

Royal County of Berkshire Pension Fund  
Funding Strategy Statement – March 2023

Contents

|   |           |
|---|-----------|
| <b>1. INTRODUCTION</b>  | <b>2</b>  |
| <b>2. PURPOSE OF THE FUNDING STRATEGY STATEMENT</b>           | <b>2</b>  |
| <b>3. AIMS OF THE FUND</b>                                    | <b>2</b>  |
| <b>4. PURPOSE OF THE FUND:</b>                                | <b>2</b>  |
| <b>5. FUNDING OBJECTIVES</b>                                  | <b>3</b>  |
| <b>6. KEY PARTIES</b>   | <b>3</b>  |
| <b>7. FUNDING STRATEGY</b>                                    | <b>4</b>  |
| <b>8. NEW EMPLOYERS JOINING THE FUND</b>                      | <b>11</b> |
| <b>9. CONTRIBUTION REVIEWS BETWEEN ACTUARIAL VALUATIONS</b>   | <b>13</b> |
| <b>10. CESSATION VALUATIONS</b>                               | <b>14</b> |
| <b>11. BULK TRANSFERS</b>                                     | <b>17</b> |
| <b>12. LINKS WITH THE INVESTMENT STRATEGY STATEMENT (ISS)</b> | <b>17</b> |
| <b>13. RISKS AND COUNTER MEASURES</b>                         | <b>18</b> |

**Employer Consultation Period: 1 February 2023 – 28 February 2023**

**Date of Committee approval: 13 March 2023**

**Date of implementation and application: 1 April 2023**

## 1. Introduction

**1.1.** This is the Funding Strategy Statement for the Royal County of Berkshire Pension Fund (the Fund). It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) (the Regulations) and describes the Royal Borough of Windsor and Maidenhead's strategy, in its capacity as administering authority, for the funding of the Royal County of Berkshire Pension Fund.

**1.2.** The Fund's employers and the Fund Actuary, Barnett Waddingham LLP, have been consulted on the contents of this statement.

**1.3.** This statement should be read in conjunction with the Fund's Investment Strategy Statement (ISS) and has been prepared with regard to the guidance (Preparing and Maintaining a funding strategy statement in the LGPS 2016 edition) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

**1.4.** In developing the funding strategy, the administering authority has considered the likely outcomes of the review carried out under Section 13(4)(c) of the Public Service Pensions Act 2013. Section 13(4)(c) requires an independent review of the actuarial valuations of the LGPS funds; this involves reporting on whether the rate of employer contributions set as part of the actuarial valuations are set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scheme so far as relating to the pension Fund. The review also looks at compliance and consistency of the actuarial valuations.

## 2. Purpose of the Funding Strategy Statement

**2.1.** Establish a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;

**2.2.** Support the desirability of maintaining an as nearly constant primary contribution rate as possible, as defined in Regulation 62(6) of the Regulations;

**2.3.** Ensure that the regulatory requirements to set contributions to meet the future liability to provide Scheme member benefits in done so in a way that ensures the solvency and long-term cost efficiency of the Fund are met; and

**2.4.** Take a prudent longer-term view of funding those liabilities.

## 3. Aims of the Fund

**3.1.** Manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due;

**3.2.** Enable contribution rates to be kept as near to constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to all relevant parties (such as the taxpayers, scheduled, resolution and admitted bodies), while achieving and maintaining Fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the Fund and employers, and the risk appetite of the administering authority and employers alike; and

**3.3.** Seek returns on investment within reasonable risk parameters (risk adjusted returns).

## 4. Purpose of the Fund:

**4.1.** Pay pensions, lump sums and other benefits to Scheme members as provided for under the Regulations;

**4.2.** Meet the costs associated in administering the Fund; and

**4.3.** Receive and invest contributions, transfer values and investment income.

## 5. Funding Objectives

- 5.1. Ensure that pension benefits can be met as and when they fall due over the lifetime of the Fund;
- 5.2. Ensure the short, medium and long term solvency of the Fund;
- 5.3. Set levels of employer contribution rates to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions, while taking into account the different characteristics of participating employers;
- 5.4. Build up the required assets in such a way that employer contribution rates are kept as stable as possible, with consideration of the long-term cost efficiency objective; and
- 5.5. Adopt appropriate measures and approaches to reduce the risk, as far as possible, to the Fund, other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.

## 6. Key Parties

- 6.1. The key parties involved in the funding process and their responsibilities are set out below.
- 6.2. **The administering authority** for the Fund is the Royal Borough of Windsor and Maidenhead (RBWM). The main responsibilities of the administering authority are to:
  - 6.2.1. Operate the Fund in accordance with the LGPS Regulations;
  - 6.2.2. Collect employee and employer contributions, investment income and other amounts due to the Fund as stipulated in the Regulations;
  - 6.2.3. Invest the Fund's assets in accordance with the Fund's Investment Strategy Statement;
  - 6.2.4. Pay the benefits due to Scheme members as stipulated in the Regulations;
  - 6.2.5. Ensure that cash is available to meet liabilities as and when they fall due;
  - 6.2.6. Take measures as set out in the Regulations to safeguard the Fund against the consequences of employer default;
  - 6.2.7. Manage the actuarial valuation process in conjunction with the Fund Actuary;
  - 6.2.8. Prepare and maintain this FSS and also the ISS after consultation with other interested parties;
  - 6.2.9. Monitor all aspects of the Fund's performance;
  - 6.2.10. Effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme employer; and
  - 6.2.11. Enable the Local Pension Board to review the valuation process as they see fit.
- 6.3. **Scheme employers.** In addition to the administering authority, a number of other Scheme employers participate in the Fund. The responsibilities of each employer that participates in the Fund, including the administering authority, are to:
  - 6.3.1. Collect employee contributions and pay these together with their own employer contributions, as certified by the Fund Actuary, to the administering authority within the statutory timescales;
  - 6.3.2. Notify the administering authority of any new Scheme members and any other membership changes promptly;

**6.3.3.** Develop a policy on certain discretions and exercise those discretions as permitted under the Regulations;

**6.3.4.** Meet the costs of any augmentations or other additional costs in accordance with agreed policies and procedures; and

**6.3.5.** Pay any exit payments due on ceasing participation in the Fund.

**6.4. Scheme members.** Active Scheme members are required to make contributions into the Fund as set by the Department for Levelling Up, Housing and Communities (DLUHC).

**6.5. The Fund Actuary** for the Fund is Barnett Waddingham LLP. The main responsibilities of the Fund Actuary are to:

**6.5.1.** Prepare valuations including the setting of employers' contribution rates at a level to ensure Fund solvency and long-term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and the Regulations;

**6.5.2.** Prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters such as pension strain costs, ill-health retirement costs, compensatory added years costs, etc;

**6.5.3.** Provide advice and valuations on the exiting of employers from the Fund;

**6.5.4.** Provide advice and valuations relating to new employers, including recommending the level of bonds or other forms of security required to protect the Fund against the financial effect of employer default;

**6.5.5.** Assist the administering authority in assessing whether employer contributions need to be revised between valuations as permitted or required by the Regulations;

**6.5.6.** Ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to their role in advising the Fund; and

**6.5.7.** Advise on other actuarial matters affecting the financial position of the Fund.

## 7. Funding Strategy

**7.1.** The factors affecting the Fund's finances are constantly changing, so it is necessary for its financial position and the contributions payable to be reviewed from time to time by means of an actuarial valuation to check that the funding objectives are being met.

