

# **Worcestershire Pension Fund**



## **FUNDING STRATEGY STATEMENT**

**Approved by Pensions Committee on [DATE]**

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

# Executive Summary

Ensuring that the Worcestershire Pension Fund (the “Fund”) has sufficient assets to meet its pension liabilities in the long term is the fiduciary responsibility of the Administering Authority (Worcestershire County Council).

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

The details contained in this FSS will have a financial and operational impact on all participating employers in the Worcestershire Pension Fund.

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

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

The results of the 2022 valuation show the liabilities to be {100}% covered by the current assets using the prudent assumptions set out in Appendix A. The Fund’s long-term objective is to secure and maintain sufficient assets to cover all pension liabilities in the longer term. Deficit recovery / surplus offset periods vary by employer category. For employers in deficit, a maximum deficit recovery period of 12 years applies. For employers in surplus a maximum surplus spreading period of 15 years applies.

The key financial assumptions used to determine the funding liabilities and the future service (“Primary”) contribution rate for each investment pot at the valuation date are:

	<b>Growth pot</b>	<b>Medium pot</b>	<b>Cautious pot</b>
Funding liabilities discount rate:	{4.60}% p.a.	{4.35}% p.a.	{2.45}% p.a.
Future service discount rate:	{5.10}% p.a.	{4.85}% p.a.	{2.45}% p.a.
CPI price inflation	{3.10}% p.a.	{3.10}% p.a.	{3.10}% p.a.

In assessing the value of the Fund’s liabilities, allowance has been made for asset out-performance (above CPI inflation) by taking into account the investment strategy adopted by the Fund. If, at the valuation date, the Fund had been invested in a “minimum risk” portfolio, the assessed value of the Fund’s liabilities at the valuation would have been significantly higher, resulting in a funding level of

58%. To help maintain stability of contributions in the future, the Fund has implemented a number of strategies to help manage risk:

- Investment pots to offer to employers which exhibit lower investment risk than the current whole fund strategy. Further detail regarding the asset strategy for each pot is available in the Fund's Investment Strategy Statement (ISS).
- Equity Protection strategy to protect against potential falls in the equity markets via the use of derivatives.
- Covenant assessment and monitoring for participating employers, as detailed in Appendix E.
- Provided employers with the facility to take out ill-health liability insurance to ensure that the eligible employers are not exposed to potentially large funding strains on the ill health retirement of one or more of their members.

The Fund has a number of key aims and objectives. The key funding objectives are referred to throughout the FSS and are summarised below:

- Achieve and maintain assets equal to 100% of liabilities within a target 15 year average timeframe, whilst remaining within reasonable risk parameters.
- Determine employer contribution requirements to maintain long term cost efficiency, whilst recognising the constraints on affordability and strength of employer covenant, with the aim being to maintain as predictable an employer contribution requirement as possible.
- Strike the appropriate balance between long-term investment performance and the Fund's funding objectives.
- Ensure net cash outgoings can be met as/when required.
- Minimise unrecoverable debt on employer termination.
- Ensure that the future strategy, investment management actions, governance and reporting procedures take full account of longer-term risks and sustainability.
- To provide more certainty in employer contribution outcomes (within reasonable parameters) by implementing a number of risk management techniques to manage various aspects of the Fund's financial risks, specifically an Equity Protection strategy and investment strategies reflective of the risk associated to each employer.

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

Key elements of the funding strategy are as follows:

- To include appropriate margins to allow for the possibility of adverse events (e.g., material reduction in investment returns, economic downturn and higher inflation outlook) leading to a worsening of the funding position which would normally lead to volatility of contribution rates at future valuations if these margins were not included. This prudence is required by the regulations and guidance issued by professional bodies and Government agencies to assist the Fund in meeting its primary solvency and long term cost efficiency objectives.
- Deficit recovery periods are determined by the Fund with the aim of recovering deficits as quickly as participating employers can reasonably afford given other competing cost pressures, taking into account the Fund's view of the employer's covenant and the risk to the Fund.
- The deficit recovery periods will be set by the Administering Authority with a maximum deficit recovery period of 12 years, although employers will be free to select any shorter deficit recovery period if they wish.
- Employers who are expected to have a shorter participation period e.g., closed to new entrants will generally have a shorter recovery period.
- Deficit recovery contributions will be expressed in £s.
- Similar principles are applied to employers who have a surplus of assets over liabilities where the surplus is being run off over a maximum period of 15 years as an offset to future service contributions.
- It is possible for employers to prepay their contributions for the full 3 years or annually at each April in return for a cash saving.
- The key financial assumption – the discount rate – is derived for each investment pot by considering the prudent long term expected return on the underlying assets. For the Growth and Medium Pot this is measured over and above assumed future Consumer Prices Index (CPI) inflation. For the Cautious Pot this is measured over and above gilt yields.
- The demographic assumptions for the whole Fund have been determined by carrying out a bespoke analysis of the Fund's membership along with a review of other LGPS funds.
- As part of the Fund's risk management framework, employer type, maturity, funding position, status and ongoing covenant strength will be considered by the Fund when allocating an employer to a specific investment pot.

