children's Centres under the Childcare Act 2006. The Act places duties on these authorities in relation to establishing and running Children's Centres and therefore the financial obligation to cover the LGPS costs of eligible staff remains a responsibility of the local education authority regardless of service delivery vehicle. The local education authority is liable for all the LGPS liabilities of the Children's Centre.

As the staff cannot be employed directly by an Academy or Academy Trust, the South Yorkshire Pension Fund will permit admission of a <u>separate participating employer</u> (with its own contribution rate requirements based on the transferring staff), through a tri-partite admission agreement between the South Yorkshire Pension Fund, the Local Education Authority of the ceding Council and the body responsible for managing the Children's Centre (this could be an Academy Trust or private sector employer).

SECOND GENERATION OUTSOURCINGS FOR STAFF NOT EMPLOYED BY THE SCHEME EMPLOYER CONTRACTING THE SERVICES TO AN ADMITTED BODY

[Drafting Note – This section will potentially need amending when the outcome of the consultation published by the MHCLG on 10 January 2019 is known (found here: https://www.gov.uk/government/consultations/local-government-pension-scheme-fair-deal-strengthening-pension-protection).]

A 2nd generation outsourcing is one where a service is being outsourced for the second time, usually after the previous contract has come to an end. For Best Value Authorities, principally the unitary authorities, they are bound by The Best Value Authorities Staff Transfers (Pensions) Direction 2007 so far as 2nd generation outsourcings are concerned. In the case of most other employing bodies, they should have regard to Fair Deal Guidance issued by the Government.

It is usually the case that where services have previously been outsourced, the transferees are employees of the contractor as opposed to the original scheme employer and as such will transfer from one contractor to another without being re-employed by the original scheme employer. There are even instances where staff can be transferred from one contractor to another without ever being employed by the outsourcing scheme employer that is party to the Admission Agreement. This can occur when one employing body takes over the responsibilities of another, such as a maintained school (run by the local education authority) becoming an academy. In this instance the contracting body is termed a 'Related Employer' for the purposes of the Local Government Pension Scheme Regulations and is obliged to guarantee the pension liabilities incurred by the contractor

"Related employer" is defined as "any Scheme employer or other such contracting body which is a party to the admission agreement (other than an administering authority in its role as an administering authority)".

LGPS REGULATIONS 2013: SCHEDULE 2 PART 3, PARA 8

Where, for any reason, it is not desirable for an admission body to enter into an indemnity or bond, the admission agreement must provide that the admission body secures a guarantee in a form satisfactory to the administering authority from—

(a) a person who funds the admission body in whole or in part;

(b) in the case of an admission body falling within the description in paragraph 1(d), the Scheme employer referred to in that paragraph;

> *(d) a body that is providing or will provide a service or assets in connection with the exercise of a function of a Scheme employer as a result of—*
>
> *(i) the transfer of the service or assets by means of a contract or other arrangement,*
>
> *(ii) a direction made under section 15 of the Local Government Act 1999 (115) (Secretary of State's powers),*
>
> *(iii) directions made under section 497A of the Education Act 1996 (116)* ;

(c) a person who—

(i) owns, or

(ii) controls the exercise of the functions of, the admission body; or

In accordance with the above Regulations, the Fund requires a guarantee from the related employer. The related employer may seek a bond from the admitted body taking into account the risk assessment carried out by the Fund actuary.

ILL-HEALTH CAPTIVE

Those employers determined by the administering authority as being automatically eligible for the ill-health captive arrangement on entry to the Fund are as follows:

- Academies
- Admitted Bodies formerly known as Community Admission Bodies
- Designating / Resolution Bodies
- Transferee Admission Bodies
- All other bodies with less than 100 members

EXITING THE FUND

INTRODUCTION

Admission bodies are required to have an "admission agreement" with the Fund. In conjunction with the Regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.

