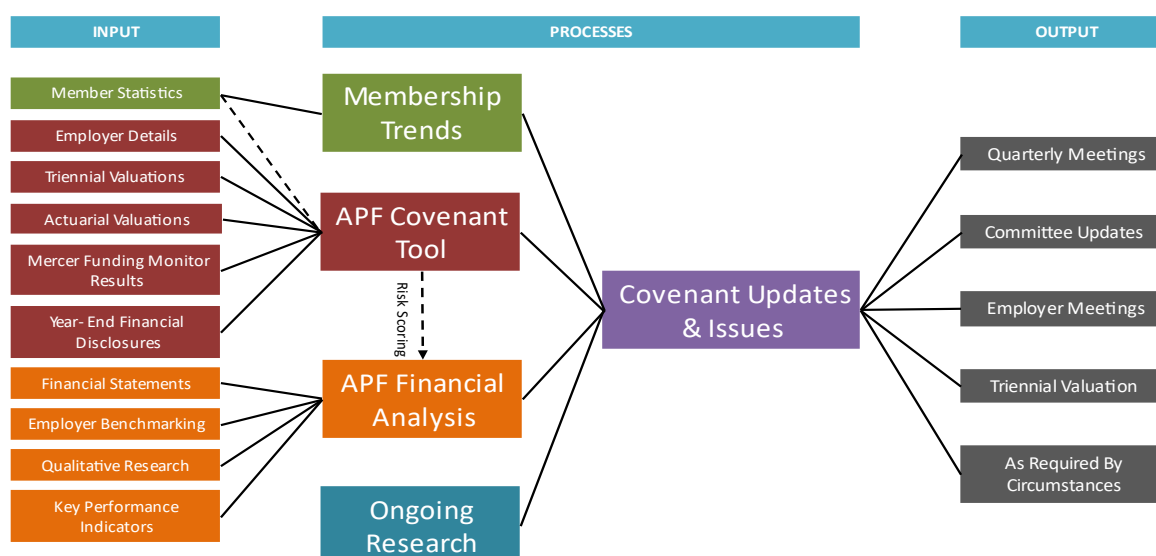




# Overview of Covenant Process



As highlighted in the above diagram, the data “INPUTS” into the Covenant processes are from many sources, whether it be internal data on membership movements or collecting financial statements.

“Membership Trends” looks at the most recent membership data, running a series of tests (primarily looking at trends), and then flagging any concerns such as an accelerated decrease in membership leading to a point where there are no active members and an exit from the Fund.

The “APF Covenant Tool” acts primarily as a database, holding all relevant (internal) information on employers in the Fund. The information is used to identify employers in the Fund who may be ‘higher-risk’ to the Fund and thus should be reviewed in more detail. This is not an assessment of the employer’s financial risk.

The “APF Financial Analysis” differs between employer groups, but is an analysis of an employer’s financial position, looking at external data such as financial statements, management accounts, benchmark results and using key performance indicators (KPI) to look for any trends and compare against peers. The Fund’s primary focus when looking at this information, and what forms the basis for many of the KPI’s, is whether there are any concerns around LGPS affordability in the short, medium, or long-term.


“Ongoing Research” is any further qualitative analysis undertaken, this could be specific to an employer, a sector as a whole, or general macro-economic changes and how certain events may have a bearing on employers in the Fund. These are recorded and then given a risk rating based on how imminent the event is and its severity.

These four processes are updated in the “Covenant Updates and Issues” database, which is a central knowledge hub covering APF Covenant related matters.

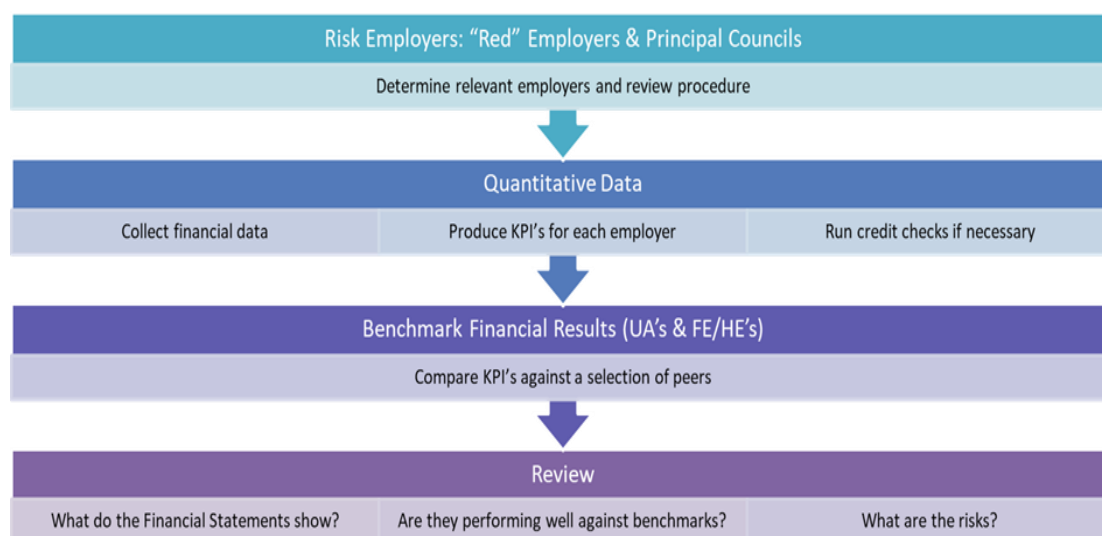
The primary focus of the Fund's covenant work is to ensure employers can maintain their legal obligation and financial ability to support the LGPS now and in the future. At least once a quarter Officers meet to discuss developments of employers in the Fund, any flags identified by the Covenant work and what steps are needed to address concerns. This ensures that Covenant risk is regularly reviewed and Officers are aware of affordability constraints and concerns raised by employers.

