

# AVON PENSION FUND

## FUNDING STRATEGY STATEMENT (FSS)

*This Statement has been prepared by Bath and North East Somerset Council (the Administering Authority for the Local Government Pension Scheme in the area formerly known as Avon) to set out the funding strategy for the Avon Pension Fund (“the Fund”), in accordance with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) and the guidance paper issued in March 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.*

### 1. Introduction

The Local Government Pension Scheme (Administration) Regulations 2008 (as amended) (the “Administration Regulations”) replaced the Local Government Pension Scheme Regulations 1997 (as amended) providing 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 Scheme the Administering Authority will prepare and publish their funding strategy;**
- **In preparing the FSS, the Administering Authority must have regard to:-**
  - (i) the guidance issued by CIPFA for this purpose; and**
  - (ii) the Statement of Investment Principles (SIP) for the Scheme published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (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 Statement of Investment Principles.**

Benefits payable under the Scheme are guaranteed by statute and thereby the pensions promise is secure. 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 Scheme is a defined benefit final salary scheme under which the benefits are specified in the governing legislation (the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as

amended), the “BMC Regulations”). The required level of employee contributions are also specified in the BMC Regulations.

Employer contributions are determined in accordance with the Regulations (principally Administration Regulation 36) which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate. Contributions to the Scheme should be set so as to “secure its solvency”, whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

## **2. Purpose of the FSS in policy terms**

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

The purpose of this Funding Strategy Statement is:

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

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 Pension Fund**

**The aims of the fund are to:**

- ensure that sufficient resources are available to meet all liabilities as they fall due
- enable employer contribution rates to be kept as nearly constant as possible and at a reasonable and affordable cost to the taxpayers, scheduled, resolution and admitted bodies
- support the employers so that they can manage their liabilities effectively, and
- maximise the returns from investments within reasonable risk parameters.

**The purpose of the fund is to:**

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

(all the above items as defined in the Local Government Pension Scheme (Administration) Regulations 2008 (as amended), the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended)).

**4. Responsibilities of the key parties**

**The Administering Authority should:**

- collect employer and employee contributions
- invest surplus monies in accordance with underlying legislation
- ensure that cash is available to meet liabilities as and when they fall due
- manage the valuation process in consultation with the actuary
- prepare and maintain an FSS and a SIP, both after due consultation with interested parties, and
- monitor all aspects of the Scheme's performance and funding, amending the FSS/SIP as necessary.

**The Individual Employer should:**

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with BMC Regulation 3)
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- exercise discretions within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain, and
- notify the Administering Authority promptly of any changes to membership which may affect future funding, before the event.

**The Fund Actuary should:**

- prepare valuations including the setting of employers' contribution rates after consulting the Administering Authority and having regard to their FSS, and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters, and
- advise on funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the SIP.

## 5. Solvency issues and target levels

To meet the requirements of the Administration Regulations the Administering Authority's long-term funding objective is to achieve and then maintain assets equal to 100% of projected accrued liabilities, assessed on an ongoing basis including allowance for projected final pay.

The financial assumptions making up the funding strategy in respect of past service and as adopted for the 2010 valuation are:

Rate of discount	[6.85]% per annum (pre-retirement) 5.70% per annum (post-retirement)
Rate of Pensionable Pay Inflation	[4.50]% per annum
Rate of pension increase inflation	[3.00]% per annum

The key financial assumptions for Past Service are as follows:

- the extent to which the Fund's investments are expected to outperform a portfolio of Government bonds ("asset outperformance assumption" – AOA). An AOA of 2.35% per annum has been assumed in respect of pre-retirement liabilities and 1.2% per annum in respect of post-retirement liabilities.
- the expected rate of Pensionable Pay increase above CPI price inflation ("real Pensionable Pay growth"). This has been assumed to be 1.50% per annum in the long term (see further comments below).

The AOA represents the advance allowance which, for valuation purposes, the actuary is making for the return which will be achieved on the Fund's assets over and above Government bonds. This reflects the liability profile of the Fund and the fact that the Fund is invested predominantly in higher return assets as detailed in Section 7. If the return actually achieved is higher than this the Fund deficit will be reduced; if the return is lower then the Fund deficit will increase (provided that all the other assumptions remain valid).

The rate of pensionable pay inflation relates to pay increases for scheme members during their period of employment (this will determine the level of their final salaries, on which the pension is based). If the actual rate of pensionable pay inflation is greater than the actuary's assumption the Fund deficit will increase; if it is lower then the Fund deficit will be reduced (again, provided that all the other assumptions remain valid).