A list of all current admission bodies participating in the Fund is published in the Fund's annual report http://www.sypensions.org.uk/Publications/Annual-Reports

TERMINATION POLICY

When an employer's participation in the Fund comes to its end, or is prematurely terminated for any reason (e.g. a contract with a local authority comes to an end or the employer chooses to voluntarily cease participation), employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case the employees will retain pension rights within the Fund i.e. either deferred benefits or immediate retirement benefits.

In addition to any liabilities for current employees the Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members.

Where the Fund obtains advance notice that an employer's participation is coming to an end, the Regulations enable the Fund to commission a funding assessment leading to a revised contribution certificate which is designed to eliminate, as far as possible, any surplus or deficit by the cessation date.

Whether or not an interim contribution adjustment has been initiated once participation in the Fund has ceased, the employer becomes an exiting employer under the Regulations and the Fund is then required to obtain an actuarial valuation of that employer's liabilities in respect of benefits of the exiting employer's current and former employees along with a revision of the rates and adjustment certificate showing any contributions due from the admission body.

When an employer exits the Fund the Regulations give power to the Fund to set a repayment plan to recover the outstanding debt over a period at its sole discretion and this will depend on the affordability of the repayments and financial strength of the exiting employer. Once this repayment plan is set the payments would not be reviewed for changes in the funding position due to market or demographic factors.

*[Drafting Note – "*Unless agreed otherwise *" has been added following the consultation published by the MHCLG on 8 May 2019 as it is possible employers could continue to participate in the Fund with no active members which is commonly referred to as an deferred debt arrangement (found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed. This is distinct from an employer exiting the Fund and agreeing a repayment plan.]*

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

- The default position is for exit payments and exit credits to be paid immediately in full unless.
- At the discretion of the administering authority, instalment plans over a defined period will only be agreed when there are issues of affordability that risk the financial viability of the organisation and the ability of the Fund to recover the debt.
- Any costs associated with the exit valuation will be paid by the employer by either increasing the exit payment or reducing the exit credit by the appropriate amount. In the case of an employer where the exit debt/credit is the responsibility of the original employer through a risk sharing agreement the costs will be charged directly to the employer unless the original employer directs otherwise.

In the event that unfunded liabilities arise that cannot be recovered from the exiting employer, these will normally fall to be met by the Fund as a whole (i.e. all employers) unless there is a guarantor or successor body within the Fund.

BASIS OF TERMINATION

Whilst reserving the right to consider the options on a case by case basis, the Fund's general policy is that a termination assessment will be made based on a more cautious "minimum risk" funding basis, **unless** a Transferor Body (e.g. guaranteeing employer within the Fund) exists to take over the admission body's liabilities (including those for former employees). This is to protect the other employers in the Fund as, at termination, the admitted body's liabilities will become "orphan liabilities" within the Fund, and there will be no recourse to the admission body if a shortfall emerges in the future (after the admission has terminated).

Under the "minimum risk" basis of termination the discount rate assumption used will be derived to be consistent with a lower risk investment strategy linked to low risk income generating assets such as bonds. At the 2019 valuation date the discount rate adopted would have been 1.5% per annum. The "minimum risk" assumptions will be updated on a case-by-case basis, with reference to prevailing market conditions at the relevant employing body's cessation date. 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.

In addition to using a more cautious discount rate, the Actuary will also use a more cautious mortality assumption when assessing the size of the liabilities for termination purposes. In particular, the Actuary will assume a higher improvement rate for future improvements to 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 and as such, the assumption will build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 2% per annum for males and females, compared to 1.75% per annum used in the 2019 valuation for ongoing funding and contribution purposes.

[Drafting Note – in the light of recent mortality trends emerging, and also the September announcement on the change in RPI inflation (and consequently the RPI/CPI gap), the assumptions applying in the minimum risk termination basis will be reassessed in due course.]

If a Transferor Body exists to take over the admission body's liabilities, the Fund's policy is that the most recent valuation funding basis will be used for the termination assessment updated for market yields and inflation applying at the termination date. The Transferor Body will then, following any termination payment made, subsume the assets and liabilities of the admission body within the Fund (sometimes known as the "novation" of the admission agreement). This will include the novation to the Transferor Body of any funding deficit (or surplus) on closure, which the Authority has been unable to resolve with the exiting employer or its insurer, indemnifier or bondsman.

