

Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND COMMITTEE	
MEETING DATE:	27 June 2025	AGENDA ITEM NUMBER
TITLE:	DRAFT FUNDING STRATEGY STATEMENT 2025	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report:		
Appendix 1 – Draft Funding Strategy Statement		

1 THE ISSUE

- 1.1 The Local Government Pension Scheme (LGPS) regulations require each administering authority to prepare and publish a Funding Strategy Statement (FSS). The FSS sets out the key assumptions which the Fund's Actuary has used in preparing the actuarial valuation and the policies adopted by the Administering Authority.
- 1.2 A Committee workshop was held on 3 June 2025 to discuss the broad principles in the FSS in more detail prior to the committee meeting. The only substantive change to the policies is the introduction of a surplus policy (see Appendix D of the FSS).
- 1.3 The Actuary will be at the meeting to present the draft FSS and answer any queries. Once the Committee has agreed the draft, it will be circulated to the employing bodies and Pension Board for comment. The comments arising from the consultation (including any technical updates) will be reported to the Committee meeting on 26 September 2025 when the FSS will be approved.
- 1.4 The 2025 actuarial outcome will be reported to Committee at the March 2026 meeting.
- 1.5 Individual employer results will be disseminated in October and November.

2 RECOMMENDATION

The Committee:

- 2.1 **Approves the draft Funding Strategy Statement as set out in Appendix 1 for wider consultation, subject to the insertion of information which can only be included when the actuarial valuation and consultation processes are complete.**
- 2.2 **Delegates power to officers, having taken advice from the Actuary, to amend the draft FSS for technical updates and updated information as appropriate.**

3 FINANCIAL IMPLICATIONS

- 3.1 The actuarial costs for reviewing the FSS are included in the 2025 actuarial valuation fee and are provided for in the 2025/26 budget.

4 BACKGROUND AND PROCESS

- 4.1 The LGPS regulations require each administering authority to prepare and publish a Funding Strategy Statement. New Guidance for Preparing and maintaining a Funding Strategy Statement was issued by the Ministry of Housing Communities & Local Government (MHCLG) in January 2025. The key requirements for preparing the FSS are as follows:
- The administering authority must prepare and, after consultation with all relevant interested parties involved with the Fund, publish their funding strategy
 - In preparing the FSS, the administering authority must have regard to:
 - (i) Guidance issued by MHCLG for this purpose
 - (ii) The Investment Strategy Statement (ISS) for the Fund published under the LGPS (Management and Investment of Funds) Regulations 2016
 - The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the ISS.
 - The Fund's Actuary must have regard to the FSS as part of the valuation process.
- 4.2 The FSS sets out all the key assumptions which the Actuary will use in preparing the actuarial valuation, together with the Administering Authority's policies in the areas where it has discretion to manage the funding position of the Fund.
- 4.3 The draft FSS attached as Appendix 1 is based on preliminary information that can only be finalised once the valuation, consultation processes and associated analysis have been completed.
- 4.4 The draft FSS will be circulated to employers and interested parties for consultation during July and August. Comments will be considered by Officers and reported to the Committee at the Committee meeting (26 September 2025) where the FSS will be approved. Under the governing regulations, the Fund's Actuary cannot finalise the valuation until the FSS has been approved by the Committee.
- 4.5 The 2025 valuation outcome will be reported to Committee in March 2026.

5 DRAFT FUNDING STRATEGY STATEMENT

- 5.1 At the Committee workshop on 3 June 2022, the Actuary gave a presentation on the FSS covering the broad principles, how it relates to the actuarial valuation process and the basis for the assumptions to be used in the valuation.
- 5.2 The FSS is an important document for the Fund and its employers. It sets out a clear and transparent funding strategy that will identify how each employer's pension liabilities will be met going forward. Therefore the policies and information contained within the FSS will have a financial and operational impact on all participating employers within the Fund. In addition it contains the key policies by which the Fund manages funding, employer and financial risk.
- 5.3 The FSS is the key governance document as it sets out the risk management strategy by which the administering authority ensures the solvency of the Fund for all employers. The other key strategy, the investment strategy, influences the FSS

as the Actuary must allow for the investment return expectations when finalising the discount rate assumption adopted in the funding strategy.

5.4 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 professional advice provided by the Actuary.

5.5 The objective of the FSS is to secure the solvency and long-term cost efficiency of the Fund. In doing this it seeks to balance solvency with affordability of the employing bodies. The purpose of the FSS 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" via sustainable employer contribution rates.
- To have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

5.6 The key financial and demographic assumptions in the FSS are set following advice from the Fund Actuary after consultation with the administering authority. Some of the demographic assumptions have yet to be finalised but the Actuary has done some preliminary analysis to inform on the "direction of travel".

