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 guidance issued 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") 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 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 one with its benefit structure having been reviewed recently by the Government. Members will have final salary benefits for service accrued prior to 1 April 2014 with Career Averaged Revalued Earnings ("CARE") benefits accruing on and after this date.

The Scheme's governing legislation currently consists of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended), the "BMC Regulations" and the Administration Regulations referred to above. New legislation *{The Local Government Pension Scheme Regulations 2013}* governs the Scheme from 1 April 2014. The required level of employee contributions is specified in the *{new legislation}.*

Employer contributions are determined in accordance with the governing Regulations (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 2013 valuation are:

Rate of discount	4.70% per annum
Rate of Pensionable Pay Inflation	4.10% per annum
Rate of CPI inflation	2.60% per annum
Rate of pension increase inflation	2.60% 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 1.6% per annum has been assumed.
- 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 expected rate of indexation of benefits accrued post 1 April 2014 up to retirement will be in line with the CPI inflation assumption.

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 liabilities relating to pre 1 April 2014 benefits for active members will increase and therefore 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).

For many of the employers that participate in the Fund, there is still significant downward pressure on future pay increases especially in the short term. The Administering Authority will take into account any short-term pay expectations based on reasonable evidence from the employers (such as that built into financial plans) and/or nationally proposed pay inflation.

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. The CPI assumption will be calculated by making a 1% p.a. downward adjustment to the market implied RPI assumption at the valuation date. This adjustment is to take account of general market trends, the risk premia and the fact that the CPI in the long term is systematically lower than RPI due to methodology.

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 2013 valuation assumes a real rate of discount in excess of price inflation of 3.0% per annum. This is a reduction compared to the previous valuation which to some extent reflects the continuing trend of increasing pension costs due to falling interest rates and yields applying at the valuation date.

The 2013 valuation takes into account modified longevity (pre & post retirement), ill & normal health rates of early retirement 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 (for both past and future service liabilities).

The following two tenets underpin the 2013 valuation:

- that the Fund and the majority of 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.

This allows us to take a longer term view when assessing the contribution requirements for certain employers. As part of this valuation when looking to potentially stabilise contribution requirements we will consider whether we can build into the funding plan the following:-

- some allowance for interest rates and bond yields to revert to higher levels over the medium to long term; and
- whether some allowance for increased investment return (in excess of AOA) can be built into the funding plan over the agreed recovery period.

In considering this the Actuary, following discussions with the Administering Authority, will consider if this results in a reasonable likelihood that the funding plan will be successful.

The current actuarial valuation of the Fund is effective as at 31 March 2013. The results indicate that overall the assets of the Fund represented [tbc]% of projected accrued liabilities at the valuation date.

Prior to 2004 any shortfall of assets relative to liabilities was recovered over a period of 15 years, which broadly equated to the expected future working lifetime of the active members at that valuation. At the 2004 valuation, the administering authority increased the maximum recovery period from 15 to 20

years and this position remained unchanged at the 2007 valuation. At the 2010 valuation recognising the pressures on public sector finances the maximum recovery period for Scheduled and Designating Bodies was increased to 30 years with the aim of maintaining a stable rate of contribution, subject to certain conditions. The intention was to reduce this at each subsequent valuation by three years or more quickly subject to affordability constraints. In the longer term this would benefit employers due to reduced interest costs on the deficits.

We would apply similar conditions to the 2013 valuation, as well as a maximum recovery period of 27 years as follows:

i. there being no reduction from the 2010 levels in the monetary value of each employer's deficit contributions payable including future indexation of the annual monetary amounts
ii. an assessment of the strength of the employer's financial covenant where the resulting analysis would support employer specific adjustments to the deficit recovery period being applied
iii. recognition of the need to use any improvements in the funding position and/or affordability of contributions for an individual employer at the 2013 valuation to reduce the deficit recovery period initially towards the 2007 position.