[Subject to sufficient financial covenant and at the sole discretion of the Administering Authority an employer may continue to participate in the Fund with no contributing members under the Deferred Debt arrangement.]

[Drafting Note – Wording has been added following the consultation published by the MHCLG on 8 May 2019 (found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf).

The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

IMPLEMENTATION

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 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.

If all parties do not agree then the surplus will be paid directly to the exiting employer within 3 months of completion of the cessation by the Actuary (despite any other agreements that may be in place). In maintaining a consistent approach, the Fund will seek to recover the deficit from the exiting employer in the first instance. However, if this is not possible, the deficit will be subsumed by the guarantor and all remaining assets and liabilities will then be subsumed by the guarantor.

The Fund will inform the guarantor of the exiting employer's request to receive the surplus before making payment of the exit credit. However, the Fund will not become embroiled in any disagreement over the refund of any surplus which is contrary to commercial agreements.

Ultimately the Fund will have to comply with the Regulations and therefore pay any exit credit. It is then up to the guarantor to contest the surplus payment citing the commercial contract in place and the desire for equal treatment in the event of a deficit.

In the event of parties unreasonably seeking to crystalise the exit credit on termination unreasonably the Fund will consider its overall policy and seek to recover termination deficits as opposed to allowing them to be subsumed with no impact on contribution requirements until the next assessment of the contribution requirements for the guarantor. Equally where a guarantor decides not to underwrite the residual liabilities then the basis on termination the basis of assessment will assume the liabilities are orphaned and the minimum risk basis of termination will be applied.

As the guarantor will absorb the residual assets and liabilities, it is the view of the Actuary that the ongoing valuation basis 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 be fully funded based on liabilities assessed on the valuation basis.

If the guarantor refuses to take responsibility, then the residual deferred pensioner and pensioner liabilities should be assessed on the more cautious minimum risk 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.

NON CONTRACT BASED ADMISSION BODIES 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. Indeed, it may be that Fund is prepared to accept that no actual termination payment is needed (even if one is calculated) and that all assets/liabilities can simply be absorbed by the guarantor.

ADMISSION BODIES WITH NO GUARANTOR IN THE FUND

These are the cases where the residual liabilities would be orphaned within Fund. It is possible that a bond would be in place. The termination calculation would be on the more cautious “minimum risk” basis.

The actuarial valuation and the revision of any Rates and Adjustments Certificate in respect of the outgoing admission body must be produced by the Actuary at the time when the admission agreement ends; 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 3 months of completion of the cessation by the Actuary). This is subject to the exiting employer providing sufficient notice to the Fund of their intent to exit; any delays in notification will impact on the payment date.

• In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as an immediate lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

The Administering Authority also reserves the right to modify this approach on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary.

The above funding principles will also impact on the **bond requirements** for certain admitted 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.

[EMPLOYERS THAT JOINED VIA THE 'DEEMED EMPLOYER' ROUTE

In the event of cessation, the assets and liabilities will remain with the outsourcing scheme employer and no termination assessment or payment will be required.]

[Drafting Note – This has been added following the consultation published by the MHCLG on 10 January 2019 (found here: https://www.gov.uk/government/consultations/local-government-pension-scheme-fair-deal-strengthening-pension-protection).
The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

CONNECTED ENTITIES

In the event of cessation, the connected entity will be required to meet any outstanding liabilities valued in line with the approach outlined above. In the event there is a shortfall, the assets and liabilities will revert to the Fund as a whole (i.e. all current active employers).

In the event that a scheme employer provides a guarantee for their connected entity, the assets and liabilities will revert in totality to that scheme employer on termination, including any unrecovered deficit.

