

Leicestershire County Council Pension Fund

Funding Strategy Statement

March 2020

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Funding Strategy Statement

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1 Introduction

1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the Leicestershire County Council Pension Fund (“the Fund”), which is administered by Leicestershire County Council, (“the Administering Authority”).

It has been prepared by the Administering Authority in collaboration with the Fund’s actuary, Hymans Robertson LLP, and after consultation with the Fund’s employers and investment adviser. It is effective from 1 March 2020. This FSS supersedes the FSS in place from February 2019.

1.2 What is the Leicestershire County Council Pension Fund?

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the Leicestershire County Council Pension Fund, in effect the LGPS for the Leicestershire area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund’s assets grow over time with investment income and capital growth;
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in [Appendix B](#).

1.3 Why does the Fund need a Funding Strategy Statement?

Employees’ benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees’ contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers’ contributions, and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in [Appendix A](#).

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework of which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- the Fund's policies on admissions, cessations and bulk transfers;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Investment Strategy Statement (see [Section 4](#)).

1.4 How does the Fund and this FSS affect me?

This depends who you are:

- a member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;
- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, in what circumstances you might need to pay more and what happens if you cease to be an employer in the Fund. Note that the FSS applies to all employers participating in the Fund;
- an Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- a Council Tax payer: your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- to ensure the long-term solvency of the Fund, using a prudent long-term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (**NB** this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

1.6 How do I find my way around this document?

In [Section 2](#) there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In [Section 3](#) we outline how the Fund calculates the contributions payable by different employers in different situations.

In [Section 4](#) we show how the funding strategy is linked with the Fund's investment strategy.

In the [Appendices](#) we cover various issues in more detail if you are interested:

- A. the regulatory background, including how and when the FSS is reviewed,
- B. who is responsible for what,
- C. what issues the Fund needs to monitor, and how it manages its risks,
- D. some more details about the actuarial calculations required,
- E. the assumptions which the Fund actuary currently makes about the future,
- F. a [glossary](#) explaining the technical terms occasionally used here.

If you have any other queries please contact Ian Howe, Pensions Manager in the first instance at e-mail address ian.howe@leics.gov.uk or on telephone number 0116 305 6945.

The LGPS Regulations define various types of employer as follows:

Scheduled bodies - councils, and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such **academies (or Multi Academy Trusts)**, as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as “Scheduled Bodies”, the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the MHCLG regarding the terms of academies’ membership in LGPS Funds.

Designating employers - employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

Other employers are able to participate in the Fund via an admission agreement and are referred to as ‘admission bodies’. These employers are generally those with a “community of interest” with another scheme employer – **community admission bodies** (“CAB”) or those providing a service on behalf of a scheme employer – **transferee admission bodies** (“TAB”). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund’s admissions policy are not met. (NB the terminology CAB and TAB has been dropped from recent LGPS Regulations, which instead combine both under the single term ‘admission bodies’; however, we have retained the old terminology here as we consider it to be helpful in setting funding strategies for these different employers).

2.4 How does the calculated contribution rate vary for different employers?

All three steps above are considered when setting contributions (more details are given in [Section 3](#) and [Appendix D](#)).

1. The **funding target** is based on a set of assumptions about the future, (e.g. investment returns, inflation, pensioners’ life expectancies). If an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation;
2. The **time horizon** required is the period over which the funding target is achieved. Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and
3. The **likelihood of achieving** the funding target over that time horizon will be dependent on the Fund’s view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker than the required likelihood will be set higher, which in turn will increase the required contributions (and vice versa).

For some employers it may be agreed to pool contributions [3.4](#)

Any costs of non-ill-health early retirements must be paid by the employer, see [3.6](#).

Costs of ill-health early retirements are covered in [3.7](#) and [3.8](#).

2.5 How is a funding level calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see [Appendix D](#), section [D5](#), for further details of how this is calculated), to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's "deficit"; if it is more than 100% then the employer is said to be in "surplus". The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

It is important to note that the funding level and deficit/surplus are only measurements at a particular point in time, on a particular set of assumptions about the future. Whilst we recognise that various parties will take an interest in these measures, for most employers the key issue is how likely it is that their contributions will be sufficient to pay for their members' benefits (when added to their existing asset share and anticipated investment returns).

In short, funding levels and deficits are short term, high level measures, whereas contribution-setting is a longer-term issue.

2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher Pension fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;
- Contributions which Academies pay to the Fund will therefore not be available to pay for providing education; and
- Other employers will provide various services to the local community, perhaps through charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services at a reasonable cost.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;

- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible. However, a recent shift in regulatory focus means that solvency within each generation is considered by the Government to be a higher priority than stability of contribution rates;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result;
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefiting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see [3.1](#)). In deciding which of these techniques to apply to any given employer, the Administering Authority takes a view on the financial standing of the employer, i.e. its ability to meet its funding commitments and the relevant time horizon.

The Administering Authority will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc.

For instance, where the Administering Authority has reasonable confidence that an employer will be able to meet its funding commitments, then the Fund will permit options such as stabilisation ([see 3.3 Note \(b\)](#)), a longer time horizon relative to other employers, and/or a lower likelihood of achieving their funding target. Such options will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, where there is doubt that an employer will be able to meet its funding commitments or withstand a significant change in its commitments, then a higher funding target, and/or a shorter time horizon relative to other employers, and/or a higher likelihood of achieving the target may be required.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see [Appendix A](#).