Academies

At the 2010 valuation the Actuary drew 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 were no immediate concerns about the financial covenant over the next three years, the same maximum deficit recovery period was applied to the colleges and academies as to the scheduled bodies.

In July 2013, the Department for Education (DfE) provided a guarantee that in the event of the closure of an Academy Trust, any outstanding pension liabilities would not revert to an LGPS fund. In the first instance, where an Academy Trust closes, the liabilities will be met from the Trust's assets on closure (the Secretary of State has the power to determine how the assets of an Academy Trust are disposed). Any remaining outstanding LGPS deficit would then be met by the DfE in full. However, the DfE and the Treasury reserve the right to withdraw the guarantee at any time. Grounds for withdrawing the guarantee include if the contingent liability levels set by the DfE are exceeded or if projected costs are no longer affordable from within the DfE's existing budget or are not approved by the Treasury. The Treasury also reserves the option to re-assess the approval of the guarantee at a later date, as appropriate, due to spending considerations or policy developments. Therefore the Fund's policy is to treat the academies in line with the unitary authorities in terms of the flexibility afforded under the 2013 funding strategy. However, in the event the guarantee is withdrawn or amended or there is a specific incidence of the government leaving an academy deficit with a LGPS fund, the Fund will amend this policy to reflect any material detriment to covenant of the academies.

The Government's guarantee does not extend to Higher/Further Education bodies. These bodies will be subject to the strength of their individual covenant assessment and this will determine the extent to which flexibility within the funding plan can be applied.

In addition, special arrangements continue to apply so far as the admitted bodies are concerned (see Appendix 1).

Contingent Assets and security

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. Generally this would result in a longer recover period being acceptable to the Administering Authority.

The maximum recovery periods are summarised in the table below.

Employer Category	Maximum Deficit Recovery Period
Tax-raising Scheduled and Designating Bodies (except Bath Tourism Plus and Destination Bristol)	27 years
Academy Trusts	In line with their original LEA schools group
Higher Education Bodies (Universities)	27 years
Further Education Bodies (Colleges)	25 years
Community Admission Bodies (guaranteed by another Scheme Employer within the Fund)	27 years subject to agreement with Guarantor but will be no longer than the recovery period of the 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 but will be no longer than the letting scheme employer recovery period

Employers will be able to select any shorter deficit recovery period than the periods adopted under this funding plan.

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 this has not proved practicable. In particular savings from the new scheme anticipated at the 2010 valuation which might have reduced the deficits have not materialised due primarily to the full protection of accrued benefits up to 2014. Nevertheless **any savings arising from an improvement in the funding position at future valuations will be used to reduce the deficit recovery period**. Only after this has been achieved, will any reductions in employer contribution rates be considered. The medium term objective is to recover any deficit over a maximum of 15 years.

For this valuation, where the Actuary determines that an increase in contribution rates is necessary to restore full funding, 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 for the Actuary to extend this facility to all employers and in particular certain admitted bodies.

For those bodies with a weaker covenant, the Administering Authority will need to balance the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans. At 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.

In order to enable the employing bodies to exercise their discretion within the maximum deficit recovery period, they will be given detailed information by the Avon Pension Fund.

6. Admitted Bodies, Destination Bristol, Bath Tourism Plus and VISTA SWP

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 2013 actuarial valuation assumptions but updated for market yields/inflation applying at the cessation date, or**
- **a "corporate bond yield" basis; consistent with the 2013 actuarial valuation assumptions, updated for market yields/inflation applying at the cessation date <u>but</u> with a discount rate based on the long dated Sterling AA Corporate Bond yield of appropriate duration**,

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 the liabilities are left with the Fund rather than being transferred to another employing body, the liabilities 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 2013 valuation show the liabilities to be [tbc]% covered by the current assets, with the funding deficit of [tbc]% 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 2013 valuation would have been significantly higher, resulting in a funding level of [tbc]%.