**7.2.** The most recent actuarial valuation of the Fund was carried out at 31 March 2022. The overall results of the 2022 valuation are summarised as follows:

|                            |                |
|----------------------------|----------------|
| <b>Surplus / (Deficit)</b> | <b>(£446m)</b> |
| <b>Funding Level</b>       | <b>86%</b>     |

**7.3.** At a whole Fund level, the primary rate required to cover the employer cost of future benefit accrual was 16.9% of payroll p.a.

**7.4.** The individual employer contribution rates are set out in the Rates and Adjustments Certificate which forms part of the Fund's 2022 valuation report.

**7.5.** The actuarial valuation involves a projection of future cashflows to and from the Fund. The main purpose of the valuation is to determine the level of employers' contributions that should be paid to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund. A summary of the methods and assumptions adopted is set out in the sections below.

## 7.6. Funding Method

**7.6.1.** The key objective in determining employers' contribution rates is to establish a funding target and then set levels of employer contribution rates to meet that target over an agreed period. The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund.

**7.6.2.** For all employers, the method adopted is to consider separately the benefits accrued before the valuation date (past service) and benefits expected to be accrued after the valuation date (future service). These are evaluated as follows:

**7.6.3.** The past service funding level of the Fund is the ratio of accumulated assets to liabilities in respect of past service. It makes allowance for future increases to members' pay and pensions. A funding level in excess of 100% indicates a surplus of assets over liabilities; while a funding level of less than 100% indicates a deficit; and

**7.6.4.** The future service funding rate (also referred to as the primary rate as defined in Regulation 62(5) of the Regulations) is the level of contributions required from the individual employers which, in combination with employee contributions is expected to cover the cost of benefits accruing in future.

**7.6.5.** The adjustment required to the primary rate to calculate an employer's total contribution rate is referred to as the secondary rate, as defined in Regulation 62(7). Further details of how the secondary rate is calculated for employers is given below in the Deficit recovery/surplus amortisation periods section.

**7.6.6.** The approach to the primary rate will depend on specific employer circumstances and in particular may depend on whether an employer is an "open" employer – one which allows new recruits access to the Fund, or a "closed" employer – one which no longer permits new staff access to the Fund. The expected period of participation by an employer in the Fund may also affect the total contribution rate.

**7.6.7.** For open employers, the actuarial funding method that is adopted is known as the Projected Unit Method. The key feature of this method is that, in assessing the future service cost, the primary rate represents the cost of one year's benefit accrual only.

**7.6.8.** For closed employers, the actuarial funding method adopted is known as the Attained Age Method. The key difference between this method and the Projected Unit Method is that the Attained Age Method assesses the average cost of the benefits that will accrue over a specific period, such as the length of a contract or the remaining expected working lifetime of active members.

**7.6.9.** The approach by employer may vary to reflect an employer's specific circumstance, however, in general the closed employers in the Fund are admission bodies who have joined the Fund as part of an outsourcing contract and therefore the Attained Age Method is used in setting their contributions. All other employers (for example councils, higher education bodies and academies) are generally open employers and therefore the Projected Unit Method is used. The administering authority holds details of the open or closed status of each employer.

## 7.7. Valuation assumptions and funding model

**7.7.1.** In completing the actuarial valuation, it is necessary to formulate assumptions about the factors affecting the Fund's future finances such as price inflation, pay increases, investment returns, rates of mortality, early retirement and staff turnover etc. The assumptions adopted at the valuation can therefore be considered as:

**7.7.2.** The demographic (or statistical) assumptions which are essentially estimates of the likelihood or timing of benefits and contributions being paid, and

**7.7.3.** The financial assumptions which will determine the estimates of the amount of benefits and contributions payable and their current (or present) value.

## 7.8. Future price inflation.

**7.8.1.** The base assumption in any valuation is the future level of price inflation over a period commensurate with the duration of the liabilities, as measured by the Retail Price Index (RPI). This is derived using the 20 year point on the Bank of England implied Retail Price Index (RPI) inflation curve, with consideration of the market conditions over the six months straddling the valuation date.

**7.8.2.** The 20 year point on the curve is taken as 20 years and is consistent with the average duration of an LGPS Fund. A deduction of 0.3% p.a. is applied to the yield at the 20 year point to reflect the shape of the yield curve. A further deduction of 0.4% p.a. is applied to reflect the view that investors are willing to pay a premium for inflation-linked products in return for protection against unexpected inflation.

## 7.9. Future pension increases.

**7.9.1.** Pension increases are linked to changes in the level of the Consumer Price Index (CPI). Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods. However, RPI is due to be aligned with CPIH (CPI but with allowance for housing costs) from 2030. Therefore, reflecting the anticipated amendment to RPI from 2030 and therefore the relative difference between RPI and CPI, a deduction of 0.35% p.a. is made to the RPI assumption to derive the CPI assumption.

## 7.10. Future pay increases.

**7.10.1.** As some of the benefits are linked to pay levels at retirement, it is necessary to make an assumption as to future levels of pay increases. Historically, there has been a close link between price inflation and pay increases with pay increases exceeding price inflation in the longer term. The long-term pay increase assumption adopted at 31 March 2022 was CPI plus 1.0% p.a. which includes allowance for promotional increases.

## 7.11. Future investment returns/discount rate

**7.11.1.** To determine the value of accrued liabilities and derive future contribution requirements it is necessary to discount future payments to and from the Fund to present day values.

**7.11.2.** The discount rate that is applied to all projected liabilities reflects a prudent estimate of the rate of investment return that is expected to be earned from the Fund's long-term investment strategy by considering average market yields in the six months straddling the valuation date.

**7.11.3.** The discount rate as determined by the Actuary may be referred to as the "ongoing" discount rate. It may be appropriate for an alternative discount rate approach to be taken to reflect an individual employer's situation. This may be, for example, to reflect an employer targeting a cessation event or to reflect the administering authority's views on the level of risk that an employer poses to the Fund. The Fund Actuary will incorporate any such adjustments after consultation with the administering authority. A summary of the financial assumptions adopted for the 2022 valuation is set out in the following table:

|  |                                   |
|--|-----------------------------------|
| <b>RPI inflation</b>   | <b>3.2% p.a.</b>                  |
| <b>CPI inflation</b>   | <b>2.9% p.a.</b>                  |
| <b>Pension/deferred pension increases and CARE revaluation</b> | <b>In line with CPI inflation</b> |
| <b>Pay increases</b>   | <b>CPI inflation + 1.0% p.a.</b>  |
| <b>Discount rate</b>   | <b>5.1% p.a.</b>                  |

## 7.12. Asset valuation.

**7.12.1.** For the purpose of the valuation, the asset value used is the market value of the accumulated fund at the valuation date, adjusted to reflect average market conditions during the six months straddling the valuation date. This is referred to as the smoothed asset value and is calculated as a consistent approach to the valuation of the liabilities.

**7.12.2.** The Fund's assets are notionally allocated to employers at an individual level by allowing for actual Fund returns achieved on the assets and cashflows paid into and out of the Fund in respect of each employer (e.g., contributions received, and benefits paid).

### **7.13. Demographic assumptions**

**7.13.1.** The demographic assumptions incorporated into the valuation are based on Fund-specific experience and national statistics, adjusted as appropriate to reflect the individual circumstances of the Fund and/or individual employers.

**7.13.2.** Further details of the assumptions adopted are included in the Fund's 2022 valuation report.

### **7.14. McCloud/Sargeant judgments**

**7.14.1.** When the Government reformed public service pension schemes in 2014 and 2015, they introduced protections for older members. In December 2018, the Court of Appeal ruled that younger members of the Judges' and Firefighters' Pension schemes have been discriminated against because the protections do not apply to them.

