

FUNDING STRATEGY STATEMENT

AVON PENSION FUND

[DATE]

BATH AND NORTH EAST SOMERSET COUNCIL

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

EXECUTIVE SUMMARY

Ensuring that the Avon Pension Fund (the “Fund”) has sufficient assets to meet its pension liabilities in the long-term is the fiduciary responsibility of the Administering Authority (**BATH AND NORTH EAST SOMERSET COUNCIL**). The Funding Strategy adopted by the Avon Pension Fund will therefore be critical in achieving this.

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

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

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

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



THE FUND’S OBJECTIVE

The Administering Authority’s long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due. This objective will be considered on an employer specific level where appropriate.

The general principle adopted by the Fund is that the assumptions used, taken as a whole, will be chosen sufficiently prudently for pensions and benefits already in payment to continue to be paid, and to reflect the commitments which will arise from members’ accrued pension rights.

The funding strategy set out in this document has been developed alongside the Fund’s investment strategy on an integrated basis taking into account the overall financial and demographic risks inherent in the Fund. The funding strategy includes appropriate margins to allow for the possibility of events turning out worse than expected which would normally lead to volatility of contribution rates at future valuations if these margins were not included. The level of prudence has been quantified by the Actuary to show the level of contingency to provide protection against future adverse experience in the long term. Individual employer results will also have regard to their covenant strength and the investment strategy applied to the asset shares of those employers.

SOLVENCY AND LONG TERM COST EFFICIENCY



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

Employer contributions are also set in order to achieve long term cost efficiency. Long-term cost-efficiency implies that the rate must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time. Equally, the FSS must have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

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

DEFICIT RECOVERY PLAN AND CONTRIBUTIONS



As the solvency level of the Fund is [xx]% at the valuation date i.e. the assets of the Fund are less than the liabilities, a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall.

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

The medium term objective is to recover any total Fund deficit over an average period of [12] years, and this will be periodically reviewed depending on the maturity profile of the Scheme. Subject to affordability considerations a key principle will be to maintain the deficit contributions at the expected monetary levels from the preceding valuation (allowing for any indexation in these monetary payments over the recovery period). Full details are set out in this FSS.

The average recovery period for the Fund as a whole is [13] years at this valuation which is [3] years shorter than the average recovery period from the previous valuation. Subject to affordability and other considerations individual employer recovery periods would also be expected to reduce at this valuation.

Where there is a material increase in contributions required at this valuation, in certain circumstances the employer will be able to 'phase in' contributions over a period of [3] years in a pattern agreed with the Administering Authority and depending on the affordability of contributions as assessed in the covenant review of an employer. Equally employers will be able to phase in their contributions changes to tie in with their financial year if this does not end on 31 March.

[The Fund has also considered its policy in relation to costs that could emerge from the Cost Management Process and/or McCloud judgement in line with the guidance from the Scheme Advisory Board in conjunction with the Actuary. The costs have been quantified and notified to employers so they can make provisions where relevant. Drafting Note: This will have to be set out clearly in the policies once way forward is agreed.]

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



ACTUARIAL ASSUMPTIONS

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

The discount rate in excess of CPI inflation (the “real discount rate”) has been derived from the expected return on the Fund’s assets based on the long term strategy set out in its Investment Strategy Statement (ISS). When assessing the appropriate prudent discount rate, consideration has been given to the level of expected asset returns in excess of CPI inflation (i.e. the rate at which the benefits in the LGPS generally increase each year). The Fund Actuary is proposing that the real return over CPI inflation for determining the past service liabilities should be [1.75]% per annum and [2.25]% per annum for determining the future service (“primary”) contribution rate.

The Fund has improved its “lower risk investment strategy” (previously described as the “corporate bond” strategy) that it offers to employers so it is better matched to the risk profile of the liabilities supported by this strategy. Existing “corporate bond” employers will be transitioned into the lower risk investment strategy with effect from 1 April 2019. This strategy exhibits a lower investment risk than the current whole fund strategy. If an employer is deemed to have a weaker covenant than others in the Fund, is planning to exit the Fund or it would like to target a lower risk strategy, the Administering Authority has the discretion to move that employer (typically following discussions with the employer) into this investment strategy to protect the Fund as a whole. The current Fund investment strategy will be known as the “higher risk investment strategy”.

The lower risk investment strategy is predominately linked to corporate bond investment assets that match the liabilities of the employers within it (as a minimum this will be reviewed following each actuarial valuation). In these circumstances, the discount rate is directly linked to the yields on the corporate bonds within the lower risk investment strategy. In addition, the strategy has exposure to the Liability Driven Investment (“LDI”) portfolio to provide protection against changes in market inflation expectations.

[Within the next valuation cycle, the Fund will consider the merits of implementing a medium risk investment strategy. This strategy will have a lower level of growth assets compared with the higher risk whole Fund strategy.]

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

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



EMPLOYER ASSET SHARES

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

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation. In addition, the asset share may be restated for changes in data or other policies.

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



FUND POLICIES

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

1. Covenant assessment and monitoring

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

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital to the overall risk management and governance of the Fund. The employers' covenants will be assessed and monitored objectively in a proportionate manner and their ability to meet their obligations in the short and long term will be considered when determining an individual employer's funding strategy.

The Fund will continue to monitor changes in covenant in conjunction with the funding position over the inter-valuation period which will enable the Fund to anticipate and pre-empt any material issues arising and thus adopt a proactive approach in partnership with the employer. More details are provided in **Appendix G** in this statement.

2. Admitting employers to the Fund

Various types of employers are permitted to join the LGPS under certain circumstances, and the conditions upon which their entry to the Fund is based and the approach taken is set out in

Appendix C. Examples of new employers include:

- Mandatory Scheme Employers - for example new academies (see later section)
- Designated bodies - those that are permitted to join if they pass a resolution
- Admission bodies - usually arising as a result of an outsourcing or an entity that provides some form of public service and their funding primarily derives from local or central government.
- [Employers may also join the Fund under the ‘Deemed Employer’ route. Further information on this is set out within **Appendix C.**]

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

The key objective for the Fund is to only admit employers where the risk to the Fund is mitigated as far as possible. The different employers pose different risks to the Fund and the risk management policy for existing and new employers applied is set out in **Appendix F.**

Certain employers may be required to provide a guarantee or alternative security before entry will be allowed.