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 over gilts (long term, p.a.)
UK Equities	15%	3.75%
Developed Overseas Equities	25%	3.75%
Emerging market Equities	10%	4.25%
Diversified Growth Funds	10%	3.75%
Index-Linked Gilts	6%	-0.25%
Fixed Coupon Gilts	3%	0%
UK Corporate Bonds	8%	1.0%
Overseas Fixed Interest	3%	1.0%
Fund of Hedge Funds	5%	1.5%
Infrastructure	5%	2.5%
Property	10%	2.5%

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 long term funding target adopted for the 2013 valuation is based on an assumed asset out-performance of 1.6% per annum. 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 [x] 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 inserted]

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.

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 being insured with a third party or internally within the Fund.

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 2013 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
August 2013

FUNDING STRATEGY STATEMENT – APPENDIX 1

ADMITTED BODIES including DESTINATION BRISTOL, BATH TOURISM PLUS & VISTA SWP

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 – Employers which participate 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 prior to 2004 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 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 (= higher funding target) 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 2013 actuarial valuation assumptions but updated for market yields/inflation applying at the cessation date,**

   or

   - **a "corporate bond yield" basis consistent with the 2013 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 of appropriate duration,**

   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" (but not inflation or longevity risk). The Sterling AA Corporate Bond yield is, of course, the discount rate currently used for FRS 17/IAS19 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. Currently only a small number of admitted bodies are in the position of having their liabilities valued on the Sterling AA Corporate Bond basis. Unfavourable financial circumstances will make it difficult to move more admitted bodies onto the corporate bond basis without compromising their financial stability.

10. However, for the benefit of the admitted bodies, additional information will be provided showing the past service deficit and contribution rate 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, or to phase the move in gradually over time as this reduction in volatility will come with an increase in the contribution rate.

Transferee Admission Bodies

11. As at 31 March 2013 the transferee admission bodies in the Avon Pension Fund, listed by outsourcing Scheme Employer were as follows:-

Bath & North East Somerset Council
- Aquaterra Leisure Ltd.
- Direct Cleaning Services (SW)
- Mouchel Business Services Ltd

Bristol City Council
- Active Community Engagement Ltd
- BAM Construction UK Ltd
- Bristol Drugs Project
- Creative Youth Network
- CT Plus
- Churchill Contract Services Ltd
- Eden Food Services
- English Landscapes
- Genuine Dining Ltd
- ISS Mediclean
- Keeping Kids Company
- Learning Partnership West
- Quadron Services Ltd
- SLM Community Leisure
- SLM Fitness and Health
- Skanska Rashleigh Weatherfoil

Cabot Learning Federation
- ISS Mediclean
- Skanska

City of Bristol College
- Aramark Ltd

Oasis Community Learning
- Keir Facilities Services
- Sodexho

North Somerset Council
- Agilisys
- Liberata
- Mouchel Business Services – Nailsea IT
- Shaw Healthcare (North Somerset) Ltd
- The Brandon Trust
- Tone Leisure

South Gloucestershire College
- Bespoke Cleaning Services Ltd
- Cater Link Ltd

South Gloucestershire Council
- Circadian Trust
- SITA Holdings UK Ltd.

University of Bath
- UPP Residential Services Ltd

12. Until the Funding Strategy Statement was last revised in March 2012, an outsourcing scheme employer had a choice as to whether, at the conclusion of a transferee admission agreement, they left the liabilities of the transferee admission body with the Fund or took them back in-house. For transferee admission agreements which commenced after March 2012, the Fund's policy is that the liabilities of a transferee admission body will in all cases revert to the outsourcing scheme employer when the agreement ceases.

13. For those transferee admission agreements which were in operation as at 16 March 2012, the relevant outsourcing scheme employers will, prior to the 2013 valuation being finalised, indicate whether they intend to take the transferee admission body's liabilities back in-house when the agreement ceases or whether they intend to leave them with the Fund. This will enable the liabilities to be managed more effectively from an actuarial standpoint.