**7.14.2.** The Government has confirmed that there will be changes to all main public sector schemes, including the LGPS, to remove this age discrimination. A consultation has been run in relation to the changes proposed for the LGPS and legislation is now being drafted to bring forward these changes. We understand the updated Regulations are to be consulted on over the course of 2022/23 with revised Regulations effective from October 2023.

**7.14.3.** For the 2022 valuation, as required by the Department for Levelling Up, Housing & Communities, in calculating the value of members' liabilities it was assumed that:

**7.14.4.** The current underpin (which only applies to those members within 10 years of their NPA on 31 March 2012) will be revised and will apply to all members who were active in the Scheme on or before 31 March 2012 and who join the post 1 April 2014 scheme without a disqualifying service gap;

**7.14.5.** The period of protection will apply from 1 April 2014 to 31 March 2022 but will cease when a member leaves active service or reaches their final salary scheme normal retirement age (whichever is sooner);

**7.14.6.** Where a member remains in active service beyond 31 March 2022 the comparison of their benefits will be based on their final salary when they leave the LGPS or when they reach their final salary scheme normal retirement age (again whichever is sooner);

**7.14.7.** Underpin protection will apply to qualifying members who leave active membership of the LGPS with an immediate or deferred entitlement to a pension; and

**7.14.8.** The underpin will consider when members take their benefit.

**7.14.9.** Further details of the McCloud/Sergeant judgment can be found below in the Regulatory risks section.

### **7.15. Guaranteed Minimum Pension (GMP) indexation and equalisation**

**7.15.1.** On 23 March 2021, the Government published the outcome to its Guaranteed Minimum Pension Indexation consultation, concluding that all public service pension schemes, including the LGPS, will be directed to provide full indexation to members with a GMP reaching State Pension Age (SPA) beyond 5 April 2021. This is a permanent extension of the existing 'interim solution' that has applied to members with a GMP reaching SPA on or after 6 April 2016. Details of the consultation outcome can be found [here](#).

**7.15.2.** The 2022 valuation approach for GMP is that the Fund will pay limited increases for members that have reached SPA by 6 April 2016, with the government providing the remainder of the inflationary increase. For members that reach SPA after this date, the Fund will be required to pay the entire inflationary increase.

## 7.16. Stabilisation mechanism

**7.16.1.** The LGPS Regulations (Regulation 62(6)(b)) specify that the Actuary must have regard to the desirability of maintaining as nearly constant a primary rate as possible. However, it is a key objective of the Fund to maintain stability of total rates as far as possible. The Fund therefore adopts a stabilisation approach as shown below to achieve this aim:

**7.16.2.** Where an employer is in deficit, the current contribution rate (2022/23) will be increased by a minimum of 1% of assumed gross pensionable pay;

**7.16.3.** For an employer that is in surplus, with no guarantor in the fund liable to pick up the residual liabilities and assets upon ceasing, the total contribution rate payable will be the higher of the 2022 primary rate and the current (2022/23) rate plus 1% of assumed gross pensionable pay, unless the employer has a funding level in excess of 130%. For the avoidance of doubt, employers with a funding level above 130% will still pay a minimum of the primary contribution rate.

**7.16.4.** Notwithstanding the above, there may be some cases where it is appropriate to set a different rate and the Administering Authority can apply discretion as appropriate. A general example is where an admitted body has a guarantor in the Fund, and as a result would be valued on an ongoing basis upon ceasing. For these employers, particularly those who have few active members, it may not be appropriate to set a secondary contribution rate if they have a large surplus, as they would have little chance of receiving an exit credit upon ceasing. In all fringe cases such as this, the Administering Authority may exercise discretion and has the final decision. Another example, relating specifically to pooled employers, is detailed in section 7.18.5

**7.16.5.** An employer with a funding level in excess of 130% pays the 2022 primary rate as a minimum (i.e., there is no scope for an adjustment to total contributions by applying negative secondary contributions).

**7.16.6.** The stabilisation mechanism will be reviewed at the next triennial valuation exercise, expected at 31 March 2025.

## 7.17. Deficit recovery/surplus amortisation periods

**7.17.1.** Whilst one of the funding objectives is to build up sufficient assets to meet the cost of benefits as they accrue, it is recognised that at any particular point in time, the value of the accumulated assets will be different to the value of accrued liabilities, depending on how the actual experience of the Fund differs to the actuarial assumptions. This theory applies down to an individual employer level; each employer in the Fund has their own share of deficit or surplus attributable to their section of the Fund.

**7.17.2.** Where the valuation for an employer discloses a deficit then the level of required employer contributions includes an adjustment to fund the deficit over a maximum period of 17 years from 1 April 2023. The adjustment (or secondary contribution) may be set either as a percentage of payroll or as a fixed monetary amount.

**7.17.3.** The Fund's deficit overall maximum recovery period is therefore 17 years from 1 April 2023, revised from 21 years at the date of the last FSS publication. The reduction of 4 years has been due to a combination of the passage of time and management decision making to reduce the deficit.

**7.17.4.** The deficit recovery period or amortisation period that is adopted for any particular employer will depend on:

**7.17.4.1.** The significance of the surplus or deficit relative to that employer's liabilities;

**7.17.4.2.** The covenant of the individual employer (including any security in place) and any limited period of participation in the Fund;

**7.17.4.3.** The remaining contract length of an employer in the Fund (if applicable); and



**7.17.4.4.** The implications in terms of stability of future levels of employers' contributions.

**7.17.5.** A general summary of the approach used for employers in the Fund is set out in the table below, however, the approach adopted may differ to reflect the situation specific to the employer as agreed by the Administering Authority.

| Type of employer                    | Examples                                       | Maximum recovery period*                        |
|-------------------------------------|--|---|
| Major scheduled bodies              | Unitary authorities                            | 17 years  |
| Higher and further education bodies | Colleges (excluding University of West London) | 8 years   |
| Housing associations                |  | 8 years   |
| Academies                           | Academies, free schools                        | 9 years   |
| Admission bodies                    | Contractors                                    | Maximum of remaining contract length or 8 years |

*\*An element of discretion may be exercised by the Fund as agreed in advance, subject to not breaching the Fund's overall maximum deficit recovery period as specified in Paragraph 7.17.2*

**7.17.6.** In circumstances where employers are in significant surplus, subject to the provisions of the Stabilisation Mechanism in section 7.16, the surplus may be amortised over a reasonable timeframe as agreed with the Administering Authority. This, in effect, leads to negative secondary contributions for a finite period of time, this may also be interpreted as a negative adjustment to the total contribution rate.

**7.17.7.** The Fund maintains a policy to restrict upfront payments of secondary contributions to the value of the deficit as certified by the Fund actuary.

## 7.18. Pooling of individual employers

**7.18.1.** The policy of the Fund is that each individual employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly, contribution rates are set for individual employers to reflect their own particular circumstances. However, certain groups of individual employers are pooled for the purposes of determining contribution rates to recognise common characteristics or where the number of Scheme members is small.

**7.18.2.** Currently, other than Scheme employers that are already connected, the funding pools adopted for the Fund at the 2022 valuation are summarised in the table below:

| Pool                       | Type of pooling                 | Notes  |
|----------------------------|---------------------------------|--|
| Academies                  | Past and future service pooling | All academies in the pool pay the same total contribution rate   |
| Community Admission bodies | Past service pooling only       | All CABs in the pool pay the same secondary rates but pay a primary rate bespoke to their membership     |
| Colleges (excluding UWL)   | Past service pooling only       | All colleges in the pool pay the same secondary rates but pay a primary rate bespoke to their membership |

**7.18.3.** The main purpose of pooling is to produce more stable employer contribution levels, although recognising that ultimately there will be some level of cross-subsidy of pension cost amongst pooled employers.