2.7 What approach has the Fund taken to dealing with uncertainty arising from the McCloud court case and its potential impact on the LGPS benefit structure?

The LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The courts have ruled that the 'transitional protections' awarded to some members of public service pension schemes when the schemes were reformed (on 1 April 2014 in the case of the LGPS) were unlawful on the grounds of age discrimination. At the time of writing, the Ministry of Housing, Communities and Local Government (MHCLG) has not provided any details of changes as a result of the case. However, it is expected that benefits changes will be required, and they will likely increase the value of liabilities. At present, the scale and nature of any increase in liabilities are unknown, which limits the ability of the Fund to make an accurate allowance.

[The LGPS Scheme Advisory Board \(SAB\) issued advice to LGPS funds in May 2019](#). As there was no finalised outcome of the McCloud case by 31 August 2019, the Fund Actuary has acted in line with SAB's advice and valued all member benefits in line with the current LGPS Regulations.

The Fund, in line with the advice in the SAB's note, has considered how to allow for this risk in the setting of employer contribution rates.

The Fund has taken the following action:

An additional margin of prudence has been included in the method for setting contribution rates to allow for the uncertainty in the cost of past and future benefits. This margin has been established by targeting a higher likelihood of success for employers – see table 3.3.

The Fund has also considered the McCloud judgement in its approach to cessation valuations. Please see note (k) to table 3.3 for further information.

2.8 When will the next actuarial valuation be?

On 8 May 2019 MHCLG issued a [consultation](#) seeking views on (among other things) proposals to amend the LGPS valuation cycle in England and Wales from a three year (triennial) valuation cycle to a four year (quadrennial) valuation cycle.

On 7 October 2019 MHCLG confirmed the next LGPS valuation cycle in England and Wales will be 31 March 2022, regardless of the ongoing consultation. The Fund therefore instructed the Fund Actuary to certify contribution rates for employers for the period 1 April 2020 to 31 March 2023 as part of the 2019 valuation of the Fund.

3.3 The different approaches used for different employers

| Type of employer | Scheduled Bodies | | | Community Admission Bodies and Designating Employers (including Parish/Town Councils) | | Transferee Admission Bodies* |
|--|--|---|--------------------------|---|--|---|
| Sub-type | Local Authorities (incl. Police & Fire) | Colleges & Universities | Academies | Open to new entrants | Closed to new entrants | (all) |
| Funding Target basis used | Ongoing participation basis assumes long-term Fund participation (see Appendix E) | | | Ongoing participation basis, but may move to "gilts basis" - see Note (a) | | Contractor exit basis, assumes fixed contract term in the Fund (see Appendix E) |
| Primary Contribution rate | (see Appendix D – D.2) | | | | | |
| Stabilised contribution rate? | Yes - see Note (b) | No | | | | |
| Maximum time horizon – Note (c) | 17 years | 15 years | 17 years | 17 years | Future working lifetime | 17 years |
| Secondary rate – Note (d) | % of payroll / monetary amount | % of payroll / monetary amount | % of payroll | % of payroll | % of payroll/monetary amount | % of payroll/monetary amount depending on circumstances |
| Treatment of surplus | Covered by stabilisation arrangement | Preferred approach: contributions kept at Primary contribution rate. However, reductions may be permitted by the Admin. Authority | | | Reduce contributions by spreading the surplus over the remaining contract term | |
| Likelihood of achieving target – Note (e) | 75% | 80% | 80% | 80% | 80% | 80% |
| Phasing of contribution changes | Covered by stabilisation arrangement | 3 years | | | | None, unless increases are particularly large |
| Review of rates – Note (f) | Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations | | | | | Particularly reviewed in last 3 years of contract |
| New employer | n/a | n/a | Note (h) | Note (i) | | Notes (i) & (j) |
| Cessation of participation: cessation exit debt/credit payable | Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation principles applied would be as per Note (k) . | | | Can be ceased subject to terms of admission agreement. Cessation surplus or debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (k) . | | Participation is assumed to expire at the end of the contract. Cessation credit or debt calculated on ongoing basis, unless cessation is caused by deliberate action taken by the employer. Awarding Authority will be liable for future deficits that arise. |

* Where the Administering Authority recognises a fixed contribution rate agreement between a letting authority and a contractor, the certified employer contribution rate will be derived in line with the methodology specified in the risk sharing agreement. Additionally, in these cases, upon cessation the contractor's assets and liabilities will transfer back to the letting employer with no crystallisation of any deficit or surplus. Further detail on fixed contribution rate agreements is set out in [note \(j\)](#).

Note (a) (Gilts exit basis for CABs and Designating Employers closed to new entrants)

In the circumstances where:

- the employer is a Designating Employer, or an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may set a higher funding target (e.g. based on the return from long-term gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Designating Employers and Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease, or the Designating Employer alters its designation.

Note (b) (Stabilisation)

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" (and may therefore be paying less than their theoretical contribution rate) should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long-term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria based on tax raising status, financial security and time horizon in the Fund set by the Administering Authority and;
- there are no material events which cause the employer to become ineligible, e.g. significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring) or changes in the security of the employer.