Community Admission Bodies (with guarantee)

14. 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 be accompanied by a guarantee or, failing that, a bond.

15. As at 31 March 2013 the community admission bodies in the Avon Pension Fund supported by a guarantee were as follows:-

Guaranteed by South Gloucestershire Council:
- Merlin Housing Society Ltd. (Transferred Staff Only)

Guaranteed by North Somerset Council:
- Alliance Homes

Guaranteed by Bath & North East Somerset Council:
- Sirona Healthcare

Guaranteed by Bristol City Council:

Bristol Music Trust
Disability Equality Forum
Park Community Trust

Multiple guarantors:

Southwest Grid for Learning Trust
West of England Sport Trust (Wesport)

16. Where a body is guaranteed by a single employer 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 at the outset 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.

17. 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 2013 valuation.

18. Wesport is guaranteed by the four unitary councils. It was agreed with these Councils that the Sterling AA Corporate Bond valuation basis should apply from the outset.

19. In those cases where a guarantee exists the scheme employer has a choice as to whether to take the community admission body’s liabilities back in-house when the admission agreement ceases or leave them with the Fund. This choice will continue to apply for those bodies which were in the scheme prior to 16 March 2012. However, for admission agreements which commenced after that date, the guaranteeing scheme employer is, as mentioned above, required to exercise that choice at the outset. For those in place prior to 16 March 2012, the choice must be exercised before the 2013 valuation is finalised.

Community Admission Bodies (without guarantee)

20. 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.

21. As at 31 March 2013 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
Care Quality Commission

Centre for Deaf People
Clifton Suspension Bridge Trust
Holburne Museum of Art
Learning Partnership West Ltd
Merlin Housing (new staff)
Off The Record Bath & North East Somerset
Somer Community Housing Trust
Somer Housing Group Ltd
Southern Brooks Community Partnership
University of Bath
North Somerset Levels ITB
Woodspring Association for Blind People

22. The Administering Authority's approach to agreeing the funding plans of admitted bodies will have regard to the financial strength of each individual body. The aim will be to achieve a balance between securing the solvency of the Fund and the sustainability of the organisation. For those with less secure income streams, the Fund will consider how it can manage contributions into the Fund in the short to medium term without compromising the financial stability of the organisation. Where there are assets or reserves, the Administering Authority will explore how these contingent assets could be used to assist in funding the liabilities or providing security to the Fund and its employing bodies.

23. 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).

24. 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.

25. The bodies to which this "link" relates are limited to:

Centre for the Deaf
Off the Record Bath & North East Somerset
Southern Brooks
Woodspring Association for Blind People

In view of the small number of bodies that fall into this category and the minimal impact which "linking" would have on the "linked funders", the Fund will take account of this "link" in the event that outstanding liabilities are left with the Fund.

26. Learning Partnership West is a body linked to the four local authorities in that it has provided a service for the Councils but the pension liabilities are not guaranteed by these councils. However, in light of changes to the funding of this service, the Councils have entered an agreement with LPW to fund the pension liabilities in the event that the funding is withdrawn (by one or more of the Councils). In the event that this agreement fails, the Fund will instruct the Actuary to apportion the outstanding liabilities equitably between the unitary authorities.

27. 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, Bath Tourism Plus and Vista SWP

28. 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. However, despite the Fund's representations, the Government has declined to address this issue when drafting new scheme regulations. 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 with the employers as part of the 2013 valuation.

29. In the case of Vista SWP, Bristol City Council was given the option of either taking over the assets and liabilities of the body on closure or having the future service rate based on corporate bond yields from the outset. It opted for the former.

Valuation 2013

30. The Fund's officers will monitor the admitted bodies on a regular basis to assess the scope for paying off any deficit within a realistic timeframe. In particular at this valuation affordability considerations will be paramount and action to accelerate deficit recovery will be difficult. However, when setting the individual funding plans the Administering Authority will be looking to protect the Funds and other participating employers' interests.