3. New academy conversions and multi-academy trusts

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

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

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

4. Termination policy for employers exiting the Fund

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

Where there is no guarantor who would subsume the liabilities of the exiting employer, the Fund's policy is that a discount rate linked to investment returns on the lower risk investment strategy and a more prudent longevity assumption is used for assessing liabilities on termination. Any exit payments due should be paid immediately although instalment plans will be considered by the Administering Authority on a case by case basis. Any exit credits (surplus assets over liabilities) will be paid from the Fund to the exiting employer within 3 months of completion of the cessation assessment by the Actuary. The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it [and, for example, may adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers].

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

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

[Drafting Note – This section has been adjusted following the consultation published by the MHCLG on 8 May 2019 (found here:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

5. Insurance arrangements

The Fund has implemented an internal captive insurance arrangement in order to pool the risks associated with ill health retirement costs. The captive has been designed for employers that could be materially affected by the ill health retirement of one of their members. The captive arrangement has been considered when setting the employer contribution rates for the eligible employers. More details are provided in **Appendix H**.

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INTRODUCTION

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

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

BENEFITS

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

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

EMPLOYER CONTRIBUTIONS

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

PRIMARY RATE

The “Primary rate” for an employer is the contribution rate required to meet the cost of the future accrual of benefits including ancillary death in service and ill health benefits together with administration costs. It is expressed as a percentage of pensionable pay, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer’s covenant.

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

SECONDARY RATE

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

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

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

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

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PURPOSE OF FSS IN POLICY TERMS

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

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

The purpose of this Funding Strategy Statement is therefore:

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

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

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AIMS AND PURPOSE OF THE FUND

THE AIMS OF THE FUND ARE TO:

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

THE PURPOSE OF THE FUND IS TO:

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

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RESPONSIBILITIES OF THE KEY PARTIES

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

KEY PARTIES TO THE FSS

The **Administering Authority** should:

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

The **Individual Employer** should:

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

The **Fund Actuary** should:

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

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SOLVENCY FUNDING TARGET

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

SOLVENCY AND LONG TERM EFFICIENCY

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

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

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

DETERMINATION OF THE SOLVENCY FUNDING TARGET AND DEFICIT RECOVERY PLAN

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

Underlying these assumptions are the following two tenets:

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

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

In considering this the Administering Authority, based on the advice of the Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful potentially taking into

account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2020 at the latest.

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

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

- Subject to consideration of affordability, as a general rule the deficit recovery period will reduce by at least 3 years for employers at this valuation when compared to the preceding valuation. This is to target full solvency over a similar (or shorter) time horizon. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. Subject to affordability considerations and other factors a bespoke period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan in **Appendix B**). This has resulted in an average recovery period of [x] years being adopted across all employers.
- For any employers assessed to be in surplus, their individual contribution requirements will be adjusted to such an extent that any surplus is used (i.e. run-off) over a [12] year period in line with the medium term recovery period target for the whole Fund, subject to a total employer contribution minimum of zero. If an employer is expected to exit the Fund before this period, contribution requirements will be set to target a nil termination deficit within reasonable expectations (subject to periodic review).
- The employer contributions will be expressed and certified as two separate elements:
 - the **Primary rate**: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits and ancillary death in service and ill health benefits
 - the **Secondary rate**: a schedule of lump sum monetary amounts or % of pay adjustments over 2020/23 in respect of an employer's surplus or deficit (including phasing adjustments)
- Where increases (or decrease) in employer contributions are required from 1 April 2020, following completion of the 2019 actuarial valuation, the increase (or decrease) from the rates of contribution payable in the year 2020/21 may be implemented in steps, over a maximum period of 3 years. Any step up in future service contributions will be implemented in steps of at least 0.5% of pay per annum. However, where there has been a reduction in contributions paid in respect of an employer's surplus or deficit at the valuation, the Fund would not consider it appropriate for any increase in contributions paid in respect of future accrual of benefits to be implemented in steps.
- For employers that do not have a financial year end of 31 March 2020 (e.g. 31 July 2020), the Fund can, at the employers request before 28th February 2020 allow the employer to continue to pay their current contribution plan until their financial year end date. The new contribution plan would then be implemented after this date (i.e. 1 August 2020 in this case).

- Employers must notify the Fund as soon as they become aware of their planned exit date. Where appropriate, the Fund will review their certified contribution in order to target a fully funded position at exit. Consideration will be given to any cap and collar arrangements when reviewing contribution rates. The costs of the contribution rate review will be payable by the employer or the outsourcing Scheme Employer (where necessary).
- On the cessation of an employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment.

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

The residual assets and liabilities and hence any surplus or deficit will transfer back to the guarantor. This is subject to agreement from all interested parties who will need to consider any separate agreements that have been put in place between the exiting employer and the guarantor. If all parties do not agree, then the following arrangements will apply:

- In the case of a surplus, the Fund will pay this directly to the exiting employer within 3 months of completion of the cessation assessment by the Actuary (despite any other agreements that may be in place).
- In the case of a deficit, in order to maintain a consistent approach, the Fund will seek to recover this from the exiting employer in the first instance although if this is not possible then the deficit will be recovered from the guarantor either as a further contribution collection or at the next valuation.

The Fund will notify all parties in the event that agreement cannot be reached, however ultimately the Fund will comply with the Regulations and therefore any exit credit will be paid to the exiting employer. In some instances, the outgoing employer may only be responsible for part of the residual deficit or surplus as per the separate risk sharing agreement. This would only be taken into account if the Administering Authority is made aware of any such arrangement. [for the avoidance of doubt where the outgoing employer is not responsible for any costs under a risk sharing agreement (including for employers entering through the deemed employer route) then no exit credit will be paid as per the Regulations.]

If a guarantor unjustifiably deviates from the Fund's policy (e.g. to subsume the residual assets, liabilities and any surplus or deficit of an exiting employer), any future termination events will be treated in line with the approach adopted for employers without a guarantor in the Fund (e.g. the guarantor will be required to pay the termination deficit as a lump sum cash payment at the time of exit, any surplus would also be paid by the Fund to the guarantor at this point). The higher risk valuation funding basis will still be adopted in this case.

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

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 3 months of completion of the cessation assessment by the Actuary).
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise)

by the Administering Authority at their sole discretion) following completion of the termination process.

The Administering Authority can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary [and, for example, may adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers].