On the basis of modelling carried out as part of the 2019 valuation exercise (see [Section 4](#)), the stabilised details are as follows:

| Type of employer | Max cont increase p.a. | Max cont decrease p.a. |
|---|------------------------|------------------------|
| Tax raising body (excl. Town & Parish Councils) | +1% of pay | -1% of pay |

The stabilisation criteria and limits will be reviewed at the next formal valuation. However, the Administering Authority reserves the right to review the stabilisation criteria and limits at any time before then, on the basis of membership and/or employer changes as described above.

Note (c) (Maximum time horizon)

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2020 for the 2019 valuation). The Administering Authority would normally expect the period to reduce at successive triennial valuations so that the deficit recovery plan is a natural continuation of the previous plan but would reserve the right to propose alternative spreading periods.

Where stabilisation applies, the resulting employer contribution rate would be amended to comply with the stabilisation mechanism.

For employers with no (or very few) active members at this valuation, the deficit should be recovered by a fixed monetary amount over a period to be agreed with the body or its successor, not to exceed the expected future working lifetime of active members or contract end date whichever is sooner.

Note (d) (Secondary rate)

For employers where stabilisation is not being applied, the Secondary contribution rate for each employer covering the period until the next formal valuation will often be set as a percentage of salaries. However, the Administering Authority reserves the right to amend these rates between formal valuations and/or to require these payments in monetary terms instead.

Where an employer is a transferee admission body, the Secondary rate has been set to spread the funding surplus / deficit over the future working lifetime of active members or contract end date whichever is sooner.

Note (e) (Likelihood of achieving funding target)

Each employer has its funding target calculated, and a relevant time horizon over which to reach that target. Contributions are set such that, combined with the employer's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum likelihood. A higher required likelihood bar will give rise to higher required contributions, and vice versa.

The way in which contributions are set using these three steps, and relevant economic projections, is described in further detail in [Appendix D](#).

Different likelihoods are set for different employers depending on their nature and circumstances: in broad terms, a higher likelihood may apply due to one or more of the following:

- the Fund believes the employer poses a greater funding risk than other employers,
- the employer does not have tax-raising powers;
- the employer does not have a guarantor or other sufficient security backing its funding position; and/or
- the employer is likely to cease participation in the Fund in the short or medium term.

Note (f) (Employer Risk)

The administering authority considers employer risk, when setting employer contribution rates.

Employers that have low employer contribution rates without additional security in place (e.g.a bond), the administering authority may decide to increase the rates to reduce the risk, or ringfence any potential surplus in lieu of a bond.

Note (g) (Regular Reviews)

Such reviews may be triggered by significant events including but not limited to: an employer approaching exit from the Fund, significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

Note (h) (New Academy conversions)

At the time of writing, the Fund's policies on academies' funding issues are as follows:

- i. The new academy will be regarded as a separate employer in its own right and will not be pooled with other employers in the Fund. The only exception is where the academy is part of a Multi Academy Trust (MAT) in which case the academy's figures will be calculated as below but can be combined with those of the other academies in the MAT;
- ii. The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status;
- iii. The new academy will be allocated an initial asset share from the ceding council's assets in the Fund. This asset share will be calculated using the estimated funding position of the ceding council at the date of academy conversion. The share will be based on the active members' funding level, having first allocated assets in the council's share to fully fund deferred and pensioner members. The asset allocation to the academy will be limited if necessary so that its initial funding level is subject to a maximum of 100%. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion.
- iv. It is possible for an academy to leave one MAT and join another. If this occurs, all active, deferred and pensioner members of the academy transfer to the new MAT. The transferring academy will pay the certified contribution rate of the MAT they are joining. If two MATs merge during the period between formal valuations, the new merged MAT will pay the higher of the two certified individual MAT rates until the rates are reassessed at the next formal valuation.

The Fund's policies on academies are subject to change in the light of any amendments to MHCLG and/or Dfe guidance (or removal of the formal guarantee currently provided to academies by the DfE). Any changes will be notified to academies and will be reflected in a subsequent version of this FSS. In particular, policy (iv) above will be reconsidered at each valuation.

Note (i) (New Admission Bodies)

With effect from 1 October 2012, the LGPS 2012 Miscellaneous Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date. Under these Regulations, all new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a greater than expected rise in liabilities;
- allowance for the possible non-payment of employer and member contributions to the Fund;
- the current deficit.

For all new Transferee Admission Bodies, the security must be to the satisfaction of the Administering Authority as well as the letting employer and will be reassessed on an annual basis. See also [Note \(j\)](#) below.

The Administering Authority will only consider requests from Community Admission Bodies (or other similar bodies, such as section 75 NHS partnerships) to join the Fund if they are sponsored by a Scheduled Body with tax raising powers, guaranteeing their liabilities and also providing a form of security as above.

The above approaches reduce the risk to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

Note (j) (New Transferee Admission Bodies)

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council or academy) to another organisation (a “contractor”). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Historically, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset value equal to the past service liability value of the employees’ Fund benefits. The quid pro quo is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see [Note \(k\)](#).