### 7.18.4. Forming/disbanding a funding pool

**7.18.4.1.** Where the Fund identifies a group of employers with similar characteristics and potential merits for pooling, it is possible to form a pool for these employers. Advice should be sought from the Fund Actuary to consider the appropriateness and practicalities of forming the funding pool.

**7.18.4.2.** Conversely, the Fund may consider it no longer appropriate to pool a group of employers. This could be due to divergence of previously similar characteristics or an employer becoming a dominant party in

the pool (such that the results of the pool are largely driven by that dominant employer). Where this scenario arises, advice should be sought from the Fund Actuary.

**7.18.4.3.** Funding pools should be monitored on a regular basis, at least at each actuarial valuation, in order to ensure the pooling arrangement remains appropriate.

**7.18.5.** The stabilisation mechanism as outlined in 7.16 (referring to the minimum increase of contributions by 1%), may not be appropriate in some specific scenarios concerning the Higher and Further education pool. For example, where employers in the pool pay the same secondary rate but their own primary rate. There may be situations where the employers primary rate decreases due to membership changes and the blanket increase in secondary rate doesn't offset in primary rate, resulting in a total contribution rate decrease or an increase of less than 1%. The Administering Authority may exercise discretion not to apply the stabilisation mechanism in situations such as this.

## **7.19. Risk sharing**

**7.19.1.** There are employers that participate in the Fund with a risk-sharing arrangement in place with another employer in the Fund.

**7.19.2.** For example, there are employers participating in the Fund with pass-through provisions: under this arrangement the pass-through employer does not take on the risk of underfunding as this risk remains with the letting authority or relevant guaranteeing employer. When the pass-through employer ceases participation in the Fund, it is not responsible for making any exit payment, nor receiving any exit credit, as any deficit or surplus ultimately falls to the letting authority or relevant guaranteeing employer.

**7.19.3.** At the 2022 valuation, risk-sharing arrangements were allowed for by allocating any deficit/liabilities covered by the risk-sharing arrangement to the relevant responsible employer.

**7.19.4.** From 1 April 2023, in anticipation of "new fair deal" being legislated before the date of the next triennial valuation, all new employers created through the outsourcing or contracting of other scheme employers will now be considered on a full risk transfer basis.

**7.19.5.** The Fund, from the date of this FSS, maintains a policy of pass-through arrangements only. Under this policy, the "fair deal" employer (letting employer), or employer transferring staff to a contractor (or equivalent), will retain the majority of scheme employer responsibilities and be classed as a "deemed employer".

**7.19.6.** Under this arrangement, the contractor may or may not have direct responsibility for making payments to the LGPS, but the indirect responsibility for guaranteeing these payments will fall to the "fair deal" or outsourcing employer.

**7.19.7.** There are several approaches to pass through arrangements and several risk categories to be considered for responsibility under this pass-through arrangement policy. The full approach to risk-sharing shall be agreed in advance between the Fund and the letting employer in consultation with the Fund Actuary before any contract procurement commences as this is highly likely to impact contract pricing.

**7.19.8.** The final terms of the risk sharing agreement shall be ratified in the admission agreement between the Fund and the Deemed employer, as previously agreed by the Letting Employer.

**7.19.9.** The Fund Actuary shall be engaged in all pass-through arrangement and risk-sharing negotiations to ensure the Fund and the letting employer receive appropriate professional advice due to the complicated and technical nature of these arrangements.

## **7.20. Contribution payments**

**7.20.1.** Employers pay contributions on a monthly basis. Primary contributions are certified as a percentage of payroll and therefore amounts paid by employers each month will fluctuate in line with payroll each month. Secondary contributions can be certified as a percentage of payroll or as a monetary amount. Monetary

amounts are payable in 12 equal monthly instalments throughout the relevant year unless agreed otherwise with the administering authority.

**7.20.2.** Employers must pay contributions in line with the Rates and Adjustments Certificate, but they may be able to alter the timing of contributions payable and/or pay in additional contributions with agreement from the administering authority.

**7.20.3.** The administering authority has agreed to allow a discount to major scheduled bodies who pay their total secondary contributions up front, as long as the payment is received by the end of April 2023. The discount applied is notified to employers and set out in the Rates and Adjustment certificate. The discount for paying three years of contributions in advance is roughly 3.5%. Employers should discuss with and gain agreement from the administering authority before making up front payments at the discounted rate.

**7.20.4.** For the avoidance of doubt, the total secondary contributions referred to above just refers to those certified in the Rates and Adjustments certificate. The Rates and Adjustments certificate is issued based on the results of the 2022 triennial valuation and sets the rates payable of the three year period from 1 April 2023 until 31 March 2026.

**7.20.5.** The 3.5% discount referred to above may vary from employer to employer and is for example purposes only, applying only to the results of the 2022 valuation and may be subject to change or withdrawal in future valuation periods. Discounts may, from time to time, be offered to other employers but the percentage amount may vary considerably especially where their recovery period is less than three years from 1 April 2023. Employers interested in paying their secondary contributions in bulk should contact the administering authority to discuss and agree relevant arrangements.

**7.20.6.** Employers may, from time to time, wish to consider an upfront payment of Secondary (or deficit recovery) contributions greater than those certified in the three year rates and adjustment certificate. Larger up-front payments may be agreed at the discretion of the Fund and subject to prior agreement on the specific terms of the upfront payment (discount rate, timing etc.).

**7.20.7.** The Fund maintains a policy to restrict upfront payments of secondary contributions to the value of the deficit as certified by the Fund actuary.

## **8. New employers joining the Fund**

**8.1.** When a new employer joins the Fund, the Fund Actuary is required to set the contribution rates payable by the new employer and allocate a share of Fund assets to the new employer as appropriate. The most common types of new employers joining the Fund are admission bodies and new academies. These are considered in more detail below.

**8.2.** All new employers joining the fund where relevant shall be applicable to the risk sharing provisions set out in Section 7.19, fully implemented by 1 April 2023.

### **8.3. Admission bodies**

**8.3.1.** New admission bodies in the Fund are commonly a result of a transfer of staff from an existing employer in the Fund to another body (for example as part of a transfer of services from a council or academy to an external provider under Schedule 2 Part 3 of the Regulations). Typically, these transfers will be for a limited period (the contract length), over which the new admission body employer is required to pay contributions into the Fund in respect of the transferred members.

#### **8.3.2. Funding at start of contract:**

**8.3.2.1.** Generally, when a new admission body joins the Fund, they will become responsible for all the pensions risk associated with the benefits accrued by transferring members and the benefits to be accrued over the contract length. This is known as a full risk transfer. In these cases, it may be appropriate that the new admission body is allocated a share of Fund assets equal to the value of the benefits transferred, i.e., the

new admission body starts off on a fully funded basis. This is calculated on the relevant funding basis and the opening position may be different when calculated on an alternative basis (e.g., on an accounting basis).

**8.3.2.2.** However, there may be special arrangements made as part of the contract such that a full risk transfer approach is not adopted. In these cases, the initial assets allocated to the new admission body will reflect the level of risk transferred and may therefore not be on a fully funded basis or may not reflect the full value of the benefits attributable to the transferring members.

### **8.3.3. Contribution rate**

**8.3.3.1.** The contribution rate may be set on an open or a closed basis. Where the funding at the start of the contract is on a fully funded basis then the contribution rate will represent the primary rate only; where there is a deficit allocated to the new admission body, the contribution rate will also incorporate a secondary rate with the aim of recovering the deficit over an appropriate recovery period.

**8.3.3.2.** Depending on the details of the arrangement, for example if any risk sharing arrangements are in place, then additional adjustments may be made to determine the contribution rate payable by the new admission body. The approach in these cases will be bespoke to the individual arrangement.