There are special circumstances relating to this valuation such as the government's announcement that all public sector employees earning over a whole time equivalent of £21,000 per annum, would not receive any pay increases for at least two years whilst other employees would receive a flat increase. Given this, the Administering Authority will, on the advice of the Fund Actuary, make an adjustment to the valuation results to reflect this short term pay progression as far as it relates to those employers affected by the change.

The rate of price inflation applies primarily to pensions in payment and the assumption incorporates an adjustment to allow for supply/demand distortions in the bond market which is used to derive the market implied rate as at the valuation date. The rate of price inflation is important as retirement pensions are increased each April by the Consumer Price Index applying in the previous September. This is a departure from the historic approach based on the Retail Price Index and was announced by the Chancellor in his Emergency Budget in June 2010 and will apply from April 2011. The above assumptions make due allowance for this revised basis of indexation as advised by the Actuary.

In testing whether actual experience has been in line with the actuary's assumptions (which are intended to be long term allowances rather than predictive of rates in the three year period between valuations), any monitoring exercise would need to focus on their aggregate effect.

For calculating the cost of future accruals (the future service basis) a non-market related basis is adopted. This focuses on stability in the future service contribution rate, rather than linking it directly to variable gilt yields at each valuation, with the object of introducing an element of smoothing into the costs falling on employers. The use of a different basis for future service also reflects the fact that market conditions at time of payment of future contributions are at present unknown.

The future service basis for the 2010 valuation assumes a real rate of discount in excess of price inflation of 3.75% per annum (pre and post retirement).

The 2010 valuation takes into account modified longevity, ill health and proportions married assumptions compared to that adopted at the previous valuation following an analysis of Fund experience carried out by the Fund Actuary. It also assumes that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, builds in a minimum level of longevity 'improvement' year on year in the future.

The following two tenets underpin the 2010 valuation:

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

The current actuarial valuation of the Fund is effective as at 31 March 2010. The results indicate that overall the assets of the Fund represented [83]% of projected accrued liabilities at the valuation date.

Historically, any shortfall of assets relative to liabilities has been recovered over a period of 15 years. At the 2004 valuation, the administering authority for the Avon Pension Fund, Bath & North East Somerset Council agreed to consider requests from employing bodies to increase their recovery periods from 15 to 20 years and this position remained unchanged at the 2007 valuation. At this valuation the Administering Authority is recognising the pressures on public

sector finances by extending the recovery period for Scheduled and Designating Bodies with the aim of maintaining a stable rate of contribution, subject to an employer's strength of financial covenant. The Actuary has drawn the Fund's attention to the uncertain position regarding the willingness of the government to guarantee the outstanding pension liabilities of a scheduled body, in particular, a college or academy. Because there are no immediate concerns about the financial covenant over the next three years, the same maximum deficit recovery period applied to the scheduled bodies will be applied to the colleges and academies. The financial risks of the colleges and academies will be monitored during the valuation period and, on the basis of this, different treatment may be necessary at the next valuation. In addition, special arrangements continued to apply so far as the admitted bodies are concerned, these being subject to the outcome of the Fund's review (see Appendix 1).

Therefore the administering authority proposes to introduce the option for employing bodies to extend the maximum deficit recovery period to those shown in the table below, **subject to there being no reduction in the employer contribution rate**. Employers will be able to select any shorter deficit recovery period than the maximum periods stated below.

<b>Employer Category</b>	<b>Maximum Deficit Recovery Period</b>
Scheduled and Designating Bodies (except Bath Tourism Plus and Destination Bristol)	[30] years subject to no reduction in the employer rate
Community Admission Bodies (guaranteed by another Scheme Employer within the Fund)	[30] years subject to agreement with Guarantor
Community Admission Bodies (with no guarantee), Bath Tourism Plus and Destination Bristol	Determined on a case by case basis
Transferee Admission Bodies (guaranteed by the letting Scheme Employers)	Deficit recovery period to be agreed with the letting scheme employer

Ideally, the Fund would have been seeking to move back to a lower deficit recovery period at this stage but, in view of the continuing funding pressures it has not proved practicable. **Any savings arising as a result of scheme changes or any improvement in the funding position at the next valuation will be used to reduce the deficit recovery period to at least the 2007 position** and therefore reduce the overall cost of the scheme. Only after this has been achieved, will any reductions in employer contribution rates be considered.