The Fund’s policy is that new admission body outsourcings are set up under a “pass through” arrangement (although exceptions will be considered on a case-by-case basis at the Fund’s discretion). Pass through arrangements allow for the pension risks to be shared between the letting employer and new contractor. Typically, the majority of the pension risk is borne by the letting employer and thus the liability is retained on their balance sheet – as such the contractor would not be required to pay any deficit or receive any surplus at the end of the contract (subject to any agreed exceptions). However, there is some flexibility within a pass-through arrangement. In particular there are three different routes that the letting employer may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) Pooling

Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same or similar rate as the letting employer.

ii) Letting employer retains pre-contract risks

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor's contribution rate could vary from one valuation to the next. It would be liable for any deficit or be entitled to any surplus at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term and actions wholly attributable to the new employer for example excessive pay awards. Where there is a surplus the Administering Authority will determine, at its discretion, the amount of exit credit (if any) to be paid in accordance with the Regulations (see note (k) below).

iii) Fixed contribution rate agreed

Under this option the contractor pays a fixed contribution rate throughout its participation in the Fund and doesn't pay any cessation deficit or receive an exit credit at the end of the contract term. In other words, the pension risks "pass through" to the letting employer.

The Administering Authority's preferred approach is that a new TAB will participate in the Fund via a pooling arrangement with the letting employer. The certified employer contribution rate of the contractor will normally be set equal to the rate of the letting authority. The rate paid by the contractor in the future will change in line with the contribution rate of the letting authority. Upon cessation the contractor's assets and liabilities will transfer back to the letting authority with no crystallisation of any deficit or surplus.

Although each matter will be dealt with on a case by case basis the Administering Authority default position is pooling with any surplus or deficit passing back to the letting employer. The Admission Agreement as well as the transfer agreement reflects this. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example, the contractor should typically be responsible for pension costs that arise from;

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above;
- redundancy and early retirement decisions.

Employers which outsource should be aware that all actuarial costs relating to the outsourcing (which will include any work that is required at the end of a contract) will be charged to either the outsourcing employer or the contractor and will NOT be met by the Fund. The exception will be the setting of employer contribution rates as part of a normal actuarial valuation, where the Fund pays actuarial fees as the work covers all employing bodies.

Note (k) (Admission Bodies Ceasing)

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund.
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund;
- The failure by the Admission Body to sign the admission agreement and/or bond documents and secure the required guarantee as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where the cessation valuation identifies a deficit, payment of this amount in full will be sought from the Admission Body. Unless otherwise agreed the Admission Body shall settle any liability within 28 days of the service of the cessation valuation.

In circumstances where there is a surplus, the Administering Authority will determine, at its sole discretion, the amount of exit credit (if any) to be paid to the Admission Body.

The Administering Authority's entitlement to determine whether exit credits are payable in accordance with these provisions shall apply to all Admission Bodies ceasing their participation in the Fund after 14 May 2018. This provision therefore is retrospectively effective to the same extent as provisions of the Local Government Pension Scheme (Amendment) Regulations 2020.

The Administering Authority may determine the amount of exit credit payable to be zero, however, in making a determination, the Administering Authority will take into account the following factors;

- a) **the extent to which there is an excess of assets in the fund relating to the employer over and above the liabilities specified;**
- b) **the proportion of the excess of assets which has arisen because of the value of the employer's contributions;**
- c) **any representations to the Administering Authority made by the exiting employer, guarantor or Scheme Employer or by someone who owns, funds or controls the exiting employer; or in some cases, the Secretary of State; and**
- d) **any other relevant factors**

Disputes

In the event of any dispute or disagreement on the amount of any exit credit paid and the process by which that has been considered, the appeals and adjudication provisions contained in Regulations 74-78 of the LGPS Regulations 2013 would apply.

Please refer to appendix G for the Fund's policy on exit credits.

As discussed in Section 2.7, the LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The Fund has considered how it will reflect the current uncertainty regarding the outcome of this judgement in its approach to cessation valuations. For cessation valuations that produce a deficit value carried out before any changes to the LGPS benefit structure (from 1 April 2014) are confirmed, the Fund's policy is that the actuary will apply an appropriate loading to the ceasing employer's past service benefit accrual, as an estimate of the possible impact of resulting benefit changes.

The Fund Actuary charges a fee for carrying out an employer's cessation valuation which the Fund will recharge to the employer.

For Transferee Admission Bodies, any cessation valuation would normally be carried out on an on-going basis, as this will be the basis on which their opening position was calculated upon joining the Fund. Where a Transferee Admission Body has taken, in the view of the Administering Authority, action that has been deliberately designed to bring about a cessation event (stopping future accrual of LGPS benefits, for example), then the cessation valuation will be carried out on a gilts basis.