### **8.3.4. Security**

**8.3.4.1.** To mitigate the risk to the Fund that a new admission body will not be able to meet its obligations to the Fund in the future, the new admission body may be required to put in place a bond in accordance with Schedule 2 Part 3 of the Regulations, if required by the letting authority and administering authority.

**8.3.4.2.** If, for any reason, it is not desirable for a new admission body to enter into a bond, the new admission body may provide an alternative form of security which is satisfactory to the administering authority.

### **8.3.5. Risk sharing**

**8.3.5.1.** Although a full risk transfer (as set out above) is most common, subject to agreement with the administering authority where required, new admission bodies and the relevant letting authority may make a commercial agreement to deal with the pensions risk differently. For example, it may be agreed that all or part of the pensions risk remains with the letting authority.

**8.3.5.2.** Although pensions risk may be shared, it is common for the new admission body to remain responsible for pensions costs that arise from:

**8.3.5.2.1.** Above average pay increases, including the effect on service accrued prior to contract commencement; and

**8.3.5.2.2.** Redundancy and early retirement decisions.

**8.3.5.2.3.** Any other scenario not specifically mentioned whereby a decision is taken by the employer that disproportionately increases pension liabilities.

**8.3.5.3.** The risk-sharing arrangements must be clearly documented in the admission agreement, the transfer agreement or any other side agreement.

**8.3.5.4.** Any agreed arrangement should not lead to any undue risk to the other employers in the Fund. Legal and actuarial advice in relation to risk-sharing arrangements should be sought where required.

**8.3.5.5.** This section is subject to the provisions outlined in section 7.19

## 8.4. New academies

**8.4.1.** When a school converts to academy status, the new academy (or the sponsoring multi-academy trust) becomes a Scheme employer in its own right.

### 8.4.2. Funding at start

**8.4.2.1.** On conversion to academy status, the new academy will be allocated assets based on the active cover of the relevant local authority at the conversion date. The active cover approach is based on the funding level of the local authority's active liabilities, after fully funding the local authority's deferred and pensioner liabilities. The new academy will join the existing academy pool, with the academy pool funding level.

### 8.4.3. Contribution rate

**8.4.3.1.** The contribution rate payable when a new academy joins the Fund will be in line with the contribution rate certified for the Academies funding pool at the 2022 valuation.

## 9. Contribution reviews between actuarial valuations

**9.1.** It is anticipated for most Scheme employers that the contribution rates certified at the formal actuarial valuation will remain payable for the period of the rates and adjustments certificate.

**9.1.1.** There may be circumstances where a review of the contribution rates payable by an employer (or a group of employers) under Regulation 64A is deemed appropriate by the administering authority.

**9.1.2.** A contribution review may be requested by an employer or be required by the administering authority. The review may only take place if at least one of the following conditions are met:

**9.1.2.1.** it appears likely to the administering authority that the amount of the liabilities arising or likely to arise has changed significantly since the last valuation;

**9.1.2.2.** it appears likely to the administering authority that there has been a significant change in the ability of the Scheme employer or employers to meet the obligations of employers in the Scheme; or

**9.1.2.3.** a Scheme employer or employers have requested a review of Scheme employer contributions and have undertaken to meet the costs of that review. A request under this condition can only be made if there has been a significant change in the liabilities arising or likely to arise and/or there has been a significant change in the ability of the Scheme employer to meet its obligations to the Fund.

**9.1.3.** Guidance on the administering authority's approach considering the appropriateness of a review and the process in which a review will be conducted is set out in the Fund's separate Contribution review policy which can be accessed on the Pension Fund's website. This includes details of the process that should be followed where an employer would like to request a review.

**9.1.4.** Once a review of contribution rates has been agreed, unless the impact of amending the contribution rates is deemed immaterial by the Fund Actuary, then the results of the review will be applied with effect from the agreed review date, regardless of the direction of change in the contribution rates.

**9.1.5.** Employers should be mindful of the Fund's stabilisation mechanism as prescribed in Section 7.16 when requesting a contribution review, this mechanism applies automatically in all scenarios unless the administering authority exercise their discretion to make an exemption.

**9.1.6.** Note that where a Scheme employer seems likely to exit the Fund before the next actuarial valuation then the administering authority can exercise its powers under Regulation 64(4) to carry out a review of contributions with a view to providing that assets attributable to the Scheme employer are equivalent to the exit payment

that will be due from the Scheme employer. These cases do not fall under the separate contribution review policy.

**9.1.7.** With the exception of any cases falling under Regulation 64(4), the administering authority will not accept a request for a review of contributions where the effective date is within 12 months of the next Rates and Adjustments Certificate.

## 10. Cessation valuations

**10.1.** When a Scheme employer exits the Fund and becomes an exiting employer, as required under the Regulations the Fund Actuary will be asked to carry out an actuarial valuation in order to determine the liabilities in respect of the benefits held by the exiting employer's current and former employees. The Fund Actuary is also required to determine the exit payment due from the exiting employer to the Fund or the exit credit payable from the Fund to the exiting employer.

**10.2.** Any deficit in the Fund in respect of the exiting employer will be due to the Fund as a single lump sum payment, unless it is agreed by the administering authority and the other parties involved that an alternative approach is permissible. For example:

**10.2.1.** It may be agreed with the administering authority that the exit payment can be spread over some agreed period;

**10.2.2.** the assets and liabilities relating to the employer may transfer within the Fund to another participating employer; or

**10.2.3.** the employer's exit may be deferred subject to agreement with the administering authority, for example if it intends to offer Scheme membership to a new employee within the following three years.

**10.3.** The Fund maintains a separate Employer Flexibilities policy referring to the Deferred Debt Agreements and Debt Spreading Agreements available to employers under Regulations 64(7A) and 64(7B) of the Local Government Pension Scheme (LGPS) Regulations 2013 (as amended).

**10.4.** Any surplus in the Fund in respect of the exiting employer may be treated differently to a payment of an exit credit, subject to the agreement between the relevant parties and any legal documentation and always subject to the Fund's exit credit policy as outlined in section 10.7.

**10.5.** In assessing the value of the liabilities attributable to the exiting employer, the Fund Actuary may adopt differing approaches depending on the employer and the specific details surrounding the employer's cessation scenario. For example, those subject to a minimum risk cessation as outlined in section 10.6.

### 10.6. Minimum risk policy

**10.6.1.** Cessation Deficits calculated on a minimum-risk basis usually apply to an employer when the last remaining active scheme member ceases to exist (i.e., is transferred, leaves employment or retires) in the Fund and there is no guarantor to take over the liabilities.

**10.6.2.** Prior to 31 March 2023, the minimum-risk basis was calculated using 20-year Gilt yields, broadly replicating what happens in the private sector, when a defined benefit scheme wishes to "buy out" its liabilities and pass them on to an insurer. In the private sector, the resulting funds are then used to pay the benefits to the members whose liabilities the insurer has just taken on. The value the insurer places on the bought-out liabilities is therefore highly correlated with the future return they can expect to receive from gilts.

**10.6.3.** There is of course no current provision for LGPS liabilities to be bought out in this way although the gilts-based approach has been a common proxy for calculating minimum risk debts for many years. In this case, the role of "insurer" is taken on by the remaining employers in the Fund, who are essentially liable for additional contributions if future funding experience does not go as well as hoped. The term "minimum risk" is something of a misnomer, as investment risk is often left on the table.

**10.6.4.** The use of gilt yields, having been at very low levels for so long, has historically led to significantly larger exit payments being requested than if an ongoing methodology was applied. This has the effect of protecting Funds as it reduces the risk that the exit payment is insufficient, and that Funds will need to call upon their remaining employers to meet any future deficit that could arise.