RELEVANT REGULATIONS WITHIN THE LOCAL GOVERNMENT PENSION SCHEME REGULATIONS 2013 (AS AMENDED BY THE LOCAL GOVERNMENT PENSION SCHEME (AMENDMENT) REGULATIONS 2018)

Regulation 64 sets out special circumstances where revised actuarial valuations and certificates must be obtained including Regulation 64 (2) where an admission agreement ceases to have effect, the Administering Authority who made it must obtain –

• an actuarial valuation as at the date it ceases the liabilities in respect of current and former employees of the admission body which is a party to that admission agreement ("the outgoing admission body"),

• a revision of any rates and adjustments certificate for any Pension Fund which is affected, showing the exit payment due from the exiting body or exit credit payable to the exiting body. Where it is not possible for any reason to obtain revised contributions from the exiting body, or from an insurer or any person providing an indemnity or bond on behalf of the body, the Administering Authority may obtain a further revision of any rates and adjustment certificate for the Pension Fund, showing –

a) in the case where the exiting body falls within paragraph 1(d) of Part 3 of Schedule 2 the revised contributions due from the body which is the related employer in relation to that admission body, and

b) in any other case, the revised contributions due from each employing authority who contributes to the fund.

If the Administering Authority becomes aware or is of the opinion of a Scheme employer becoming an exiting employer, Regulation 64 (4) provides that it may obtain from an actuary a certificate specifying, in the case of an admission body, the percentage or amount by which, in the actuary's opinion -

- the contribution at the primary rate should be adjusted, or

- any prior secondary rate adjusted should be increased or reduced, with a view to providing that assets equivalent to the exit payment that will fall due from the Scheme employer are provided to the fund by the likely exit date or, where the Scheme employer is unable to meet the liability by that date, over such period of time thereafter as the administering authority considers reasonable.

APPENDIX D - ACADEMIES / MULTI-ACADEMY TRUSTS

ACADEMY CONVERSIONS AND DEFICIT TRANSFERS

The Fund's policy regarding the treatment of schools when converting to academy status is for the new academy to inherit the school's share of the historic local authority deficit prior to its conversion. This is in accordance with the Department for Education (DfE) guidance issued when the Academy conversion programme was extended to cover all schools.

Therefore, the transferring deficit is calculated as the capitalised amount of deficit funding contributions (based on the local authority deficit recovery period) the school would have made to the Fund had it not converted to academy status. This deficit amount is subject to a limit to ensure that the minimum asset share of the new academy is nil.

If the contribution rate for a local authority does not include any allowance for deficit funding contributions at the point at which a school converts to academy status, then no deficit will be allocated to the academy at the point of conversion.

MULTI ACADEMY TRUSTS

Multi Academy Trusts (MATS) are groups of Academies managed and operated by one proprietor. The employer of non-teaching staff in Academies is the proprietor of the Academy Trust and not the individual Academy within the Trust. It is therefore the proprietor who is the employer for LGPS purposes making the MAT legally responsible for staff across all schools in the pool.

Within a MAT all Academies are governed by one Trust and a Board of Directors. The MAT holds ultimate responsibility for all decisions regarding the running of the individual Academies, however, the governing bodies of the individual academies remain in place and the MAT will need to decide the extent to which it delegates functions to these governing bodies to enable more focused local control.

Multi-Academy Trusts are set up to cover a number of academies across England. The employees of the former schools can be employed directly by the Trust so they can be deployed across different academy schools in the Trust if necessary.

In cases where numerous academies which participate in the Fund are in the same Multi-Academy Trust, the Fund's default position is that the a combined funding position and average contribution requirements will apply (unless the Multi-Academy Trust requests separate contribution rates). Notwithstanding this, the Fund will continue to track the constituent academies separately on an approximate basis, in the interests of transparency and clarity around entry and exit of individual academies to the Trust in future.

APPROACH TO SETTING CONTRIBUTION RATES

The South Yorkshire Pension Fund must have a separate employer number for each academy for transparency of cashflows, managing risks should an academy need to leave one Trust for another and for accounting reporting where disaggregated disclosure reports are required. It should also be noted that, at the present time, the Department for Education (DfE) have confirmed that guarantee relates to individual academies and MATs.