Any cessation valuation, whether carried out on an on-going or a gilts basis, will calculate the surplus or deficit at the point of the cessation and full payment of any deficit amount will release the Transferee Admission Body from any further liability to the Fund. In the event that the sub-fund of the Transferee Admission Body subsequently falls into a deficit position, the outsourcing organisation will become responsible for the deficit even if they did not act as a guarantor for the admission agreement. At no stage will the Fund, and hence all ongoing employing bodies within it, bear any financial risk in respect of any Transferee Admission Body.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

- a) Where there is a guarantor for future deficits and contributions, the details of the guarantee will be considered prior to the cessation valuation being carried out. In some cases, the guarantor is simply guarantor of last resort and therefore the cessation valuation will be carried out consistently with the approach taken had there been no guarantor in place. Alternatively, where the guarantor is not simply guarantor of last resort, the cessation may be calculated using the ongoing participation basis or contractor exit basis as described in [Appendix E](#);
- b) Alternatively, depending on the nature of the guarantee, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit or surplus. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee;
- c) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit (or surplus) will normally be calculated using a "gilts exit basis", which is more prudent than the ongoing participation basis. This has no allowance for potential future investment outperformance above gilt yields and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

Under (a) and (c), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund may spread the payment subject to there being some security in place for the employer such as a bond indemnity or guarantee.

In the event that the Fund is not able to recover the required payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body (whether a Transferee Admission Body or a Community Admission Body) is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit on the gilts exit basis and would carry out the cessation valuation on the ongoing participation basis. Secondary contributions would be derived from this cessation debt. This approach would be monitored as part of each formal valuation and secondary contributions would be reassessed as required. The Admission Body may terminate the agreement only via payment of the outstanding debt assessed on the gilts exit basis. Furthermore, the Fund reserves the right to revert to the "gilts exit basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Admission Body would have no contributing members.

3.4 Pooled contributions

The Administering Authority will only allow employer pools to be set up if it legally required (perhaps as a result of LGPS Regulations or where a pass-through agreement is in place) or where a request is received from a group of employers that they wish to become a pool.

Even if such a request is received, the Administering Authority will only agree to an employer pool if it is satisfied that the relevant employers have adequately considered the consequences of the pool and that there is a legal agreement in place which makes it impossible for the pool to be dissolved without the agreement of all parties, which will include an agreement on how the assets and liabilities will be split upon dissolution. Allowing pooling is entirely at the discretion of the Administering Authority.

Maintained schools do not have a separate legal identity so are not pooled with the relevant local authority; they are part-and-parcel of it. However, there may be exceptions for specialist or independent schools.

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

3.5 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended time horizon, or permission to join a pool with another body (e.g. the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan;
- whether the admission agreement is likely to be open or closed to new entrants.

3.6 Non-ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). (**NB** the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014). Employers are required to pay additional contributions ('strain' or 'capitalised costs') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

For any early retirements where the Administering Authority has not specifically agreed to payment in instalments, all costs must be met by way of a single payment in the year of retirement.

3.7 Ill health early retirement costs

Each employer has an 'ill health allowance' built into the full contribution rate that is set at each actuarial valuation. If an employer decides to insure against the risk of ill-health retirements, there will be a reduction to the employer's contribution rate that is the equivalent to the external insurance premium rate.

Where an employer does not take out ill-health insurance, they will be offered the opportunity to make payment for any funding strain cost associated with ill-health retirements that occur annually inbetween formal valuations thereby more closely managing their future rates, but for higher risk employers or breaches of the "ill health allowance" the Fund may require payment. Employers may choose to pay in additional contributions in respect of these potential funding strains to minimise any detrimental effect on their future funding position (or otherwise, e.g. for budgeting or accounting purposes).

3.8 External ill health insurance

If an employer provides satisfactory evidence to the Administering Authority of a current external insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that employer's total outlay (pension contribution plus insurance premium) is unchanged; and
- there is no need for monitoring of ill-health allowances versus experience.

When an active member retires on ill health early retirement the claim amount will be paid directly from the insurer to the insured employer. This amount should then be paid to the Fund to allow the employer's asset share to be credited.

The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

New Fund employers are urged to take out the external ill health insurance offered.

3.9 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt or receive an exit credit on an appropriate basis (see [3.3, Note \(k\)](#)) and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:

- a) The employer's asset share runs out before all its ex-employees' benefits have been paid. If this employer was a former Transferee Admission Body, the outsourcing employer will become responsible for any deficit (even if they did not act as a guarantor within the admission agreement). If the employer was not a Transferee Admission Body the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations, but it should be noted that all surpluses in respect of non-Transferee Admission Bodies will be netted off any deficits so that it is only the net deficit position that will be apportioned;
- b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. If this employer was a former Transferee Admission Body, the outsourcing employer will receive the benefit of the surplus (even if they did not act as a guarantor within the admission agreement). If the employer was not a Transferee Admission Body, any surplus will be netted off the deficit of similar types of employers as described in 3.9 a). In the event that the net position is a surplus the net surplus will be apportioned;

In exceptional circumstances the Fund may permit an employer with no remaining active members and a cessation debt to continue contributing to the Fund, as opposed to paying a cessation deficit amount. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases, as the employer would have no contributing members.

3.10 Policies on bulk transfers

Each case will be treated on its own merits, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities;
- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.

Absolute considerations include:

1. the extent to which the contributions payable is sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;
2. how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy;
3. the extent to which contributions actually paid have been in line with the expected contributions based on the extant Rates and Adjustment certificate; and
4. the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual Fund experience.

MHCLG may assess and compare these metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation which may move to every four years in future – see Section 2.8). This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2022.

It is possible that (usually slight) amendments may be needed within the three-year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

In any event, meaningful changes to the FSS would need agreement by the Local Pension Committee and would be included in the relevant Committee Meeting minutes.