Similarly, any increase in contribution rates necessary to restore full funding and again after discussion with the actuary, the Fund will consider allowing employing bodies to phase in the increase over a period not normally exceeding

[three] years. However, it should be noted that it may not be possible to extend this facility to all admitted bodies.

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

In exercising their discretion within the maximum deficit recovery period, the employing bodies will be given detailed advice by the Avon Pension Fund.

## **6. Admitted Bodies, Destination Bristol and Bath Tourism Plus**

There are particular issues which need to be addressed in this Statement regarding the way in which the liabilities of admitted bodies are funded. The essential issues are (i) what valuation basis should be used when an admitted body leaves the Fund, (ii) what steps can reasonably be taken to protect employing bodies generally from the financial risk of an admitted body becoming insolvent and (iii) what level of contribution rate is affordable. These issues are addressed in detail in Appendix 1.

**The main item of policy set out in Appendix 1 is that, unless the liabilities of an admitted body are transferred on closure to another employing body, the residual liabilities will be valued using either:**

- **an “ongoing” valuation basis; consistent with the 2010 actuarial valuation assumptions but updated for market yields/inflation applying at the cessation date, or**
- **a “corporate bond yield” basis; consistent with the 2010 actuarial valuation assumptions, updated for market yields/inflation applying at the cessation date but with a discount rate based on the long dated Sterling AA Corporate Bond yield,**

**whichever produces the higher liability value.**

(It should be noted that this principle would apply to any employing body which leaves the Fund. Although the number of occasions when this is likely to occur are few, the bodies involved can be quite sizable. These events are normally triggered by restructurings initiated by government). Additionally, where an admitted body becomes insolvent and leaves a deficit with the Fund, there is a change in the way in which this deficit will be funded in future.

Although Destination Bristol and Bath Tourism Plus are resolution bodies, these have the same characteristics as some of the Fund’s admitted bodies and must be considered in the same way.

Since the Fund's policy on admitted bodies will have implications for every employing body in the Fund, this Appendix should be regarded as an integral part of the Funding Strategy Statement and be read as such.

## 7. Link to investment policy as set out in the Statement of Investment Principles (SIP)

The results of the 2010 valuation show the liabilities to be [83]% covered by the current assets, with the funding deficit of [17]% being covered by future deficit contributions.

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

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 closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

Investment of the Fund's assets in line with the least risk portfolio would minimise fluctuations in the Fund's ongoing funding level 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 out-performance of the investments or any adjustment to market implied inflation assumption due to supply/demand distortions in the bond markets. On this basis of assessment, the assessed value of the Fund's liabilities at the 2010 valuation would have been significantly higher.

Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The target position of having sufficient assets to meet the Fund's pension obligations might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

**The current benchmark investment strategy, and expected long-term returns, as set out in the SIP are:**

Asset Class	% of Fund	Expected Return (long term, p.a.)
UK Equities	27%	8.4%
Overseas Equities	33%	8.4%
Index-Linked Gilts	6%	5.1%
Fixed Coupon Gilts	6%	4.7%
UK Corporate Bonds	5%	5.6%
Overseas Fixed Interest	3%	5.6%
Fund of Hedge Funds	10%	6.6%
Property	10%	7.4%

As documented in the SIP, the investment strategy and return expectations set out above equate to an overall expected return of 2.8% per annum in excess of



long-dated gilt returns. 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.

The funding strategy adopted for the 2010 valuation is based on an assumed asset out-performance of [2.35%] in respect of liabilities pre-retirement and [1.2%] in respect of post-retirement liabilities. Based on the liability profile of the Scheme at valuation, this equates to an overall average asset out-performance allowance of [1.6]% per annum in the short term to keep pace with the liabilities. The Administering Authority believes that this is a reasonable and prudent allowance for asset out-performance, based on the investment strategy set out in the SIP.

## **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 chart below illustrates the range and uncertainty in the future progression of the funding level, relative to the funding target adopted at the valuation. Using a simplified model, the chart shows the probability of exceeding a certain funding level over a [10] year period from the valuation date assuming no change in contribution rates, investment strategy or the benefits of the Scheme. For example, the top line shows the 95th percentile level (i.e. there is a 5% chance of the funding level at each point in time being better than the funding level shown, and a 95% chance of the funding level being lower.)

**CHART TO BE CONSIDERED - TBC**

### ***Financial***

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Market yields move 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

To the extent that employer contribution rates need to increase as a result of these risks, there will in turn be an impact on service delivery and the financial position of admitted/scheduled bodies.

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

### ***Demographic***

The demographic risks are as follows:-

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)

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.

Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, **employing bodies should be doing everything in their power to minimise the number of ill-health retirements.** Early retirements for reasons of redundancy and efficiency do not affect the solvency of the Fund because they are the subject of a direct charge.

### ***Regulatory***

The regulatory risks are as follows:-

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

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

### ***Governance***

The Avon Pension Fund Committee 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, it will be circulating copies of the first draft to all employing bodies for their comments and will also place a copy on the Fund's website. The first draft is being released after consultation with Members of the Avon Pension Fund Committee; the final version will be approved at the Committee's meeting in September after the Fund has received feedback from the employing bodies.

Governance risks are as follows:-

- 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.

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

## **9. Monitoring and Review**

The Administering Authority has taken advice from the actuary in preparing this Statement.

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

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

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- if there have been significant changes to the Scheme membership, or LGPS benefits
- if there 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
- if there 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 employing authorities will be contacted. In the case of admitted bodies, there is statutory provision for rates to be amended between valuations but it is unlikely that this power will be invoked other than in exceptional circumstances.

**Avon Pension Fund**  
**[to be updated]**

## FUNDING STRATEGY STATEMENT – APPENDIX 1

### ADMITTED BODIES including DESTINATION BRISTOL AND BATH TOURISM PLUS

#### Introduction

1. 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.
2. There are basically two types of admitted body, as follows:-

**Transferee admission bodies** – An employer which participates in the Fund for the benefit of employees involved with delivery of a specific function or service for a Scheme Employer (the “transferor scheme employer”). An example is where a local authority outsources a specific service (e.g. waste management) to a private sector employer. In these cases the Scheme Employer acts as ultimate guarantor and would be a party to the admission agreement in addition to the admitted body itself.

**Community admission bodies** – These are the traditional type of admitted body, i.e. those which provide some form of public service and whose 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.

**Destination Bristol and Bath Tourism Plus** – These bodies are companies limited by guarantee in which the outsourcing Scheme Employer has a controlling interest. Although they are “Designating Bodies”, they have similar characteristics to admitted bodies (viz. they are similar to transferee admission bodies in that there is an “outsourcing employer” and they are similar to most of the Fund’s community admission bodies in that there is no guarantee). For the purpose of the Funding Strategy Statement they will be treated as if they are community admission bodies.

3. As mentioned above, community admission bodies in the Avon Pension Fund are a diverse group. Some are financially very secure in that they receive funding from either the government or local authorities on a quasi permanent basis. Others either have short-term funding contracts with local authorities, which may not be renewed when they expire, or depend heavily on various forms of fund raising. Most of the recently admitted bodies are backed by a guarantee; however, those which were admitted more than eight years ago will have no such backing and, as such, will constitute a potential risk to the Fund. This is because they may cease

operations with insufficient residual assets to meet their pension liabilities.

4. The risks associated with admitted bodies have always existed but these risks have assumed a higher profile recently because most Funds – and, by extension, most employing bodies – now have a deficit of assets relative to liabilities. It is important that, in the interests of the other employing bodies, as much as possible is done to manage the risks associated with the admitted bodies. There is also the question of the basis on which the liabilities of the admitted bodies are valued by the actuary when the admitted body leaves the Fund. These have always been valued on a stronger basis (= more highly valued) than that used for the triennial valuation.

### **Valuation Basis**

5. When the actuary prepares the triennial valuation, the rate at which he discounts future pension payments back to a present value reflects the return which he expects, or “assumes”, that the Fund will earn on its investments over the long term. If this return is not achieved, either in the short term or the long term, all other things being equal, contribution rates would have to be increased at subsequent valuations.
6. When an admitted body leaves the Fund, there is no facility to revert to that body if the contributions paid by that body to meet future pension payments prove to be inadequate. Because the body responsible for generating these liabilities has no ongoing obligation to meet any future increase in liabilities relative to assets, the liabilities left with the Fund are known as “orphan liabilities”.
7. **Therefore, unless the liabilities of an admitted body are transferred on closure to another employing body, the residual liabilities will be valued by the actuary using either**
  - **an “ongoing” valuation basis consistent with the 2010 actuarial valuation assumptions but updated for market yields/inflation applying at the cessation date,**
  - or**
  - **a “corporate bond yield” basis consistent with the 2010 valuation assumptions, updated for market yields/inflation applying at the cessation date but with a discount rate based on the long dated Sterling AA Corporate Bond yield,**

**whichever produces the higher liability value.**

The theory is that, if the assets left by the admitted body are invested in corporate bonds, the Fund can be assured of achieving a return which would approximate to the underlying liabilities and thereby eliminate most of the investment risk arising from “orphan liabilities”. The Sterling AA Corporate Bond yield is, of course, the discount rate currently used for

FRS 17 purposes, albeit over a range of durations appropriate to the underlying liabilities.