As commented above, unless requested otherwise by the MAT, the Fund's policy is that the actuary will certify a common primary rate for all the academies within the MAT bearing in mind that the risks of under and over payments will be shared by all academies in the MAT pool. The Fund has requested confirmation from the DfE that the guarantee extends to MATs. In the event that MATs are not guaranteed, the Fund will review any option for MATs to have a common primary rate.

The past service deficit will still be assessed at an individual academy level so that it only relates to the staff of the respective academy. The ceding local authority requires a corresponding adjustment for the share of the deficit that transfers on conversion therefore individual academy figures will be required. In line with the approach adopted for the Primary Rate, the Fund's policy is that the actuary will certify a combined secondary rate for all academies within the MAT unless requested otherwise by the MAT.

Any new academies joining an existing MAT pool in the South Yorkshire Pension Fund can contribute at the employer contribution rate already established for the MAT but an actuarial assessment will still need to be carried out to determine the deficit applicable to the transferring staff and thus the additional secondary rate contributions payable.

For any academies who exit a MAT pool during the inter-valuation cycle, the MATs secondary rate contributions will be adjusted at the point of exit, based on the outcomes for the exiting academy at the most recent actuarial valuation.

OUTSOURCINGS BY MULTI ACADEMY TRUSTS

The South Yorkshire Pension Fund's current policy is in accordance with the regulations requiring a separate admission agreement in respect of separate contracts.

Under **Schedule 2, Part 3, paragraph 5. of the 2013 Regulations**, if the admission body is exercising the functions of the Scheme employer in connection with more than one contract or other arrangement under paragraph 1(d)(i), the administering authority and the admission body shall enter into a separate admission agreement in respect of each contract or arrangement.

The Fund will need to have sight of the contract in order to satisfy the regulatory requirement that the Admission Agreement covers one contract. The Admission Agreement will need to have provision for adding future employees should any academies join the MAT subsequent to the commencement date.

The Scheme employer, the Multi Academy Trust in this instance, needs to be a party to any admission agreement and, as such, is the ultimate guarantor. In the event of contractor failure, the LGPS regulations provide that the outstanding liabilities assessed by the Fund's actuary can be called from the Scheme employer i.e. the Multi Academy Trust.

If academies are to comply with "new" Fair Deal guidance, employees carrying out a service on behalf of the Academies must be allowed continued access to the LGPS. This can be achieved by entering into an Admission Agreement with the Administering Authority, Multi Academy Trust and the contractor (admitted body).

At every triennial valuation the actuary reviews the funding level of the admitted body and adjusts its employer contribution rate as required. Once either the service contract comes to an end or all the LGPS members have left, the admission agreement terminates and, in accordance with Fund policy, the Fund will commission a cessation valuation in all cases from the Fund actuary to recovery any outstanding deficit unless instructed otherwise by the Trust. The Trust will then become responsible for the assets and liabilities standing to the account of the admitted body.

APPENDIX E – 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/Greed (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) using an online system provided to officers by the Fund Actuary.

Employers subject to a more detailed review, where a risk criterion is triggered, will be reviewed at least every six months, but more realistically with a quarterly focus.

COVENANT RISK MANAGEMENT

The focus of the Fund's risk management is the identification and treatment of the risks and 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 (e.g. the termination basis).
3. Shortened recovery periods and increased cash contributions.
4. Managed exit strategies and bespoke investment strategies in the run up to exit.
5. Contingent assets and/or other security such as escrow accounts.

APPENDIX F – ILL-HEALTH CAPTIVE INSURANCE ARRANGEMENT

OVERVIEW

With effect from 1 October 2014, for certain employers in the Fund, following discussions with the Fund Actuary and after considering potential alternative insurance arrangements, a captive insurance arrangement was established by the administering authority to cover ill-health retirement costs.

The captive arrangement operates as follows:

- “Premiums” are paid by the eligible employers into a captive fund which is tracked separately by the Fund Actuary in the valuation calculations.