A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Investment Strategy Statement, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at <http://www.leics.gov.uk/pensions>.

B3 The Fund Actuary should: -

- prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
- provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see [Section 5](#));
- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
- advise on the termination of employers' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties: -

- investment advisers (either internal or external) should ensure the Fund's ISS remains appropriate, and consistent with this FSS;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the ISS;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures.
- MHCLG (assisted by the Government Actuary's Department) and the Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

| Risk | Summary of Control Mechanisms |
|--|--|
| Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies | An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions. |
| Orphaned employers give rise to added costs for the Fund | <p>The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.</p> <p>If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 3.9).</p> |

C3 Demographic risks

| Risk | Summary of Control Mechanisms |
|--|---|
| Pensioners living longer, thus increasing cost to Fund. | <p>Set mortality assumptions with some allowance for future increases in life expectancy.</p> <p>The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.</p> |
| Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees. | Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies. |
| Deteriorating patterns of early retirements | <p>Employers are charged the extra cost of non-ill-health retirements following each individual decision.</p> <p>Employer ill health retirement experience is monitored, and insurance is an option.</p> |
| Reductions in payroll causing insufficient deficit recovery payments | <p>In many cases this may not be sufficient cause for concern and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:</p> <p>Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (b) to 3.3).</p> <p>For other employers, review of contributions is permitted in general between valuations (see Note (f) to 3.3) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.</p> |

C4 Regulatory risks

| Risk | Summary of Control Mechanisms |
|--|---|
| Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform. | <p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>The Administering Authority is monitoring the progress on the McCloud court case and will consider an interim valuation or other appropriate action once more information is known.</p> <p>The government's long-term preferred solution to GMP indexation and equalisation - conversion of GMPs to scheme benefits - was built into the 2019 valuation.</p> |
| Time, cost and/or reputational risks associated with any MHCLG intervention triggered by the Section 13 analysis (see Section 5). | Take advice from Fund Actuary on position of Fund as at prior valuation, and consideration of proposed valuation approach relative to anticipated Section 13 analysis. |
| Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies. | <p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.</p> |

C5 Governance risks

| Risk | Summary of Control Mechanisms |
|---|--|
| Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants. | <p>The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.</p> <p>The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions between triennial valuations</p> <p>Deficit contributions may be expressed as monetary amounts.</p> |

| | |
|--|--|
| <p>Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way</p> | <p>The Administering Authority maintains close contact with its specialist advisers.</p> <p>Advice is delivered via formal meetings involving Elected Members and recorded appropriately.</p> <p>Actuarial advice is subject to professional requirements such as peer review.</p> |
| <p>Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.</p> | <p>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.</p> <p>Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.</p> |
| <p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p> | <p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.</p> <p>The risk is mitigated by:</p> <p>Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see Notes (i) and (k) to 3.3).</p> <p>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</p> <p>Vetting prospective employers before admission.</p> <p>Where permitted under the regulations requiring a bond to protect the Fund from various risks.</p> <p>Requiring new Community Admission Bodies to have a guarantor that is a tax-raising body.</p> <p>Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to 3.3).</p> <p>Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to 3.3).</p> |
| <p>An employer ceasing to exist resulting in an exit credit being payable</p> | <p>The Administering Authority regularly monitors admission bodies coming up to cessation</p> <p>The Administering Authority invests in liquid assets to ensure that exit credits can be paid when required.</p> |

The Primary rate is calculated such that it is projected to:

1. meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets, and
2. at the end of the determined time horizon (see [note 3.3 Note \(c\)](#) for further details),
3. with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer (see [3.3 Note \(e\)](#) for further details).

* The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund's actuary Hymans Robertson: this allows for a wide range of outcomes about key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. Further information about this model is included in [Appendix E](#). The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

The approach includes expenses of administration to the extent that they are borne by the Fund and includes allowances for benefits payable on death in service and on ill health retirement.

D3 How is the Secondary contribution rate calculated?

The Fund aims for the employer to have assets sufficient to meet 100% of its accrued liabilities at the end of its funding time horizon based on the employer's funding target assumptions (see [Appendix E](#)).

The Secondary rate is calculated as the balance over and above the Primary rate, such that the total contribution rate is projected to:

1. meet the required funding target relating to combined past and future service benefit accrual, including accrued asset share (see [D5](#) below)
2. at the end of the determined time horizon (see [3.3 Note \(c\)](#) for further details)
3. with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer (see [3.3 Note \(e\)](#) for further details).

The projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund Actuary Hymans Robertson: this allows for a wide range of outcomes about key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. Further information about this model is included in [Appendix E](#). The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

- past contributions relative to the cost of accrual of benefits;
- different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
- the effect of any differences in the funding target, i.e. the valuation basis used to value the employer's liabilities at the end of the time horizon;
- any different time horizons;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non-ill-health retirements relative to any extra payments made;
- differences in the required likelihood of achieving the funding target.

D5 How is each employer's asset share calculated?

The Fund Actuary uses the Hymans Robertson's proprietary ("HEAT") system to track employer assets monthly. Starting with each employer's assets from the previous month end, cashflows paid in/out and investment returns achieved on the Fund's assets over the course of the month are added to calculate an asset value at the month end.

The Fund is satisfied that this approach provides the most accurate asset allocations between employers that is reasonably possible at present.