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

The termination policy [(including Deferred Debt arrangements)] is set out in **Appendix D**.

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

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

The results of the 2019 valuation show the liabilities to be [xx]% covered by the current assets, with the funding deficit of [xx]% being covered by future deficit contributions.

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

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

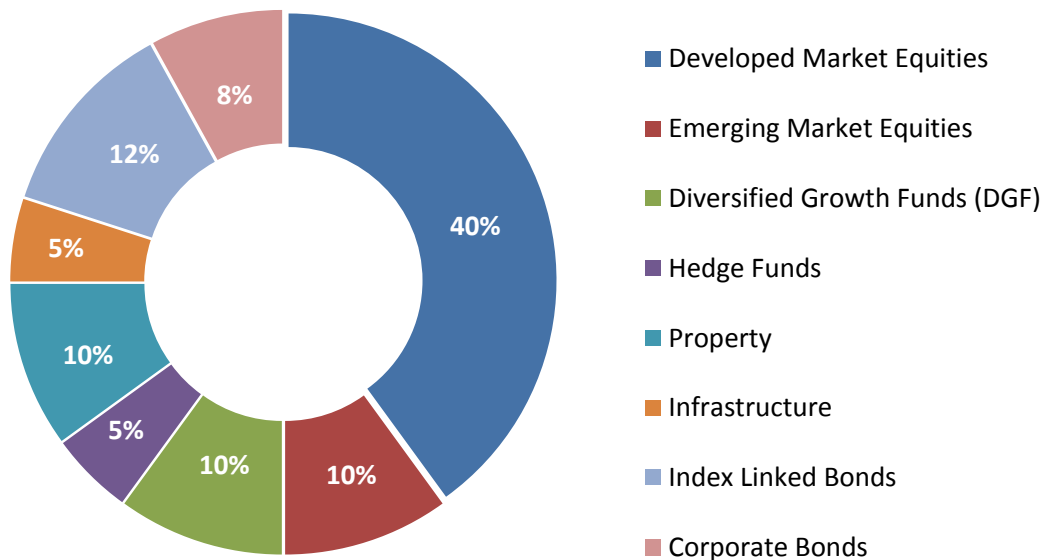
Investment of the Fund's assets in line with this portfolio would minimise fluctuations in the Fund's funding position between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out this valuation it would not be appropriate to make any allowance for growth assets out-performance or any adjustment to market implied inflation assumption due to supply/demand distortions in the bond markets. This would result in real return versus CPI inflation of [x%] per annum at the valuation date. On this basis of assessment, the assessed value of the Fund's liabilities at the valuation would have been significantly higher, resulting in a funding level of [xx]%. This is a measure of the level of reliance on future investment returns i.e. level of investment risk being taken.

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

The overall strategic asset allocation is set out in the Investment Strategy Statement.

The current strategy is:



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

A measure of overall prudence to protect against adverse experience in the future is to consider the funding level if it was assessed on a "best estimate" basis for all the principal assumptions (mainly the investment return and life expectancy). The actuary has assessed this funding level as [yy%]. This level of prudence is built in to allow the Fund to address adverse events whilst maintain stability (within reasonable parameters) in employer contributions where appropriate.

RISK MANAGEMENT STRATEGY

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

- Equity Protection - the Fund has implemented protection against potential falls in the equity markets via the use of derivatives. The aim of the protection is to provide further stability (or even a reduction) in employer deficit contributions (all other things equal) in the event of a significant equity market fall (although it is recognised that it will not protect the Fund in totality).
- Liability Driven Investments (LDI) – the Fund has implemented an LDI strategy in order to hedge part of the Fund's assets against changes in liabilities for one or more employers.
- Lower risk investment strategy – the Fund updated its lower risk investment strategy (previously known as the “corporate bond” strategy) with effect from 1 April 2019. This strategy is predominately linked to corporate bond investment assets that match the liabilities of the employers within it.

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

HIGHER AND LOWER RISK INVESTMENT STRATEGY

The Fund has improved its **lower risk investment strategy** (previously described as the “corporate bond” strategy) that it offers to employers. Existing “corporate bond” employers will be transitioned into the lower risk investment strategy with effect from 1 April 2019. This strategy exhibits a lower investment risk than the current whole fund strategy. If an employer is deemed to have a weaker covenant than others in the Fund, is planning to exit the Fund or it would like to target a lower risk strategy, the Administering Authority has the discretion to move that employer (typically following discussions with the employer) into this investment strategy to protect the Fund as a whole. The current Fund investment strategy will be known as the “**higher risk investment strategy**”.

The lower risk investment strategy is predominately linked to corporate bond investment assets that match the liabilities of the employers within it (as a minimum this will be reviewed following each actuarial valuation). In these circumstances, the discount rate is directly linked to the yields on the corporate bonds within the lower risk investment strategy. In addition, the strategy has exposure to the Liability Driven Investment (“LDI”) portfolio to provide protection against changes in market inflation expectations.

[Within the next valuation cycle, the Fund will consider the merits of implementing another alternative investment strategy where the risk sits between the higher and lower risk strategies. This strategy will have a lower level of growth assets compared with the higher risk whole Fund strategy.]

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

The applicable investment strategy will be reflected in the relevant employer's notional asset share, funding basis and contribution requirements.

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IDENTIFICATION OF RISKS AND COUNTER-MEASURES

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

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

FINANCIAL

The financial risks are as follows:-

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

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

In practice the extent to which these risks can be reduced is limited. However, the Fund's asset allocation is kept under constant review and the performance of the investment managers is regularly monitored. In addition, the implementation of the risk management framework will help to reduce the key financial risks over time.

DEMOGRAPHIC

The demographic risks are as follows:-

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

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

Ill health retirements can be costly for employers, particularly small employers where one or two costly ill health retirements can take them well above the “average” implied by the valuation assumptions. Increasingly we are seeing employers mitigate the number of ill health retirements by employing HR / occupational health preventative measures. These in conjunction with ensuring the regulatory procedures in place to ensure that ill-health retirements are properly controlled, can help control exposure to this demographic risk. The Fund’s ill health captive arrangement will also help to ensure that the eligible employers are not exposed to large deficits due to the ill health retirement of one or more of their members (see further information in **Appendix H**).

Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, **employing bodies should be doing everything in their power to minimise the number of ill-health retirements.**

Early retirements for reasons of redundancy and efficiency do not immediately affect the solvency of the Fund because they are the subject of a direct charge.

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

INSURANCE OF CERTAIN BENEFITS

The contributions for any employer may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund. More detail on how the Fund is implementing the captive insurance for ill health costs is set out in **Appendix H**.

REGULATORY

The key regulatory risks are as follows:-

- Changes to Regulations, e.g. changes to the benefits package, retirement age, potential new entrants to scheme,
- Changes to national pension requirements and/or HMRC Rules
- Political risk that the academies guarantee from the Department for Education is removed or modified along with the operational risks as a consequence of the potential for a large increase in the number of academies in the Fund due to Government policy.

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

GOVERNANCE

The Fund has done as much as it believes it reasonably can to enable employing bodies and scheme members (via their trades unions) to make their views known to the Fund and to participate in the decision-making process. So far as the revised Funding Strategy Statement is concerned, it circulated copies of the first draft to all employing bodies for their comments and placed a copy on the Fund’s website. The first draft was approved at the Committee’s meeting on 21st June 2019 and finalised on 27th September 2019 after the Fund received feedback from the employing bodies.

Governance risks are as follows:-

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

For these risks to be minimised much depends on information being supplied to the Administering Authority by the employing bodies. Arrangements are strictly controlled and monitored (e.g. the implementation of iConnect for transferring data from employers), but in most cases the employer, rather than the Fund as a whole, bears the risk.

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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 [4] years, to coincide with completion of a full statutory actuarial valuation and every review of employer rates or interim valuation. Any review will take account of the current economic conditions and will also reflect any legislative changes.

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

- has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- have been significant changes to the Scheme membership, or LGPS benefits
- have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy
- have been any significant special contributions paid into the Fund.

When monitoring the funding strategy, if the Administering Authority considers that any action is required, the relevant employers will be contacted. In the case of an employer who may exit the Fund, 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.

REVIEW OF CONTRIBUTIONS

In line with the Regulations, the Administering Authority has the ability to review employer contributions or request a full interim valuation. If considered appropriate, the Fund will carry out an interim valuation or a review of contributions for a specific employer or employer(s), if there:

1. has been a significant change in market conditions so that the funding level has changed by [more than 10% over a period of [y] months / the whole Fund funding level drops below 90%],
2. has been a material change in an employer's covenant assessed in line with the policy in Appendix G.
3. the employer has notified the Fund of their intention to exit within the next [x] years. Employers must notify the Fund as soon as they become aware of their planned exit date.
4. has been a deviation in the progress of the funding strategy for the employer.
5. have been significant changes to the Scheme membership, or LGPS benefits.
6. has been a change in employer status.
7. have been any significant special contributions paid into the Fund.

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

Consideration will be given to any cap and collar arrangements when reviewing contribution rates.

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

Where the contribution review is triggered by an employer request (e.g. points 2, 3, 4, 5, 6 and 7 above), the costs associated with the review will be included in the assessment of the contributions if deemed appropriate.

[Drafting Note: This policy can only really be developed fully once the consultation is complete. However, the above will be sufficient for discussion.]

[Drafting Note – This has been added following the consultation published by the MHCLG on 8 May 2019 (found here:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

COST MANAGEMENT AND THE M_CCLOUD JUDGEMENT

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

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

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

It is not known how these cases will affect the LGPS or the cost management process at this time. The Scheme Advisory Board issued guidance [here](#) which sets out how the McCloud case should be allowed for within the 2019 valuation.

The potential impact of the judgement (based on the information available at the time) has been quantified and communicated to employers as part of the 2019 valuation. In line with the Regulations, [employer contributions will therefore be reviewed once the outcome is known. Updated employer rates will then be implemented from the following 1 April.]

[Drafting Note – This paragraph has been added following the guidance issued by the Scheme Advisory Board on 14 May 2019 concerning how to deal with the potential additional liabilities arising from the Cost Cap process and the McCloud and Sargeant age discrimination case (McCloud) (found here:

http://www.lgpsboard.org/images/Other/Advice_from_the_SAB_on_McCloud_May_2019.pdf). This may need further adaptation once the outcome of the consultation is known. The Actuary will look at the potential cost to employers as part of the 2019 valuation process.]

APPENDIX A - ACTUARIAL METHOD AND ASSUMPTIONS

METHOD

The actuarial method to be used in the calculation of the solvency funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the scheme on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted, which makes advance allowance for the anticipated future ageing and decline of the current closed membership group potentially over the period of the rates and adjustments certificate.

FINANCIAL ASSUMPTIONS – SOLVENCY FUNDING TARGET

Investment return (discount rate)

The discount rate for the higher risk valuation funding basis has been derived based on the expected return on the Fund assets base on the long term strategy set out in the Investment Strategy Statement (ISS). It includes appropriate margins for prudence. When assessing the appropriate discount rate consideration has been given to the returns in excess of CPI inflation (as derived below). The discount rate at the valuation has been derived based on an assumed return of [1.75]% per annum above CPI inflation i.e. a real return of [1.75]% per annum and a total discount rate of [4.15]% per annum. This real return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics. The discount rate will be reviewed as a matter of course at the time of a formal valuation.

For those employers who are funding on a lower risk funding basis, the discount rate used will be linked directly to the yields available for the assets within the lower risk investment strategy. An example discount rate used at the valuation date is [x.xx]% per annum.

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities, but subject to an adjustment due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index.

The overall average reduction to the assumption to long term RPI inflation to arrive at the CPI inflation assumption at the valuation date is [1.00]% per annum. The CPI inflation assumption at the valuation date is 2.40% per annum.

Salary increases

In relation to benefits earned prior to 1 April 2014, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of [1.50]% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short

term pay restraint for some employers as budgeted in their financial plan. Depending on the circumstances of the employer, the variants on short term pay that have been applied are either no allowance or allowances of [2]%, [2.5]% or [3]% per annum for each year from the valuation date up to [31 March 2023]. The allowance made has been notified to each employer separately on their individual results schedule.

Application of bespoke salary increase assumptions as put forward by individual employers will be at the ultimate discretion of the Administering Authority but as a minimum must be reasonable and practical. To the extent that experience differs to the assumption adopted, the effects will emerge at the next actuarial valuation.

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions where the LGPS is not required to provide full indexation).