It is strongly recommended that employers also consider and understand the detailed Fund policies in the main body as these impact on your participation in the Fund over the short and long term.

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# 1. Introduction

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

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

## **BENEFITS**

The benefits provided by the LGPS are specified in the governing legislation contained in the Regulations referred to above. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time facilitating scrutiny and accountability through improved transparency and disclosure.

The LGPS is a defined benefit arrangement with final pensionable pay related benefits and Career Averaged Revalued Earnings (“CARE”) benefits earned thereafter. There is also a “50:50 Scheme Option”, where members can elect to accrue 50% of the member’s retirement benefits and pay 50% of the normal member contribution.

## **CONTRIBUTIONS**

The required levels of employee contributions are specified in the Regulations.

Employer contributions and deficit recovery contributions are determined by in accordance with the Regulations.

## **PRIMARY RATE**

The “Primary rate” for an employer is the contribution rate in the Fund Actuary's opinion required to meet the cost of the future accrual of benefits, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and the employer’s covenant. This includes provision for ancillary death in service and ill health benefits (subject to any external insurance arrangement) and administration costs. 5

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

## **SECONDARY RATE**

The "Secondary rate" is an adjustment that should, in the Fund Actuary's opinion, be made to the Primary rate to address any past service deficit or surplus. In addition, as part of the 2022 actuarial valuation. The Secondary rate may be expressed as a percentage adjustment to the Primary rate, and/or a cash adjustment in each of the three years beginning 1 April in the year following that in which the valuation date falls.

In addition to paying the Primary rate for future accrual of benefits, employers are required to make any required deficit recovery contributions via the Secondary rate.

Secondary rates for the whole Fund in each of the three years shall also be disclosed. These will be the calculated weighted average based on the whole Fund payroll in respect of percentage rates and the total amount across all employers in respect of cash adjustments.

Contribution plans are normally determined as part of an actuarial valuation although in some circumstances they may be reviewed in between valuations in accordance with the Regulations.

## 2. Purpose of the FSS in policy terms

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

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

The purpose of this FSS is therefore:

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

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



### **3. Aims and purpose of the Fund**

#### **THE AIMS OF THE FUND ARE TO:**

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

#### **THE PURPOSE OF THE FUND IS TO:**

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

## 4. Responsibilities of the key parties

The efficient and effective management of the Fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently. The key parties are the Administering Authority, the Pensions Committee, the individual employers and the Fund's Actuary and details of their roles are set out below. Other parties required to play their part are bankers, custodians, investment managers, auditors, legal/investment/governance advisors and the Local Pension Board.

### KEY PARTIES TO THE FSS

The **Administering Authority**, through delegation to the Pensions Committee, should:

- Operate the Fund
- Collect employer and employee contributions, investment income and other amounts due to the Fund as stipulated in the Regulations
- Pay from the Fund the relevant entitlements as stipulated in the Regulations
- Invest surplus monies in accordance with the Regulations
- Ensure that cash is available to meet liabilities as and when they fall due
- Take measures as set out in the Regulations to safeguard the Fund against the consequences of employer default
- Manage the valuation process in consultation with the Fund Actuary
- Prepare and maintain a FSS and an ISS, both after proper consultation with interested parties
- Monitor all aspects of the Fund's performance and funding, amending the FSS/ISS as necessary
- Effectively manage any potential conflicts of interest arising from it also being a Fund employer, and
- Enable the Local Pension Board to review the valuation process as set out in their terms of reference.

In practice the Pensions Committee may delegate responsibility for the implementation of some of the above responsibilities to Fund officers.