8. For the purposes of the actuarial valuation, there is arguably a case for using the Sterling AA Corporate Bond yield to discount the liabilities of a substantial number of admitted bodies. This would have a twofold benefit in that (i) it would achieve consistency between the triennial valuation and the valuation basis used on closure and (ii) the higher contributions would provide greater protection for the other employing bodies in the Fund who, by default, would have to meet any deficit left by an admitted body which became insolvent.
9. Ahead of the 2010 valuation only a small number of admitted bodies are in the position of having their liabilities valued on the Sterling AA Corporate Bond basis. Had financial circumstances been more favourable at the last valuation, there would have been more.
10. However, for the benefit of the admitted bodies, additional information will be provided showing the past service deficit which would have resulted if the Sterling AA Corporate Bond yield had been used as the discount rate. Employers will then have input as to whether they wish to reduce investment risk and volatility by investing in corporate bonds with the liabilities being valued accordingly. However, this reduction in volatility will come at an increase in the contribution rate.

### **Transferee Admission Bodies**

11. As at 31 March 2010 the transferee admission bodies in the Avon Pension Fund, with the outsourcing Scheme Employer in brackets, were as follows:-

Active Community Engagement Ltd (Bristol City Council)  
Agincare (Bath & North East Somerset Council)  
Aquaterra Leisure Ltd. (Bath & North East Somerset Council)  
Aramark Ltd (City of Bristol College)  
BAM Construction UK Ltd (Bristol City Council)  
Bespoke Cleaning Services Ltd (Filton College)  
Churchill Contract Services Ltd (Bristol City Council)  
Eden Food Services (Bristol City Council)  
English Landscapes (Bristol City Council)  
ISS Mediclean (Bristol City Council)  
Mama Bears (City of Bristol College)  
Mouchel Business Services Ltd (Bath & North East Somerset Council)  
Northgate Information Systems (Bristol City Council)  
Prospect Services Limited (Gloucestershire County Council)  
Quadron Services Ltd (Bristol City Council)  
Shaw Healthcare (North Somerset) Ltd. (North Somerset Council)  
SITA Holdings UK Ltd. (South Gloucestershire Council)  
Skanska Rashleigh Weatherfoil (Bristol City Council)  
SLM Community Leisure (Bristol City Council)  
SLM Fitness and Health (Bristol City Council)

South Gloucestershire Leisure Trust (South Gloucestershire Council)  
The Brandon Trust (North Somerset Council)  
Yes Dining Ltd (Bristol City Council)

The Fund's actuary has advised that, if the outsourcing employer is willing to take over the liabilities of the admitted body when the admission agreement is terminated, the existing valuation basis can continue to be used (this does not preclude the possibility of the admitted body compensating the outsourcing employer for any deficit which may exist on closure). If, however, the outsourcing employer is not willing to take over the liabilities, the admitted body's liabilities would become "orphan liabilities" and the stronger valuation basis would apply.

12. **The information which the Fund will be seeking in respect of these admitted bodies is the policy stance of the outsourcing Scheme Employer with regard to the treatment of the transferee admission body's liabilities on closure. It will also be looking for guidance from these employers with regard to ongoing deficit management.**

#### **Community Admission Bodies (with guarantee)**

13. In 2002 new legislation was introduced which made it possible for the Fund to seek guarantees from local authorities in support of applications made by potential community admission bodies wishing to participate in the Fund. **The current policy of the Avon Pension Fund is that any such applications must, with few exceptions, be accompanied by a guarantee or, failing that, a bond.**

14. As at 31 March 2010 the community admission bodies in the Avon Pension Fund supported by a guarantee were as follows:-

Merlin Housing Society Ltd. (Transferred Staff Only)  
North Somerset Housing  
Southwest Grid for Learning Trust  
West of England Sport Trust (Wesport)

15. The guarantors for Merlin Housing Society Ltd and North Somerset Housing are South Gloucestershire Council and North Somerset Council respectively. In this case the relationship between the community admission bodies and the "outsourcing" employer is, from the Fund's standpoint, much the same as for transferee admission bodies. The Fund will accordingly seek to establish the policy stance of the outsourcing employer with regard to the treatment of the community admission body's liabilities both on an ongoing basis and on closure.