DEMOGRAPHIC ASSUMPTIONS

Mortality/Life Expectancy

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

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

Commutation

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

Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the incidence of ill health retirements, withdrawal rates and the proportions married/civil partnership assumption remain in line with the assumptions adopted for the last valuation. In addition, no allowance will be made for the future take-up of the 50:50 option. Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate for the next 3 years. Other assumptions are as per the last valuation.

Expenses

Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by adding [0.xx]% of pensionable pay to the contributions as required from participating employers. This

addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

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

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

The future service liabilities are calculated using the same assumptions as the funding target except that a different financial assumption for the discount rate is used. A critical aspect here is that the Regulations state the desirability of keeping the “Primary rate” (which is the future service rate) as stable as possible so this needs to be taken into account when setting the assumptions.

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

The financial assumptions in relation to future service (i.e. the Primary rate) are based on an overall assumed real discount rate of [2.25]% per annum above the long term average assumption for consumer price inflation of 2.40% per annum.

EMPLOYER ASSET SHARES

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

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

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

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

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

Long-term yields		
	Market implied RPI inflation	[3.40]% p.a.
Solvency Funding Target financial assumptions		
	Investment return/Discount Rate	[4.15]% p.a.
	CPI price inflation	[2.40]% p.a.
	Long Term Salary increases*	[3.90]% p.a.
	Pension increases/indexation of CARE benefits	[2.40]% p.a.
Future service accrual financial assumptions		
	Investment return/Discount Rate	[4.65]% p.a.
	CPI price inflation	[2.40]% p.a.
	Long Term Salary increases*	[3.90]% p.a.
	Pension increases/indexation of CARE benefits	[2.40]% p.a.

*short term salary increases also apply on an employer by employer basis

Life expectancy assumptions

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

Current Status	Retirement Type	Mortality Table
Annuitant	Normal Health	92% S3PMA_CMI_2018 [1.75%] 87% S3PFA_M_CMI_2018 [1.75%]
	Dependant	119% S3PMA_CMI_2018 [1.75%] 87% S3DFA_CMI_2018 [1.75%]
	Ill Health	113% S2IMA_CMI_2018 [1.75%] 127% S2IFA_CMI_2018 [1.75%]
	Future Dependant	117% S3PMA_CMI_2018 [1.75%] 106% S3DFA_CMI_2018 [1.75%]
Active	Normal Health	98% S3PMA_CMI_2018 [1.75%] 88% S3PFA_M_CMI_2018 [1.75%]
	Ill Health	115% S2IMA_CMI_2018 [1.75%] 138% S2IFA_CMI_2018 [1.75%]
Deferred	All	118% S3PMA_CMI_2018 [1.75%] 105% S3PFA_M_CMI_2018 [1.75%]
Future Dependant	Dependant	124% S3PMA_CMI_2018 [1.75%] 113% S3DFA_CMI_2018 [1.75%]

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

APPENDIX B – EMPLOYER DEFICIT RECOVERY PLANS

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

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

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

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

Category	Average Deficit Recovery Period	Derivation
Unitary Authority Councils	x years	Determined by reducing the period from the preceding valuation by at least [3] years (where appropriate).
Parish/Town Councils and designating bodies	x years	Determined by reducing the period from the preceding valuation by at least [3] years (where appropriate).
Academies and Multi-Academy Trusts	x years	Determined by reducing the period from the preceding valuation by at least [3] years (where appropriate), taking into account the profile of the membership and subject to an assessment of covenant by the Fund. For new academies, determined in line with their original LEA schools groups i.e. the UA councils
Higher Education Bodies (Universities)	x years	Determined by reducing the period from the preceding valuation by at least [3] years (where appropriate), subject to an assessment of covenant by the Fund. [If a HE body closes to new employees then the recovery period will be adjusted to reflect this and the covenant assessment.].
Further Education Bodies (Colleges)	x years	Determined by reducing the period from the preceding valuation by at least [3] years (where appropriate) subject to an assessment of covenant by the Fund. [If a FE college closes to new employees then the recovery period will be adjusted to reflect this and the covenant assessment.]
Community related Admitted Bodies	x years	Subject to agreement with guarantor but will be no

(with a guarantee)		longer than the recovery period of the guarantor.
Community related Admitted Bodies (without a guarantee)	x years	Determined on a case by case basis.
[Admitted bodies that joined via the deemed employer route]	[n/a]	[In line with the recovery period of the deemed employer.]
Contract related Admitted Bodies (guaranteed by the letting Scheme Employers)	x years	Deficit recovery period to be agreed with the letting scheme employer but will be no longer than the letting scheme employer recovery period. Consideration will also be given to the contract length and the average working lifetime of the employees.

[Drafting Note – This has been added following the consultation published by the MHCLG on 10 January 2019 (found here: <https://www.gov.uk/government/consultations/local-government-pension-scheme-fair-deal-strengthening-pension-protection>). In addition it is possible HE/FE employers could close to new entrants if the proposal in the consultation on the Changes to the Local Valuation Cycle and the Management of Employer Risk (found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf) The Funding Strategy Statement and Fund policies may need further adaptation once the consultation processes has been completed.]

The medium term objective is to recover any deficit over a maximum of [12] years on average for the whole Fund, and this will be periodically reviewed with a view to reducing this in a reasonable manner depending on the maturity profile of the Scheme.

Other factors affecting the Employer Deficit Recovery Plans

As part of the process of agreeing funding plans with individual employers, the Administering Authority will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities. All other things equal this could result in a longer recovery period being acceptable to the Administering Authority, although employers will still be expected to at least cover expected interest costs (actual interest costs will vary in line with investment performance) on the deficit.

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

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

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

APPENDIX C - ADMISSION POLICY

ENTRY TO THE FUND

SCHEDULED BODIES

All scheduled bodies are entitled to join the scheme under the Regulations. Academies are scheduled bodies under the Regulations. These bodies include tax raising bodies, those funded by central government (academies and colleges) and universities (reliant on non-government income).

DESIGNATING BODIES

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

ADMISSION BODIES

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

Admitted bodies can join the Fund if

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

Admitted bodies may only join the Fund if they are guaranteed by a scheme employer. When the agreement or service provision ceases, the Fund’s policy is that the assets and liabilities of the admission body will in all cases revert to the outsourcing scheme employer or guaranteeing employer. If the outsourcing scheme employer or guaranteeing employer wishes to recover any deficit from the admission body, it is a matter between themselves and the admission body. The Fund will require appropriate instruction from the guarantor regarding any outstanding deficit to recover from the outgoing body.