D6 How does the Fund adjust employer asset shares when an individual member moves from one employer in the Fund to another?

Under the cashflow approach for tracking employer asset shares, the Fund has allowed for any individual members transferring from one employer in the Fund to another, via the transfer of a sum from the ceding employer's asset share to the receiving employer's asset share. This sum is equal to the member's Cash Equivalent Transfer Value (CETV) as advised by the Fund's administrators.

E2 What assumptions are used in the ESS?

The actuary uses Hymans Robertson's ESS model to project a range of possible outcomes for the future behaviour of asset returns and economic variables. With this type of modelling, there is no single figure for an assumption about future inflation or investment returns. Instead, there is a range of what future inflation or returns will be which leads to likelihoods of the assumption being higher or lower than a certain value.

The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2019. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the simulated yields at that time horizon.

| | | Annualised total returns | | | | | | | RPI inflation expectation | 17 year real govt bond yield | 17 year govt bond yield |
|----------|---------------------------------|--------------------------|-----------------------------|-------------------------------|-----------|-----------------|----------|----------------------------------|---------------------------|------------------------------|-------------------------|
| | | Cash | Index Linked Gilts (medium) | Fixed Interest Gilts (medium) | UK Equity | Overseas Equity | Property | A rated corporate bonds (medium) | | | |
| 5 years | 16th %ile | -0.4% | -2.3% | -2.9% | -4.1% | -4.1% | -3.5% | -2.7% | 1.9% | -2.5% | 0.8% |
| | 50th %ile | 0.7% | 0.5% | 0.3% | 4.0% | 4.1% | 2.4% | 0.8% | 3.3% | -1.7% | 2.1% |
| | 84th %ile | 2.0% | 3.3% | 3.4% | 12.7% | 12.5% | 8.8% | 4.0% | 4.9% | -0.8% | 3.6% |
| 10 years | 16th %ile | -0.2% | -1.8% | -1.3% | -1.5% | -1.4% | -1.5% | -0.9% | 1.9% | -2.0% | 1.2% |
| | 50th %ile | 1.3% | 0.0% | 0.2% | 4.6% | 4.7% | 3.1% | 0.8% | 3.3% | -0.8% | 2.8% |
| | 84th %ile | 2.9% | 1.9% | 1.7% | 10.9% | 10.8% | 7.8% | 2.5% | 4.9% | 0.4% | 4.8% |
| 20 years | 16th %ile | 0.7% | -1.1% | 0.1% | 1.2% | 1.3% | 0.6% | 0.7% | 2.0% | -0.7% | 2.2% |
| | 50th %ile | 2.4% | 0.3% | 1.0% | 5.7% | 5.8% | 4.3% | 1.9% | 3.2% | 0.8% | 4.0% |
| | 84th %ile | 4.5% | 2.0% | 2.0% | 10.3% | 10.4% | 8.1% | 3.0% | 4.7% | 2.2% | 6.3% |
| | Volatility (Disp) (1 yr) | 1% | 7% | 10% | 17% | 17% | 14% | 11% | 1% | | |

E3 What assumptions are used in the funding target?

At the end of an employer's funding time horizon, an assessment will be made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). Valuing the cost of future benefits requires the actuary to make assumptions about the following financial factors:

- Benefit increases and CARE revaluation
- Salary growth
- Investment returns (the "discount rate")

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is unlikely to be appropriate for every projection. For example, a high assumed future investment return (discount rate) would not be prudent in projections with a weak outlook for economic growth. Therefore, instead of using a fixed value for each assumption, the actuary references economic indicators to ensure the assumptions remain appropriate for the prevailing economic environment in each projection. The economic indicators the actuary uses are: future inflation expectations and the prevailing risk-free rate of return (the yield on long term UK government bonds is used as a proxy for this rate).

The Fund has three funding bases which will apply to different employers depending on their type. Each funding basis has a different assumption for future investment returns when determining the employer's funding target.

| Funding basis | Ongoing participation basis | Contractor exit basis | Low risk exit basis |
|---|---|---|--|
| Employer type | All employers except Transferee Admission Bodies and closed Community Admission Bodies | Transferee Admission Bodies | Community Admission Bodies that are closed to new entrants* |
| Investment return assumption underlying the employer's funding target (at the end of its time horizon) | Long term government bond yields plus an asset outperformance assumption (AOA) of 1.8% p.a. | Long term government bond yields plus an AOA equal to the AOA used to allocate assets to the employer on joining the Fund | Long term government bond yields with no allowance for outperformance on the Fund's assets |

*the Administering Authority may fund these bodies on the ongoing participation basis subject to agreement by the Fund where suitable risk control measures are established (e.g. a guarantor or bond indemnity is in place).

E4 What other assumptions apply?

The following assumptions are those of the most significance used in both the projection of the assets, benefits and cashflows and in the funding target.

a) Salary growth

After discussion with Fund officers, the salary increase assumption at the 2019 valuation has been set to be a blended rate combined of:

1. 2.5% p.a. until 31 March 2020, followed by
2. CPI plus 0.5% p.a. thereafter.

This gives a single "blended" assumption of CPI plus 0.5%. This is a change from the previous valuation, which assumed RPI p.a. The change has led to a reduction in the funding target (all other things being equal).

b) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. Note that the basis of such increases is set by the Government and is not under the control of the Fund or any employers.