1. The "higher-risk" employers in the Fund are identified from the "APF Covenant Tool" process, where each employer is reviewed against set variables based on internally held data. This test allocates each employer with a "score" indicating the level of risk they pose to the Fund. Those who are categorised as "red" employers (scoring more than 4) are reviewed more thoroughly alongside the FE/HE's (unguaranteed) and the UA's (on account of their size). An example of the test is below:

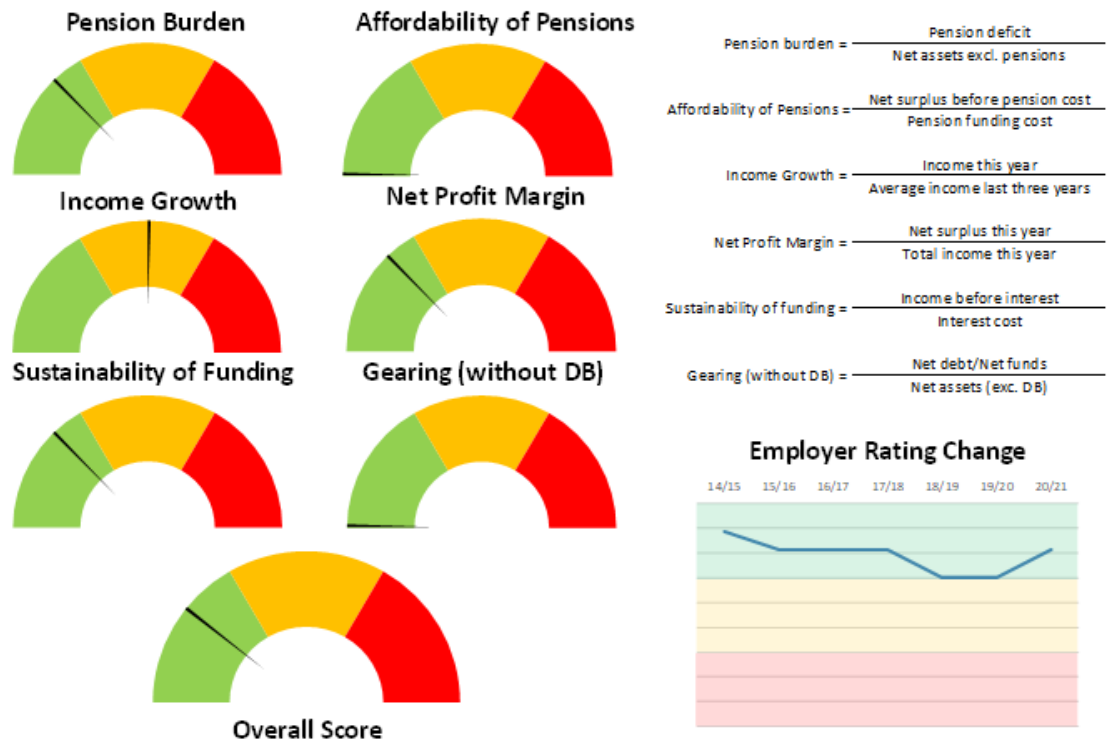
Scoring Factors	Variable	Score	Employer	Test Employer	
Funding level less than	80%	1	Funding Level	36.00%	1
Funding deficit more than	£500,000	2	Deficit/(Surplus)	£697,000	2
No Guarantor/ Tax (toll) Raising powers/ or concerns about guarantee		3	Guarantor	DfE	0
If above true, no Security		2	Security	N/A	0
Active members are less than or equal to	3	1	Members	38	0
					3



2. The higher risk employers then progress through the steps outlined below:



3. Following guidance from the Actuary, the benchmarking process has been created focusing on a selection of key performance indicators. Below is an example of the benchmarking, with the dials showing how an employer's performance compares against their peers:



- In addition to the benchmarking, which provides an indication of an employer's financial health, the Fund also looks for other trends in the financial statements, investigating any areas of concern (asking for supplementary information if necessary), and looking at how and why figures have changed. This ensures that the Fund has a good understanding of its employers and draws out any potential affordability concerns.