- The captive fund is then used to meet strain costs emerging from ill-health retirements i.e. there is no impact on funding position for employers within the captive

- Any shortfall in the captive fund is effectively be underwritten by all other employers within the Fund i.e. with potential for increases to their own contribution requirements at subsequent actuarial valuations to meet the shortfall. If any excess funds are built up in the Captive, some or all of those excess funds will be held in reserve to act as a contingency against future adverse experience at the discretion of the administering authority based on the advice of the actuary,

- Premiums payable subject to review from valuation to valuation depending on experience and included in employer rates.

- Over the longer-term, given the regular review of the premiums payable into the Captive fund there would be expected to be no net cost to those employers underwriting the Captive Fund in the long-term i.e. any fluctuations in their own contribution requirements arising from experience would smooth out over time.

EMPLOYERS

Those employers (both existing and new) determined by the administering authority as being eligible for the arrangement are as follows:

- Academies and former Grant Maintained Schools
- Admitted Bodies formerly known as Community Admission Bodies
- Designating / Resolution Bodies
- Transferee Admission Bodies
- Other scheduled bodies meeting certain criteria at the inception of the arrangement.
- All other bodies with less than 100 members

For all other employers who do not form part of the captive arrangement, the any costs associated with ill-health retirements will emerge as part of subsequent actuarial assessments.

The Fund and the Actuary will also monitor the number of retirements that each captive employer is granting over time. If any employer has an unusually high incidence of ill health retirements, consideration will be given to the governance around the eligibility criteria applied by the employer and it is possible that some or all of the costs would fall on that employer if the governance was not deemed strong enough.

PREMIUM REVIEW

As part of each actuarial valuation exercise (or earlier review if appropriate) the Fund Actuary will review the experience of the captive fund since the last review.

Should the premiums paid into the captive fund over the period not be sufficient to cover the ill-health retirement costs emerging, any shortfall in the fund will be allocated across all those employers within the Fund underwriting the captive. If any excess funds are built up in the Captive, some or all of those excess funds will be held in reserve to act as a contingency against future adverse experience at the discretion of the administering authority based on the advice of the actuary.

The ongoing premium payable by those employers within the captive fund will also be assessed as part of this process and will be set by the Actuary to cover the period until the next review (e.g. to the next actuarial valuation assessment). The Premiums that will be assessed will take into account the expected level of future ill-health retirements across those employers within the captive and also to reflect any adverse/favourable experience where appropriate.

APPENDIX G - GLOSSARY

Actuarial Valuation: an investigation by an 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.

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.

Corporate Bond Basis: an approach where the discount rate used to assess the liabilities is determined based on the market yields of high quality corporate bond investments (usually at least AA rated) based on the appropriate duration of the liabilities being assessed. This is usually adopted when an employer is exiting the Fund.

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.

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 differs 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.

Deficit: the extent to which the value of the Fund’s past service liabilities exceeds the value of the Fund’s assets.

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 Covenant: the degree to which an employer participating in an occupational pension scheme is willing and able to meet the funding requirements of the scheme.

Employer's Future Service Contribution 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.

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

Equity Protection: an insurance contract which provides protection against falls in equity markets. Depending on the pricing structure, this may be financed by giving up some of the upside potential in equity market gains.

Exit Credit: the amount payable from the Fund to an exiting employer where the exiting employer is determined to be in surplus at the point of cessation based on a termination assessment by the Fund Actuary.

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 to the Fund.

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 past service liabilities assessed on the ongoing concern basis.

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.

Ill-Health Captive: this is a notional fund designed to immunise certain employers against excessive ill-health costs in return for an agreed insurance premium.

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

Past Service Liabilities: this is the present value of the benefits accrued by members up to the valuation date. It is assessed based on a set of assumptions agreed between the Administering Authority and the Actuary.

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.

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

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

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 requires the assumptions adopted for an actuarial valuation to be prudent.

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.

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 2019 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

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