At this valuation, we have continued to assume that CPI is 1.0% p.a. lower than RPI. (Note that the reduction is applied in a geometric, not arithmetic, basis).

c) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the Club Vita's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

Allowance has been made in the ongoing valuation basis for future improvements in line with 2018 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.25% per annum minimum underpin to future reductions in mortality rates. This updated allowance for future improvements will generally result in lower life expectancy assumptions and hence a reduced funding target (all other things being equal).

The approach taken is considered reasonable in light of the long-term nature of the Fund and the assumed level of security underpinning members' benefits

d) General

The same financial assumptions are adopted for most employers (on the ongoing participation basis identified above), in deriving the funding target and the Primary and Secondary rates; as described in [\(3.3\)](#), these calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

| | |
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| 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. The LGPS is divided into 100 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers. |
| 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). |
| Primary contribution rate | The employer contribution rate required to pay for ongoing accrual of active members' benefits (including an allowance for administrative expenses). See Appendix D for further details. |
| 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 vs their salary levels, etc. A membership (or liability) profile might be measured for its maturity also. |
| Rates and Adjustments Certificate | A formal document required by the LGPS Regulations, which must be updated 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 period until the next valuation is completed. |
| 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, academies, 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). |
| Secondary contribution rate | The difference between the employer's actual and Primary contribution rates . See Appendix D for further details. |
| Stabilisation | Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund |
| Valuation | A risk management exercise to review the Primary and Secondary contribution rates , and other statutory information for a Fund, and usually individual employers too. |

participation in the Fund reflects which party is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.

- f) If the admission agreement ends early, the Fund will consider the reason for the early termination, and whether that should have any relevance on the Fund's determination of the value of any exit credit payment. In these cases, the Fund will consider the differential between employers' contributions paid (including investment returns earned on these monies) and the size of any cessation surplus.
- g) If an admitted body leaves on a gilts cessation basis (because no guarantor is in place), then any exit credit will normally be paid in full to the employer.
- h) The decision of the Fund is final in interpreting how any arrangement described under c), e), f) and g) applies to the value of an exit credit payment.

Scheduled bodies and resolution bodies

- a) Where a guarantor arrangement is in place, but no formal risk-sharing arrangement exists, the Fund will consider how the approach to setting contribution rates payable by the employer during its participation in the Fund reflects which party is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
- b) Where no formal guarantor or risk-sharing arrangement exists, the Fund will consider how the approach to setting contribution rates payable by the employer during its participation in the Fund reflects the extent to which it is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
- c) The decision of the Fund is final in interpreting how any arrangement described under a) and b) applies to the value of an exit credit payment.
- d) If a scheduled body or resolution body becomes an exiting employer due to a reorganisation, merger or take-over, then no exit credit will be paid.
- e) If a scheduled body or resolution body leaves on a gilts cessation basis (because no guarantor is in place), then any exit credit will normally be paid in full to the employer.

General

- a) The Fund will advise the exiting employer as well as the letting authority and/or other relevant scheme employers of its decision to make an exit credit determination under Regulation 64.
- b) Subject to any risk sharing or other arrangements and factors discussed above, when determining the cessation funding position the Fund will generally make an assessment based on the value of contributions paid by the employer during their participation, the assets allocated when they joined the Fund and the respective investment returns earned on both.
- c) The Fund will also factor in if any contributions due or monies owed to the Fund remain unpaid by the employer at the cessation date. If this is the case, the Fund's default position will be to deduct these from any exit credit payment.

- d) The final decision will be made by the Pension Manager, in conjunction with advice from the Fund's Actuary and/or legal advisors where necessary, in consideration of the points held within this policy.
- e) The Fund accepts that there may be some situations that are bespoke in nature and do not fall into any of the categories above. In these situations the Fund will discuss its approach to determining an exit credit with all affected parties. The decision of the Fund in these instances is final.
- f) Where there is an exit credit payable, the Fund will advise the exiting employer of the amount due to be repaid and seek to make the payment within six months of the exit date or such longer time as the administering authority and the exiting employer may agree. In order to meet the six-month timeframe, the Fund requires prompt notification of an employer's exit and all data and relevant information as requested. The Fund is unable to make any exit credit payment until it has received all data and information requested.
- g) The guidelines above at point e) in the 'Admitted Bodies' section, and at points a) and b) in the 'Scheduled bodies and resolution bodies' section, make reference to the Fund 'considering the approach to setting contribution rates during the employer's participation'. The different funding approaches, including the parameters used and how these can vary based on employer type, are covered in detail in Section 3 of this document. Considering the approach taken when setting contribution rates of the exiting employer may help the Fund to understand the extent to which the employer is responsible for funding the underlying liabilities on exit. For example, if contribution rates have been based on ongoing assumptions then this may suggest that these are also appropriate assumptions for exit credit purposes (subject to the other considerations outlined in Section 3.3). Equally, a shorter than usual funding time horizon or lower than usual probability of success parameter may reflect underlying commercial terms about how responsibility for pension risks is split between the employer and its guarantor. For the avoidance of doubt, each exiting employer will be considered in the round alongside the other factors mentioned above.