**10.6.5.** In response to recent economic events, the Gilt yield approach is no longer deemed appropriate for the Fund from a risk management perspective, as advised by the Fund Actuary. Gilt yields no longer serve to protect the remaining employers in the Fund by reducing risk. By way of an example, Gilt yields hit 5.2% in 2022, exceeding the ongoing discount rate, making this approach redundant as a proxy for minimum risk.

**10.6.6.** From 1 April 2023, the Fund maintains a policy of taking a “prudence-plus” approach to determining a minimum risk discount rate. The alternative methodology links the minimum risk discount rate to that used for ongoing funding but incorporating a higher and constant level of prudence. The assumptions adopted will therefore be consistent with the current ongoing funding position, but with additional prudence included in order to take into account potential uncertainties and risk e.g., due to adverse market changes, additional liabilities arising from regulatory or legislative change and political/economic uncertainties. A key advantage of this approach is that it reduces the reliance on gilt yields to the extent that the Fund is actually invested in this asset class and better serves the Fund and its remaining employers from a risk management perspective.

**10.6.7.** The appropriate level of prudence on this basis was reviewed as part of the Fund’s 2022 valuation, when a stochastic analysis was used to assess the “success probabilities” of certain levels of prudence. The Fund’s approach is to target a 90% success probability that an exiting employer’s assets plus the calculated exit payment/exit credit will be sufficient to meet the residual liabilities. This corresponds to a 4.3% prudence adjustment to the best estimate discount rate assumption (or “prudence-plus margin”). This adjustment will be reviewed on a regular basis, and as a minimum as part of each actuarial valuation of the Fund. For the avoidance of doubt, the prudence margin is not the minimum-risk discount rate, but the level of prudence to be deducted from the Funds ongoing best estimate discount rate.

**10.6.8.** As this is a significant change to the FSS, the Fund is introducing a transition period, whereby all cessation valuations provided before 31 March 2023 shall have the prior methodology honoured provided the full cessation is concluded within 6 months of the date of this FSS (to 30 September 2023). Under this transition period, the Fund Actuary may adopt a discount rate based on Spot Gilt Yields, Smoothed Gilt Yields or other lower risk assets and adopt different assumptions to those used at the previous triennial valuation to protect the other Scheme employers in the Fund from having to fund any future deficits from the liabilities that will remain in the Fund.

## **10.7. Exit credit policy**

**10.7.1.** The Local Government Pension Scheme (LGPS) (Amendment) Regulations 2018 were introduced in May 2018 which allow administering authorities to make an exit credit payment to exiting employers. This will be reviewed on a case by case basis before any payment is made. Considerations will be based on any previous agreements made and discussions between the administering authority, the exiting employer and the guaranteeing employer (if applicable).

**10.7.2.** Having regard to any relevant considerations, the administering authority will take the following approach to the payment of exit credits:

**10.7.2.1.** Any employer who cannot demonstrate that they have been exposed to underfunding risk during their participation in the Fund will not be entitled to an exit credit payment. This is on the basis that these employers would not have been asked to pay an exit payment had a deficit existed at the time of exit.

**10.7.2.2.** The level of risk that an employer has borne will be taken into account when determining the amount of any exit credit. It is the responsibility of the exiting employer to set out why the arrangements make payment of an exit credit appropriate.

**10.7.2.3.** Any exit credit payable may be subject to a maximum of the actual employer contributions paid into the Fund as certified in the Fund's rates and adjustments certificates, up to any cap arrangements that may have been in place and excluding any additional payments such as strain payments.

**10.7.2.4.** As detailed above, the Fund Actuary may adopt differing approaches when assessing whether an exit debt is payable by the employer, depending on the specific details surrounding the employer's cessation scenario.

**10.7.2.5.** Exit credits will only be paid if the ceasing employer has a surplus on the minimum risk basis at the cessation date. Allowance will be made for additional liabilities incurred as a result of redundancies.

**10.7.2.6.** The administering authority will pay out any exit credits within six months of the cessation date where possible. A longer time may be agreed between the administering authority and the exiting employer where necessary. If the employer does not provide all the relevant information to the administering authority within one month of the cessation date the administering authority will not be able to guarantee payment within six months of the cessation date.

**10.7.2.7.** Under the Regulations, the administering authority has the discretion to take into account any other relevant factors in the calculation of any exit credit payable and they will seek legal advice where appropriate.

**10.7.2.8.** For the avoidance of doubt, the exit credit policy detailed here takes precedent over all other areas of documentation whereby exit credits or surpluses may be referred to (for example in draft cessation reports)

## **10.8. Managing exit payments**

**10.8.1.** Where a cessation valuation reveals a deficit and an exit payment is due, the expectation is that the employer settles this debt immediately through a single cash payment. However, should it not be possible for the employer to settle this amount, providing the employer puts forward sufficient supporting evidence to the administering authority, the administering authority may agree a deferred debt agreement (DDA) with the employer under Regulation 64(7A) or a debt spreading agreement (DSA) under Regulation 64B.

**10.8.2.** The Fund maintains a separate Employer Flexibilities policy and keeps this under review. Please refer to this policy for detail and guidance on implementing, monitoring and terminating DDAs and DSAs, this includes details of when a DDA or a DSA may be permitted, and the information required from the employer when putting forward a request for a DDA or DSA.

**10.8.3.** Under a DDA, the exiting employer becomes a deferred employer in the Fund (i.e., they remain as a Scheme employer but with no active members) and remains responsible for paying the secondary rate of contributions to fund their deficit. The secondary rate of contributions will be reviewed at each actuarial valuation until the termination of the agreement.

**10.8.4.** Under a DSA, the cessation debt is crystallised and spread over a period deemed reasonable by the administering authority having regard to the views of the Fund Actuary.

**10.8.5.** Whilst a DSA involves crystallising the cessation debt and the employer's only obligation is to settle this set amount, in a DDA the employer remains in the Fund as a Scheme employer and is exposed to the same risks (unless agreed otherwise with the administering authority) as active employers in the Fund (e.g. investment, interest rate, inflation, longevity and regulatory risks) meaning that the deficit will change over time.

## **10.9. Regulatory factors**

**10.9.1.** At the date of drafting this FSS, the government is currently consulting on potential changes to the Regulations, some which may affect the timing of future actuarial valuations. This is set out in the Local Government Pension Scheme: changes to the local valuation cycle and the management of employer risk consultation document.



**10.9.2.** Further details of this can be found in the Regulatory risks section below.

## **11. Bulk transfers**

**11.1.** Bulk transfers of staff into or out of the Fund can take place from other LGPS Funds or non-LGPS Funds. In either case, the Fund Actuary for both Funds will be required to negotiate the terms for the bulk transfer – specifically the terms by which the value of assets to be paid from one Fund to the other is calculated.

**11.2.** The agreement will be specific to the situation surrounding each bulk transfer but in general the Fund will look to receive the bulk transfer on no less than a fully funded transfer (i.e., the assets paid from the ceding Fund are sufficient to cover the value of the liabilities on the agreed basis).

**11.3.** A bulk transfer may be required by an issued Direction Order. This is generally in relation to an employer merger, where all the assets and liabilities attributable to the transferring employer in its original Fund are transferred to the receiving Fund.

### **11.4. Consolidation of Multi-Academy Trusts (MATs)**

**11.4.1.** Where an academy is transferring into or out of the Fund as part of a MAT consolidation exercise, the Fund generally expects that this will proceed through a Direction Order from the Secretary of State. In these situations, and subject to the terms agreed between the Fund Actuary to both LGPS Funds, typically all the assets attributable to the academy in the ceding Fund are transferred to the receiving Fund.