5.7 Following new guidance from MHCLG on Preparing and Maintaining a Funding Strategy Statement (FSS), the format of the FSS has been updated and as a result is now a longer document. However, the majority of the content remains unchanged (except to reflect the 2025 valuation updates) and there is a new policy for managing surpluses.

5.8 In the draft FSS 2025 the following changes are being incorporated:

(1) Discount Rate basis for past service liabilities (funding target)

The key assumption which drives the value of the pension Fund liabilities (the future benefit payments) and therefore deficit or surplus is the discount rate. This is set by the Fund, based on advice from the Actuary, to reflect the overall investment return which we expect to achieve on the Fund's assets (within reasonable risk parameters) over the long term with a suitable and necessary allowance for prudence to support contribution sustainability. In terms of setting contributions, the relationship of the assumed investment return on assets compared to the rate of assumed future increases in benefit payments (i.e. CPI inflation) is critical (in other words we need to reflect the "real" investment return expected on the Fund assets).

The discount rate reflects the "real" expected asset return above the CPI baseline assumption when assessing the long-term solvency target. Increases in inflation will increase the liabilities as the benefits are inflation linked and potentially it can also reduce the real return on assets. A judgement is needed as to expected future inflation, with the risk that understating inflation and its persistency in this valuation will transpire into higher contributions at the next valuation in 2028.

The Actuary is proposing to increase the expected level of real return above CPI by 1.80% from the 2022 valuation to CPI+3.30% per annum, which includes an appropriate level of prudence to support contribution sustainability (as in the

probability of achieving the discount rate) taking into account a range of factors/assumptions including the economic and geopolitical environment. The level of prudence includes judgement for the Actuary on the level of uncertainty of these factors in the context of the current global environment. This increase is driven predominantly by market conditions (interest rates). As a result the funding level has improved, and the deficit has been replaced by a surplus (at the overall Fund level although the experience for individual employers will vary considerably).

(2) Future service rate (FSR) discount rate basis:

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 FSR should take account of the uncertainty in market conditions applying at future dates, not just the date of the valuation, it is justifiable to use a lower expected return from the investment strategy compared to the past service discount rate. The future service discount rate therefore includes an element of smoothing of current market conditions to support the sustainability of contributions in the longer term.

The Actuary's view is that the real return applied in 2022 can be increased by 0.25% to CPI +2.25% per annum. As a result, there will be a reduction in FSR (all other things equal).

(3) Mortality assumption

The baseline and short-term trend in mortality will be adjusted to reflect the Fund's experience since 2022. The full demographic analysis has yet to be completed. However, the initial demographic analysis indicates that life expectancy has in general fallen (the exception being amongst female pensioners) which will reduce the baseline liabilities. The longevity assumption used to date is in line with current Continuous Mortality Investigation (CMI) (2023) with a long-term improvement trend of 1.75% p.a. and this is set out within the FSS. This will be updated to use the 2024 CMI tables once they are available, and the Actuary will consider further the long-term improvement trend in light of the additional analysis that will follow. Overall initial indications are that the liability impact is a c.1.3% reduction versus 2022. This reduces the primary contribution rate by c.0.4% of pay, although the impact by employer will vary based on their own membership profile.

(4) Surplus Reserve Policy (see Appendix D of the FSS)

The Fund is now in a stronger funding position than at recent previous valuations and some employers may have moved into surplus position, so an enduring surplus policy is required. The Fund's objective is to maintain stability of contributions and in the 2025 valuation circumstances of worldwide financial market turmoil, there is a need for a surplus reserve to protect against adverse experience leading to unsustainable contribution levels.

Relatively small surpluses are also fragile in the context of the daily variations in funding level and so the introduction of a sustainability reserve aims to provide a cushion against adverse experience to support the sustainability of contributions rates. This is illustrated by the simple employer example below:

	No surplus reserve	Surplus reserve of 5%
2025 valuation		
- Funding level	104%	104%
- Contribution off-set	4.0%	Nil
Total contribution	12.0%	16.0%
2028 valuation		
- Funding level	100%	101%*
- Contribution off-set	Nil	Nil
Total contribution	16.0%	16.0%
2031 valuation		
- Funding level	102%	103%
- Contribution off-set	2.0%	Nil
Total contribution	14.0%	16.0%
2034 valuation		
- Funding level	99%	100%*
- Contribution off-set	(1.0) %	Nil
Total contribution	i.e. deficit contribution 17.0%	16.0%

*In practice this would be slightly higher as contributions paid over the three-year period had been higher, we have assumed a 1% impact for the illustration

The future service rate has been kept constant for illustrative purposes but would also be expected to vary to some extent between valuations – in particular for profile and other demographic changes.