Where an admission agreement involves multiple guarantors (typically under the first bullet above), who may not all be employers in the Fund, it may not be practical for any deficit on closure to be transferred to another employer in the Fund. Where this is the case, the lower risk funding basis would apply for valuing the liabilities from the outset.

[JOINING THE FUND VIA THE ‘DEEMED EMPLOYER’ ROUTE]

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

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

If the Deemed Employer route is chosen, the admitted body will not join the Fund and will instead be grouped/pooled with the original scheme employer. This may be used when a pass through arrangement has been agreed. However, the deemed employer may choose to individually track the funding position of the admitted body separately if they wish. The contributions required may be set in line with the deemed employer or may be bespoke and calculated based on the individual membership data.

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

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

CONNECTED ENTITIES

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

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

To limit the risk to the Fund, the lower risk funding basis for calculating the liabilities will apply to all new connected entities. In the event that a scheme employer provides a guarantee for their connected entity, the higher risk valuation funding basis will be applied to value the liabilities.

CHILDREN’S CENTRE TRANSFER TO ACADEMY TRUSTS

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

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

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

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

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

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

[Drafting Note – This section will potentially need amending when the outcome of the consultation published by the MHCLG on 10 January 2019 is known (found here:

<https://www.gov.uk/government/consultations/local-government-pension-scheme-fair-deal-strengthening-pension-protection>).]

LGPS REGULATIONS 2013: SCHEDULE 2 PART 3, PARAGRAPH 8

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

- (a) a person who funds the admission body in whole or in part;
- (b) in the case of an admission body falling within the description in paragraph 1(d), the Scheme employer referred to in that paragraph;

(d) a body that is providing or will provide a service or assets in connection with the exercise of a function of a Scheme employer as a result of—

(i) the transfer of the service or assets by means of a contract or other arrangement,

(ii) a direction made under section 15 of the Local Government Act 1999 (115) (Secretary of State's powers),

(iii) directions made under section 497A of the Education Act 1996 (116) ;

(c) a person who—

(i) owns, or

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

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

APPENDIX D - TERMINATION POLICY

EXITING THE FUND

TERMINATION POLICY

[Unless agreed otherwise via an employer deferred debt arrangement], an employer ceases to participate within the Fund when the last active member leaves the Fund. This includes where the employer ceases to be eligible for membership e.g. a contract with a local authority comes to an end or the employer chooses to voluntarily cease participation. The employer becomes an exiting employer under the Regulations and the Fund is then required to obtain an actuarial valuation of that employer's liabilities in respect of benefits of the exiting employer's current and former employees along with a termination contribution certificate.

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

[Drafting Note – “Unless agreed otherwise “ has been added following the consultation published by the MHCLG on 8 May 2019 as it is possible employers could continue to participate in the Fund with no active members which is commonly referred to as an deferred debt arrangement (found here:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed. This is distinct from an employer exiting the Fund and agreeing a repayment plan.]

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

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

EMPLOYERS WITHOUT A GUARANTOR

The lower risk funding basis is used for assessing liabilities on termination unless the Administering Authority agrees otherwise based on the advice of the Actuary. This basis mitigates against financial market risks as an investment strategy to run off these liabilities could be constructed to minimise fluctuations due to market shifts. In the event that the lower risk basis

produces a higher discount rate than the higher risk valuation funding basis, the higher risk valuation funding basis will be used.

The assumptions used will be consistent with the previous valuation assumptions, updated for market yields and inflation applying at the cessation date but for the lower risk funding basis, the discount rate will be based on the investment returns of the lower risk investment strategy and allowing for any further margins the Administering Authority deems appropriate based on the advice of the Actuary. At the valuation date the discount rate used would have been [x.xx]% per annum.

However, this does not provide against future adverse demographic experience relative to the assumptions which could emerge at future valuations. This risk is managed by including a higher level of prudence in the demographic assumptions on termination to further protect the remaining employers.

The termination basis for an outgoing employer currently includes an adjustment to the assumption for longevity improvements over time by increasing the rate of improvement in mortality rates to [2.25]% p.a. from those used in the 2019 valuation for ongoing funding and contribution purposes.

The policy for such employers will be:

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 3 months of completion of the cessation assessment by the Actuary).
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

The Administering Authority can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary.

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

[Drafting Note – Wording has been added following the consultation published by the MHCLG on 8 May 2019 (found here:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

EMPLOYERS WITH A GUARANTOR

If, instead, the employing body has a guarantor within the Fund or a successor body exists to take over the employing body's liabilities, the Fund's policy is that the higher risk valuation funding basis will be used for the termination assessment unless the guarantor informs the Fund otherwise.

The guarantor or successor body will then, following any termination payment made by the exiting employer, subsume the assets and liabilities (and any surplus or deficit) of the employing body within the Fund. This is subject to the agreement of all parties involved (i.e. the Fund, the exiting

employer and the guarantor) who will need to consider any separate agreements that have been put in place between the exiting employer and the guarantor.

In the event of a surplus, if all parties do not agree, then the surplus will be paid directly to the exiting employer within 3 months of completion of the cessation assessment by the Actuary (despite any other agreements that may be in place). The Fund will notify all parties in the event that agreement cannot be reached, however ultimately the Fund will comply with the Regulations and therefore pay the exit credit to the exiting employer. In some instances, the outgoing employer may only be responsible for part of the residual deficit or surplus as per the separate agreement. This would only be taken into account if the Administering Authority is made aware of any such arrangement.

In maintaining a consistent approach, if all parties do not agree, the Fund will seek to recover any deficit from the exiting employer in the first instance although if this is not possible then the deficit will be recovered from the guarantor either as a further contribution collection or at the next valuation.

If a guarantor unjustifiably deviates from the Fund's policy (e.g. to subsume the residual assets, liabilities and any surplus or deficit of an exiting employer), any future termination events will be treated in line with the approach adopted for employers without a guarantor in the Fund (e.g. the guarantor will be required to pay the termination deficit as a lump sum cash payment at the time of exit, any surplus would also be paid by the Fund to the guarantor at this point). The higher risk valuation funding basis will still be adopted in this case.

Again, the Administering Authority can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary [and, for example, may adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers].