**11.4.2.** The Fund's preference would be for any transfer to include all members, including deferred and pensioner members. Should a situation arise where an academy is transferring out of the Fund and only active members are transferring, the Fund would seek to retain a level of assets to be at least sufficient to fully fund any deferred and pensioner members left behind, as measured by the Fund's ongoing funding basis at the transfer date.

**11.4.3.** Where the academy is transferring into the Fund, where appropriate, the academy will become part of the Fund's Academy pool. However, the Fund would not accept a transfer in which would lead to a deterioration in its overall funding level, and in particular as a minimum receive a transfer amount that was no less than the equivalent individual CETVs for the transferring members, based on Government Actuary factors in force at the transfer date. The agreed basis of transfer could take into account the funding basis of the Fund and a top up payment could be made to ensure the Fund would not be significantly worse off or be subject to an unacceptable level of risk.

### **11.5. Early retirement costs**

**11.5.1.** The Fund Actuary's funding basis makes no allowance for premature retirement except on grounds of permanent ill health. Scheme employers are required to pay additional contributions whenever an employee retires before attaining the age at which the triennial valuation assumes that benefits are payable. The calculation of these costs is carried out with reference to a calculation approved by the Actuary to the Fund.

**11.5.2.** The Fund monitors each Scheme employer's ill health experience on an ongoing basis. If the cumulative number of ill health retirements in any financial year exceeds the allowance at the previous triennial valuation by a statistically significant amount, the Scheme employer may be charged additional contributions on the same basis as apply for non-ill health cases.

## **12. Links with the Investment Strategy Statement (ISS)**

**12.1.1.** The Fund's FSS is designed to be read in conjunction with the Fund's ISS.

**12.1.2.** The main link between the Funding Strategy Statement (FSS) and the ISS relates to the discount rate that underlies the funding strategy as set out in the FSS, and the expected rate of investment return which is expected to be achieved by the long-term investment strategy as set out in the ISS.

**12.1.3.** As explained above, the ongoing discount rate that is adopted in the actuarial valuation is derived by considering the expected return from the long-term investment strategy. This ensures consistency between the funding strategy and investment strategy.

**12.1.4.** Many of the risks outlined in Section 13 involve mitigations or counter measures that are dealt with through the ISS, for example ensuring that the cash-flow profile of the Fund's investments matches the maturity profile of the Fund's membership.

## 13. Risks and counter measures

**13.1.** Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of employer contributions, it is recognised that there are risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.

**13.2.** The major risks to the funding strategy are financial, although there are other external factors including demographic risks, regulatory risks and governance risks.

**13.3.** A separate risk register is maintained by the Fund and is reviewed quarterly by the Pension Fund Committee, further detail on any of these risks can be found in this risk register available on the Fund's website.

### 13.4. Financial risks

**13.4.1.** The main financial risk is that the actual investment strategy fails to produce the expected rate of investment return (in real terms) that underlies the funding strategy. This could be due to a number of factors, including market returns being less than expected and/or the fund managers who are employed to implement the chosen investment strategy failing to achieve their performance targets.

**13.4.2.** The valuation results are highly sensitive to the real discount rate (i.e., the difference between the discount rate assumption and the price inflation assumption). Broadly speaking an increase/decrease of 0.5% p.a. in the real discount rate will decrease/increase the valuation of the liabilities by 10%, and decrease/increase the required employer contribution by around 2.5% of payroll p.a.

**13.4.3.** In prior valuations, the risk of adverse intra-valuation period inflation experience (i.e., the difference between actuarial long-term inflation assumptions and actual inflation experience across the triennial period) has been somewhat of a misnomer. The Fund's approach to determining long-term Inflation expectations is outlined in paragraph 7.8. Any significant and pronounced deviation to these expectations poses a significant risk to the Fund, e.g., April 2023 assumed 2.9% inflation compared to 10.1% actual experience, ceteris paribus this equates to a 7.2% increase in liabilities. The Fund has flagged this as one of the most significant financial risks to this valuation period.

**13.4.4.** The Pension Fund Committee regularly monitors the investment returns achieved by the fund managers and receives advice from the independent advisers and officers on investment strategy. The Committee may also seek advice from the Fund Actuary on valuation related matters.

**13.4.5.** In addition, the Fund Actuary provides funding updates between valuations to check whether the funding strategy continues to meet the funding objectives.

### 13.5. Demographic risks

**13.5.1.** Allowance is made in the funding strategy via the actuarial assumptions for a continuing improvement in life expectancy. However, the main demographic risk to the funding strategy is that it might underestimate the continuing improvement in longevity. For example, an increase of one year to life expectancy of all members in the Fund will increase the liabilities by approximately 4%.

**13.5.2.** The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review. The Fund commissions a bespoke longevity analysis by

Barnett Waddingham's specialist longevity team in order to assess the mortality experience of the Fund and help set an appropriate mortality assumption for funding purposes.

**13.5.3.** In addition, in 2009 the Fund entered into a longevity insurance contract which covers all pensions in payment at the end of July 2009. This contract means the Fund pays a premium to the insurer and the insurer pays the actual pension amounts due. This contract is designed to mitigate the risk of members living longer than anticipated.

**13.5.4.** The liabilities of the Fund can also increase by more than has been planned as a result of the additional financial costs of early retirements and ill-health retirements. However, the administering authority monitors the incidence of early retirements; and procedures are in place that require individual employers to pay additional amounts into the Fund to meet any additional costs arising from early retirements.

## 13.6. Climate risk

**13.6.1.** There are a large number of interlinked systemic long-term financial risks related to climate change which could potentially have a material impact on the assets and/or the liabilities of the Fund. The most obvious of these climate change risks will be the financial risks to the value of the Fund's assets, the potential increased volatility of markets and potential changes in life expectancy. It is possible that some of these factors will impact the assets and liabilities of the Fund in the same direction, although not necessarily by the same amount.

**13.6.2.** The Fund therefore has a fiduciary duty to consider climate change risk when making investment decisions and to ensure any decisions support the effective management of climate change. The Fund therefore expects their appointed investment managers to be informed about climate change risks and take investment opportunities accordingly within their processes. More detail is included in the Fund's Investment Strategy Statement and Responsible Investment policy.

**13.6.3.** As part of the 2022 valuation, the Fund Actuary provided the Fund with a climate risk analysis which assessed the potential exposure of the Fund's funding position to climate risk under different climate scenarios. The principles behind the analysis were agreed with the Government Actuary's Department (GAD).

**13.6.4.** The results of this analysis demonstrated that the funding strategy agreed as part of the 2022 valuation was sufficiently robust in the context of climate scenario analysis and any potential contribution impacts.

**13.6.5.** The Fund will continue to assess this risk on a regular basis.

## 13.7. Maturity risk

**13.7.1.** The maturity of a Fund (or of an employer in the Fund) is an assessment of how close on average the members are to retirement (or already retired). The more mature the Fund or employer, the greater proportion of its membership that is near or in retirement. For a mature Fund or employer, the time available to generate investment returns is shorter and therefore the level of maturity needs to be considered as part of setting funding and investment strategies.

**13.7.2.** The cashflow profile of the Fund needs to be considered alongside the level of maturity: as a Fund matures, the ratio of active to pensioner members falls, meaning the ratio of contributions being paid into the Fund to the benefits being paid out of the Fund also falls. This therefore increases the risk of the Fund having to sell assets in order to meet its benefit payments. This risk is mitigated by increasing the level of income-paying assets as the Fund matures and is dealt with through the ISS.