This simple example shows one possible path of a large number of potential pathways for employer contribution rates. Nonetheless it conveys the impact of the surplus reserve over successive valuations and how it supports contribution stability. When taking decisions on the level of the surplus reserve in practice, the Fund considers the position in a more detailed way using stochastic analysis prepared by the Fund Actuary. Such analysis looks at the likelihood of contribution increases at future valuations under different levels of contributions.

The FSS sets out differing surplus reserves by employer characteristics, given that some employers' funding positions will be more sensitive to changes in market conditions, for example, than others, and at future valuations as the circumstances require the surplus reserve could be nil. A critical consideration for committee is whether the reserves should vary by employer type (linked to the sensitivity of funding position to changes in assumptions) or maintain a

constant reserve for employers and accept the potential lower likelihood of sustainable contributions. The draft policy shows provisional surplus reserves for the different categories of employer e.g. a 5% reserve for Councils/public bodies to allow for this variability in a practical way, along with circumstances where they would be considered on a case by case basis. These would be subject to review as part of the valuation project and will be consulted upon with the employers. The Actuary will discuss the pros and cons of the potential approaches at the meeting.

5.9 Employer affordability and covenants within the Fund are diverging as the public sector and its funding regimes change. The covenant assessment process is a key element of the valuation and the objectives of this are included in the FSS.

5.10 National Issues that need to be reflected in the FSS:

There are no new issues which need to be included in the FSS. Relevant updates on key aspects of the FSS are:

(1) Climate change analysis

An important part of the risk analysis underpinning the funding strategy will be to identify the impact of climate transition risks and physical risks on the potential funding outcomes. The impact of different scenarios at the whole Fund level versus the baseline (which assumes the funding assumptions are played out) will be considered as part of the valuation to ensure the funding strategy is sufficiently robust to the risks posed by climate change.

(2) McCloud

The McCloud discrimination case relates to the protections provided to members close to retirement when the Fund benefits were changed in 2014. The estimated costs of applying the remedy in respect of active members were included in the 2022 valuation balance sheet in line with guidance to Funds provided by MHCLG. Calculations for deferred and pensioners were not carried out due to lack of data; however under normal circumstances any McCloud costs for these members are not expected to be material at an individual employer or Fund level. Changes to the Regulations have now been passed into law. The Fund's approach will be to include amendments for all employers in the 2025 valuation to reflect the McCloud remedy when valuing past service liabilities, based on the actual member data. The McCloud benefit window ended on 31 March 2022 and so it does not affect employer future service contribution rates at the 2022 and 2025 valuations.

(3) GAD S13 Report

GAD reviews all fund valuations after each valuation and benchmarks each fund against GAD KPIs. The Actuary will take these KPIs into account but where it can be evidenced that they are not optimal for managing risk, the Actuary will advise the Committee and explain the possible consequences of adopting the proposed strategy. For the first time, these KPIs will consider Funds with the highest as well as the lowest contribution levels, for a given funding level.

5.11 **Changes to Fund specific policies:**

There are no substantive changes to existing policies other than being reworded to enable stakeholders to read and understand the information in a clear way.

6 RISK MANAGEMENT

- 6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. In addition it monitors the benefits administration, the risk register and compliance with relevant investment, finance and administration regulations. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.
- 6.2 A specific liability risk management framework is in place. This is designed to reduce risk and provide more stability/certainty of outcome for funding. The strategies are implemented on an opportunistic basis to ensure the most efficient and cost-effective approach is taken. Reference is made to the framework in the draft FSS. Full details are contained in the Investment Strategy Statement.

7 CLIMATE CHANGE

- 7.1 The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint. The Fund acknowledges the financial risk to its assets from climate change and addresses this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee. As noted above, in terms of the risk presented by climate change on the Fund, this is considered as part of the development of the funding strategy utilising scenario analysis prepared by the Fund Actuary in line with the guiding principles published by the Scheme Advisory Board.

8 EQUALITIES

- 8.1 An equalities impact assessment is not necessary.

9 CONSULTATION

- 9.1 A consultation process will follow after agreement from the Committee.

10 ISSUES TO CONSIDER IN REACHING THE DECISION

- 10.1 Are contained in the report.

11 ADVICE SOUGHT

- 11.1 The Council's Monitoring Officer and Section 151 Officer have had the opportunity to input to this report and have cleared it for publication.

Contact person	Julia Grace, Funding & Valuations Manager
Background papers	Guidance for Preparing and maintaining a Funding Strategy Statement (FSS) January 2025 Scheme Advisory Board (SAB) Statement on the 2025 Actuarial Valuation - 28 May 2025

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