[Drafting Note – Wording has been added following the LGPS (Amendment) Regulations 2018, which amended the LGPS 2013 Regulations to provide for the payment of an exit credit to an existing employer where, at the exit date, that employer's assets in the fund exceed its liabilities. In the case where the employer has a guarantor, the above clarifies who the recipient of the exit credit should be.]

DESIGNATING BODIES

In the event of cessation, the designating body will be required to meet any outstanding liabilities valued in line with the "employers without a guarantor" approach outlined above. Upon exit, if there is a shortfall, the assets and liabilities will revert to the Fund as a whole.

[EMPLOYERS THAT JOINED VIA THE 'DEEMED EMPLOYER' ROUTE]

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

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

CONNECTED ENTITIES

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

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

[EMPLOYERS WITH NO CONTRIBUTING MEMBERS

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

[Drafting Note – This has been added following the consultation published by the MHCLG on 8 May 2019 (found here:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/800321/LGPS_valuation_cycle_reform_consultation.pdf). The Funding Strategy Statement and Fund policies may need further adaptation once the consultation process has been completed.]

APPENDIX E - ACADEMIES / MULTI-ACADEMY TRUSTS

ACADEMY CONVERSIONS AND DEFICIT TRANSFERS

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

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

MULTI ACADEMY TRUSTS

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

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

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

In cases where numerous academies are operated by the same managing Trust, the Fund is willing to allow a combined funding position and average contribution requirements to apply to all constituent academies. Notwithstanding this, the Fund will continue to track the constituent academies separately, in the interests of transparency and clarity around entry and exit events.

APPROACH TO SETTING CONTRIBUTION RATES

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

The Fund will provide the MATs with the option of having a common Primary contribution rate for all the academies within the trust if the MAT is willing to settle for that approach bearing in mind that the risks of under and over payments will be shared by all academies in the MAT pool.

The past service deficit will still be assessed at an individual academy level so that it only relates to the staff of the respective academy. However, the MAT can opt to have the deficits for all the academies within the trust aggregated for the purposes of the actuarial valuation report.

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

OUTSOURCINGS BY MULTI ACADEMY TRUSTS

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

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

With the development of MATs, there is a case for the Fund to allow a MAT to enter into a single admission agreement with the contractor providing similar services at various sites provided the outsourcing is covered by a single commercial contract. The Fund has now developed a mechanism whereby this can be done, subject to certain conditions which must be agreed by the MAT.

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

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

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

At every triennial valuation the actuary reviews the funding level of the admitted body and adjusts its employer contribution rate as required. Once either the service contract comes to an end or all the LGPS members have left, the admission agreement terminates and, in accordance with Fund policy, the Trust becomes responsible for the assets and liabilities standing to the account of the admitted body. A cessation valuation can be provided by the Fund actuary should the Trust request it. In accordance with Fund policy, the academy becomes responsible for the assets and liabilities of and liabilities standing to the account of the admitted body when the admission agreement ceases.

APPENDIX F - RISK MANAGEMENT POLICY FOR NON-SCHEDULED BODIES

ADMISSION BODIES AS A RESULT OF OUTSOURCINGS

The Fund has always required bodies admitted to the Fund as a result of an outsourcing of services to be guaranteed (formerly transferee admission bodies). Therefore, these employers pose less financial risk to the Fund.

The Fund's policy is that the liabilities of such an admission body will in all cases revert to the outsourcing scheme employer when the agreement ceases.

The administering authority will discuss the appropriate deficit recovery period for the admission body with the outsourcing scheme employer. If the scheme employer is retaining the financial risk, the deficit recovery period applied can be the same as the mandatory scheme employer's. Otherwise the deficit recovery period will be the length of the commercial contract left to expiry (or the average working lifetime of the membership if this is shorter).

ADMISSION BODIES PROVIDING A SERVICE TO THE COMMUNITY

These admission bodies 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.

The Fund's policy has been to require a guarantee from a scheme employer and for this reason they are treated in the same way as those bodies admitted due to an outsourcing.

For historical reasons those which were admitted prior to 2004 have no guarantee and, as such, constitute a potential risk to the Fund. This is because they may cease operations with insufficient residual assets to meet their pension liabilities.

The risks associated with admitted bodies have always existed but these risks have assumed a higher profile recently because most of these bodies have a deficit of assets relative to liabilities.

The tools available to manage these risks are limited to using a more prudent valuation basis (such as the lower risk valuation basis) which minimises the deficit on exit; obtaining charges on assets in favour of the Fund; setting up escrow accounts and other security. The approach to agreeing the funding plans of these 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.

Where there are no contingent assets the policy is to move over time to the lower risk funding basis and to shorten the deficit recovery period. However, this will need to be weighed against the ability of that body to pay higher contribution rates.

CONTROLLED ENTITIES

These are employers that were “controlled entities” under the previous regulations. These do not qualify as connected entities under the new regulations and in the absence of government advice to the contrary, they remain controlled entities. As they are not guaranteed by a scheme employer, to protect the Fund, the funding basis will be moved to the lower risk funding basis on a managed basis over time.

APPENDIX G – COVENANT ASSESSMENT AND MONITORING POLICY

An employer's covenant (including those with no active members who are operating under a deferred debt arrangement) underpins its legal obligation and ability to meet its financial responsibilities now and in the future. The strength of covenant depends upon the robustness of the legal agreements in place and the likelihood that the employer can meet them. The covenant effectively underwrites the risks to which the Fund is exposed, including underfunding, longevity, investment and market forces.

An assessment of employer covenant focuses on determining the following:

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

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

RISK CRITERIA

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

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

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

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

ASSESSING EMPLOYER COVENANT

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

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

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

FREQUENCY OF MONITORING

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

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

COVENANT RISK MANAGEMENT

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

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

APPENDIX H – INSURANCE ARRANGEMENTS

OVERVIEW OF ARRANGEMENT

For certain employers in the Fund, following discussions with the Fund Actuary and after considering potential alternative insurance arrangements, a captive insurance arrangement was established by the Administering Authority to cover ill-health retirement costs. This applied to all ill-health retirements since 1 April 2017.