**13.7.3.** The government has published a consultation (Local Government Pension Scheme: changes to the local valuation cycle and management of employer risk) which may affect the Fund's exposure to maturity risk. More information on this can be found in the Regulatory risks section below.

## 13.8. Regulatory risks

**13.8.1.** The benefits provided by the Scheme and employee contribution levels are set out in Regulations determined by central government. The tax status of the invested assets is also determined by the government.

**13.8.2.** The funding strategy is therefore exposed to the risks of changes in the Regulations governing the Scheme and changes to the tax regime which may affect the cost to individual employers participating in the Scheme.

**13.8.3.** However, the administering authority participates in any consultation process of any proposed changes in Regulations and seeks advice from the Fund Actuary on the financial implications of any proposed changes.

**13.8.4.** There are a number of general risks to the Fund and the LGPS, including:

**13.8.4.1.** If the LGPS was to be discontinued in its current form, it is not known what would happen to members' benefits;

**13.8.4.2.** More generally, as a statutory scheme the benefits provided by the LGPS, or the structure of the scheme could be changed by the government;

**13.8.4.3.** The State Pension Age is due to be reviewed by the government in the next few years.

**13.8.5.** At the time of preparing this FSS, specific regulatory risks of particular interest to the LGPS are in relation to the McCloud/Sargeant judgments and the timing of future funding valuations consultation. These are discussed in the sections below.

### **13.9. McCloud/Sargeant judgments**

**13.9.1.** The Court of Appeal judgment on the McCloud and Sargeant cases, relate to age discrimination against the age-based transitional provisions put into place when the new judicial pension arrangements were introduced in 2015. The members argued that these transitional provisions were directly discriminatory on grounds of age and indirectly discriminatory on grounds of sex and race, based on the correlation between these two factors reflected in the judicial membership. The Tribunal ruled against the Government, deeming the transitional provisions as not a proportionate means of achieving a legitimate aim.

**13.9.2.** The Government subsequently applied to the Supreme Court to appeal the judgment, but their application was denied on 27 June 2019. On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases. A ministerial statement in response to this was published on 13 May 2021 and revised Regulations are awaited to bring a remedy into play.

**13.9.3.** At the time of drafting this FSS, Regulations and therefore confirmation of the remedy are not yet finalised and are expected in 2023.

### **13.10. Cost control mechanism**

**13.10.1.** As a result of the public service pension schemes reforms, the Government established a cost control mechanism for all those schemes to ensure a fair balance of risks between scheme members and the taxpayer. The process has been complex and has still not been fully resolved. Although the 2016 cost cap valuation report for the LGPS has been published, at the time of writing there is still a challenge outstanding regarding the inclusion of McCloud in the cost cap. Therefore, there is still a possibility that the 2016 valuation may have to be revisited with the small chance that benefit improvements will be required and potentially backdated to April 2019.

**13.10.2.** For the purposes of the 2022 valuation, we have made no allowance for any potential benefit changes. The Fund's prudence allowance already allows for an element of regulatory uncertainty and any potential impact is not deemed to be material.

### **13.11. Consultation: Local Government Pension Scheme: changes to the local valuation cycle and management of employer risk**

**13.11.1.** On 8 May 2019, the government published a consultation seeking views on policy proposals to amend the rules of the LGPS in England and Wales. The consultation covered:

**13.11.1.1.** amendments to the local Fund valuations from the current three year (triennial) to a four year (quadrennial) cycle;

**13.11.1.2.** a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle;

**13.11.1.3.** proposals for flexibility on exit payments;

**13.11.1.4.** proposals for further policy changes to exit credits; and

**13.11.1.5.** proposals for changes to the employers required to offer LGPS membership.

**13.11.2.** The proposals for flexibility on exit payments and for further policy changes to exit credits have been finalised, however, are still to be finalised for the remaining three proposals. This FSS will be revisited once the outcome is known and reviewed where appropriate.

### **13.12. Timing of future actuarial valuations**

**13.12.1.** LGPS valuations currently take place on a triennial basis which results in employer contributions being reviewed every three years. In September 2018 it was announced by the Chief Secretary to HMT, Elizabeth Truss, that the national Scheme valuation would take place on a quadrennial basis (i.e., every four years) along with the other public sector pension schemes. The results of the national Scheme valuation are used to test the cost control mechanism and HMT believed that all public sector schemes should have the cost control test happen at the same time.

### **13.13. Changes to employers required to offer LGPS membership**

**13.13.1.** At the time of drafting this FSS, under the current Regulations further education corporations, sixth form college corporations and higher education corporations in England and Wales are required to offer membership of the LGPS to their non-teaching staff.

**13.13.2.** With consideration of the nature of the LGPS and the changes in nature of the further education and higher education sectors, the government has proposed to remove the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer new employees access to the LGPS. Given the significance of these types of employers in the Fund, this could impact on the level of maturity of the Fund and the cashflow profile. For example, increased risk of contribution income being insufficient to meet benefit outgo, if not in the short term, then in the long term as the payroll in respect of these types of employers decreases with fewer and fewer active members participating in the Fund.

**13.13.3.** This also brings an increased risk to the Fund in relation to these employers becoming exiting employers in the Fund. Should they decide not to admit new members to the Fund, the active membership attributable to the employers will gradually reduce to zero, triggering an exit under the Regulations and a potential significant exit payment. This has the associated risk of the employer not being able to meet the exit payment and thus the exit payment falling to the other employers in the Fund.

## 13.14. Employer risks

**13.14.1.** Many different employers participate in the Fund. Accordingly, it is recognised that a number of employer-specific events could impact on the funding strategy including:

**13.14.1.1.** Structural changes in an individual employer's membership;

**13.14.1.2.** An individual employer deciding to close the Scheme to new employees; and

**13.14.1.3.** An employer ceasing to exist without having fully funded their pension liabilities.

**13.14.2.** However, the administering authority monitors the position of employers participating in the Fund, particularly those which may be susceptible to the events outlined and takes advice from the Fund Actuary when required. In particular, the Fund will commission an employer risk review from the Fund Actuary on a regular basis, every three years as a minimum, to help identify the employers in the Fund that might be considered as high risk. In the case of admitted bodies, the Fund has a policy of requiring some form of security from the employer, in the form of a guarantee or a bond, in case of employer default where the risk falls to the Fund. Where the risk of default falls on the liabilities of an original letting authority, the Fund provides advice to the letting authority to enable them to make a decision on whether a guarantee, some other form of security or a bond should be required.

**13.14.3.** In addition, the administering authority keeps in close touch with all individual employers participating in the Fund to ensure that, as administering authority, it has the most up to date information available on individual employer situations. It also keeps individual employers briefed on funding and related issues.

## 13.15. Governance risks

**13.15.1.** Accurate data is necessary to ensure that members ultimately receive their correct benefits. The administering authority is responsible for keeping data up to date and results of the actuarial valuation depend on accurate data. If incorrect data is valued, then there is a risk that the contributions paid are not adequate to cover the cost of the benefits accrued.

## 13.16. Monitoring and review

**13.16.1.** This FSS is reviewed formally, in consultation with the key parties, at least every three years to tie in with the triennial actuarial valuation process.

**13.16.2.** The most recent valuation was carried out at 31 March 2022, certifying the contribution rates payable by each employer in the Fund for the period from 1 April 2023 to 31 March 2026.

**13.16.3.** The timing of the next funding valuation is due to be confirmed as part of the government's Local Government Pension Scheme: changes to the local valuation cycle and management of employer risk consultation which closed on 31 July 2019. At the time of drafting this FSS, it is anticipated that the next funding valuation will be due as at 31 March 2025.

**13.16.4.** The administering authority also monitors the financial position of the Fund between actuarial valuations and may review the FSS more frequently if necessary.