16. The admission agreement for Southwest Grid for Learning Trust involves multiple guarantors, many of whom are not employers in the Avon Pension Fund. In this case it is not practical for any deficit on closure to be transferred to another employer in the Fund. The Sterling AA Corporate Bond valuation basis would therefore apply on closure and the

Fund will be discussing with Southwest Grid for Learning Trust the feasibility of adopting this valuation basis at the 2010 valuation.

17. Wesport was admitted to the Fund with effect from 1/1/2007. In this case the guarantors are the four unitary councils. It was agreed with these Councils that the Sterling AA Corporate Bond valuation basis should apply from the outset.

### **Community Admission Bodies (without guarantee)**

18. The majority of community admission bodies in the Fund are, for historical reasons, not supported by a guarantee. Some were admitted prior to 1974, the year in which Avon County Council became the administering authority for the Avon Pension Fund. Some were admitted during the Avon County Council era (1974 to 1996). Others were admitted during the first five years of Bath & North East Somerset Council's administration of the Fund when there was no provision in law for local authorities to provide guarantees to underpin an admission agreement.
19. As at 31 March 2010 the community admission bodies in the Avon Pension Fund without a guarantee were as follows:-

Ashley House Hostel  
Bath & North East Somerset Racial Equality Council  
Brislington Neighbourhood Centre  
Bristol Council for Racial Equality  
Care Quality Commission  
Centre for Deaf People  
Clifton Suspension Bridge Trust  
Connexions West of England  
Direxions for Success Ltd  
Holburne Museum of Art  
Learning Partnership West Ltd  
Off The Record Bath & North East Somerset  
Somerset Community Housing Trust  
Somerset Housing Group Ltd  
Southern Brooks Community Partnership  
University of Bath  
West Mendip Internal Drainage Board  
Woodspring Association for Blind People

20. Some of these organisations provide a service which, because it is supported by a particular employing body, can be regarded as providing the service on behalf of that employing body. In the event that an organisation of this sort goes into liquidation and leaves the Fund with an excess of liabilities relative to assets (using the Sterling AA Corporate Bond valuation basis) the most equitable solution, after utilising any legal remedies which may exist to obtain the necessary funds from the defunct body itself, would be to transfer the deficit to the relevant (i.e. "linked")



employing body. (Alternatively, the employing body might choose to take over both the liabilities and assets of the defunct body).

21. The test which would be applied to establish whether a “link” exists is taken from the regulations themselves, viz, whether the defunct body “has sufficient links with a Scheme Employer for the body and the Scheme Employer to be regarded as having a community of interest, whether because the operations of the body are dependent on the operations of the Scheme Employer or otherwise.” The alternative to this solution would be for the deficit to be shared among all employing bodies in the Fund in accordance with the Regulations, something which has been normal practice for the Avon Pension Fund but which clearly has shortcomings from the standpoint of equity.
22. **Since there is no regulatory backing to support this approach, it can only be adopted by agreement. To date it has not been possible to secure this agreement. However, if the employers in the Fund were willing to agree to this approach, it would also be possible to reflect the stronger covenant when calculating the contribution rate for such bodies (in particular, this could affect the deficit recovery period).**
23. **In more general terms, the question of whether the valuation basis should be changed for community admission bodies without a guarantee will depend very much on individual circumstances.** For example, some of these bodies may intend to remain with the Fund indefinitely and, in the hypothetical event of closure, would have sufficient resources to meet the closure cost. In these cases it will be sufficient to simply draw the body’s attention to the Fund’s policy on closure as set out in this Statement. Otherwise the desirability of moving to a Sterling AA Corporate Bond basis of valuation has to be weighed against the ability of that body to pay higher contribution rates.

#### **Destination Bristol and Bath Tourism Plus**

24. The Fund remains concerned that there is no provision in the Regulations for the Scheme Employers which “control” Bath Tourism Plus and Destination Bristol to underwrite the liabilities of those bodies and has brought this matter to the attention of the Government. Given the present situation where there is no guarantee in place the case for moving to a Sterling AA Corporate bond basis remains and will be explored as part of the 2010 valuation.

#### **Valuation 2010**

25. The Fund’s officers will, prior to the setting of new contribution rates, meet representatives of each of the admitted bodies, firstly, to explain the background to the 2010 valuation and, secondly, to establish, if possible, the extent to which they can accommodate any contribution rate increases. It is anticipated that on this occasion affordability

considerations will be paramount and that action to accelerate deficit recovery will need to await future valuations.