The captive arrangement operates as follows:

- “Premiums” are paid by the eligible employers into the captive arrangement which is tracked separately by the Fund Actuary in the valuation calculations. The premiums are included in the employer’s primary rate. The premium for 2020/23 is [x.xx]% of pay per annum
- The captive arrangement is then used to meet strain costs (over and above the premium paid) emerging from ill-health retirements in respect of active members i.e. there is no initial impact on the deficit position for employers within the captive.
- The premiums are set with the expectation that they will be sufficient to cover the costs in the 3 years following the valuation date. If any excess premiums over costs are built up in the Captive, these will be used to offset future adverse experience and/or lower premiums at the discretion of the Administering Authority based on the advice of the actuary.
- In the event of poor experience over a valuation period any shortfall in the captive fund is effectively underwritten by the other employers within the Fund. However, the future premiums will be adjusted to recover any shortfall over a reasonable period with a view to keeping premiums as stable as possible for employers. Over time the captive arrangement should therefore be self-funding and smooth out fluctuations in the contribution requirements for those employers in the captive arrangement.
- Premiums payable are subject to review from valuation to valuation depending on experience and the expected ill health trends. They will also be adjusted for any changes in the LGPS benefits. They will be included in employer rates at each valuation or on commencement of participation for new employers.

EMPLOYERS COVERED BY THE ARRANGEMENT

Those employers (both existing and new) that will generally be included in the captive are:

- Academies
- Community related Admitted Bodies
- Contract related Admitted Bodies
- Town and Parish Councils
- Designating Bodies.

These employers will be notified of their participation. New employers entering the Fund who fall into the categories above will also be included. At the discretion of the Administering Authority and where it is felt to be beneficial to the long term covenant and financial health of an employer, specific employers (outside of the categories listed above) may be included within the captive arrangement. In addition, the Administering Authority has the ability to exclude any employer in order to manage employer risk within the Fund.

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

For all other employers who do not form part of the captive arrangement, the current treatment of ill-health retirements will still apply. The Fund therefore continues to monitor ill-health retirement strain costs incurred in line with the allowance made in the actuarial assumptions. Once the allowance is exceeded, any excess costs are recovered from the employer, either at the next valuation or at an earlier review of the contributions due, including on termination of participation.

APPENDIX I - GLOSSARY

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

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

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

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

BEST ESTIMATE ASSUMPTION: an assumption where the outcome has a 50/50 chance of being achieved.

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

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

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

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

CORPORATE BOND EMPLOYER: an employer in the Fund, under previous Fund policies, whose asset share is invested in corporate bond assets and for whom the discount rate used to assess the liabilities is determined based on the market yields of high quality corporate bond investments (usually at least AA rated) based on the appropriate duration of the liabilities being assessed. These employers will now be moved onto the lower risk funding basis.

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

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

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

DISCOUNT RATE: the rate of interest used to convert a cash amount e.g. future benefit payments occurring in the future to a present value i.e. the liabilities. A higher discount rate means lower liabilities and vice versa.

EMPLOYER'S FUTURE SERVICE CONTRIBUTION RATE ("PRIMARY RATE"): the contribution rate payable by an employer, expressed as a % of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses.

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

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

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

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

FUNDING OR SOLVENCY LEVEL: the ratio of the value of the Fund's assets and the value of the Fund's liabilities expressed as a percentage.

FUNDING STRATEGY STATEMENT: This is a key governance document that outlines how the administering authority will manage employer's contributions and risks to the Fund.

GOVERNMENT ACTUARY'S DEPARTMENT (GAD): the GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

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

ILL HEALTH CAPTIVE: this is a notional fund designed to protect certain employers against excessive ill health costs in return for an agreed insurance premium.

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

LETTING EMPLOYER: an employer that outsources part of its services/workforce to another employer, usually a contractor. The contractor will pay towards the LGPS benefits accrued by the

transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer.

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

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

LOWER RISK FUNDING BASIS: an approach where the discount rate used to assess the liabilities is determined based on the expected long term return achieved on the Fund's lower risk investment strategy. This is usually adopted for employers who are deemed to have a weaker covenant than others in the Fund, are planning to exit the Fund or would like to target a lower risk strategy. This basis is adopted for ongoing contribution rate purposes as the employers' asset share is invested in the lower risk investment strategy.

LOWER RISK INVESTMENT STRATEGY: an investment strategy which is predominately linked to corporate bond investment assets that match the liabilities of the employers within it (as a minimum this will be reviewed following each actuarial valuation). In addition, the strategy has exposure to the Liability Driven Investment ("LDI") portfolio to provide protection against changes in market inflation expectations.

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

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

MINIMUM RISK FUNDING BASIS: an approach where the discount rate used to assess the liabilities is determined based on the market yields of Government bond investments based on the appropriate duration of the liabilities being assessed. This is usually adopted when an employer is exiting the Fund.

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

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

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

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

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

PRESENT VALUE: the value of projected benefit payments, discounted back to the valuation date.

PRIMARY RATE OF THE EMPLOYERS' CONTRIBUTION: the contribution rate required to meet the cost of the future accrual of benefits including ancillary, death in service and ill health benefits together with administration costs. It is expressed as a percentage of pensionable pay, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer's covenant. The Primary rate for the whole fund is the weighted average (by payroll) of the individual employers' Primary rates.

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

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

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

REAL RETURN OR REAL DISCOUNT RATE: a rate of return or discount rate net of (CPI) inflation.

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

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

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

SECTION 13 VALUATION: in accordance with Section 13 of the Public Service Pensions Act 2014, the Government Actuary's Department (GAD) have been commissioned to advise the Department for Communities and Local Government (DCLG) in connection with reviewing the 2019 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

SECONDARY RATE OF THE EMPLOYERS' CONTRIBUTION: an adjustment to the Primary rate to reflect any past service deficit or surplus, to arrive at the rate each employer is required to pay. The Secondary rate may be expressed as a percentage adjustment to the Primary rate, and/or a cash adjustment in each of the three years beginning 1 April in the year following that in which the valuation date falls. The Secondary rate is specified in the rates and adjustments certificate. For any employer, the rate they are actually required to pay is the sum of the Primary and Secondary rates. Secondary rates for the whole fund in each of the three years shall also be disclosed. These will be calculated as the weighted average based on the whole fund payroll in respect of percentage rates and as a total amount in respect of cash adjustments.

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

HIGHER RISK VALUATION FUNDING BASIS: the financial and demographic assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is determined based on the expected long term return achieved on the Fund's investments. This is expressed as an expected return over CPI.

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