The **Individual Employers** should:

- When determining the final level of contributions payable at each valuation within the FSS parameters, ensure they consider the appropriate balance between contribution affordability in the short term and the sustainability of contributions in the longer term. An employer should ensure they understand the potential risk that contributions may increase if experience turns out worse than the actuarial assumptions adopted. This may lead to employers choosing to pay higher contributions than the minimum requirement under the FSS.

- Deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations) and pay all contributions, including their own as determined by the Fund Actuary, promptly by the due date and ensure that any payroll estimates notified to the Fund (for example as part of any prepayment calculations) are as accurate as possible
- Develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework
- Make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain
- Have regard to The Pensions Regulator's focus on data quality and comply with any requirement set by the Fund in this context
- Notify the Fund promptly of any changes to membership which may affect future funding
- Understand the pensions impacts of any changes to their organisational structure and service delivery model, and
- Understand that the quality of the data provided to the Fund will directly impact on the assessment of the liabilities and contributions. In particular, any deficiencies in the data would normally result in the employer paying higher contributions than otherwise would be the case if the data was of high quality.

The **Fund Actuary** should:

- Prepare actuarial valuations including the setting of employers' contributions after agreeing assumptions with the Fund and having regard to their FSS and the Regulations
- Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill health retirement costs, etc.
- Provide advice and valuations on the termination of admission agreements including in relation to exit payments and exit credits
- Provide advice to the Fund on bonds and other forms of security against the financial effect on the Fund of employer default
- Assist the Fund in assessing whether employer contributions need to be revised between valuations when the Administering Authority decides to review them
- Advise on funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the ISS, and
- Ensure the Fund is aware of any professional guidance or other professional requirements which may be of relevance to the Fund Actuary's role in advising the Fund.

## 5. Solvency Funding Target

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

### **SOLVENCY AND LONG-TERM EFFICIENCY**

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

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

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

### **DETERMINATION OF THE SOLVENCY FUNDING TARGET AND DEFICIT RECOVERY CONTRIBUTIONS**

The principal method and assumptions to be used in the calculation of the funding target are set out in **Appendix A**. The assumptions for deficit recovery contributions are set out in **Appendix B**.

Underlying these assumptions are:

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

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

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

into account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2023 at the latest.

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

The Fund, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2022 actuarial valuation:

The employer contributions will be expressed and certified as two separate elements:

- the Primary rate: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits, ancillary death in service, ill health benefits and administration costs.
- the Secondary rate: a schedule of lump sum monetary amounts over 2023/26 in respect of an employer's surplus or deficit (with the exception of the Town and Parish Council Group where contributions will be certified as a % of pensionable pay).

For any employer, the total contributions they are actually required to pay in any one year is the sum of the Primary and Secondary rates (subject to an overall minimum of zero). Both elements are subject to review from 1 April 2026 based on the results of the 2025 valuation.

Employers may also elect to make lump sum prepayments of contributions.

## **DEFICIT RECOVERY CONTRIBUTIONS**

It is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Fund's view of the employer's covenant and risk to the Fund.

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

The key principles when considering deficit recovery plans are as follows:

- The Fund will consider whether it is appropriate for deficit recovery contribution reductions to apply compared to the existing funding plan (allowing for indexation where applicable) where deficits remain. This will be based on assessment of the employer covenant (including affordability of the existing funding plan) and any other relevant factors.

- Subject to consideration of affordability, as a general rule the deficit recovery period will reduce by at least 3 years for employers at this valuation when compared to the preceding valuation. This is to target full solvency over a similar (or shorter) time horizon. This is to maintain (as far as possible) equity between different generations of taxpayers and to protect the Fund against the potential for an unrecoverable deficit. The deficit recovery period will be set to at least cover the expected interest costs (actual interest costs will vary in line with investment performance) on the deficit.
- Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. Subject to affordability considerations and other factors, a bespoke period may be applied in respect of particular employers where the Fund considers this to be warranted (see Deficit Recovery Assumptions in Appendix B). The average deficit recovery period adopted by all employers will be set out within the Fund Actuary's report. Employers will be notified of their individual deficit recovery contribution amounts as part of the provision of their individual valuation results. Where increases (or decreases) in employer contributions are required from 1 April 2023, following completion of the 2022 actuarial valuation, at the sole discretion of the Fund the increase (or decrease) from the rates of contribution payable in the year 2023/24 may be implemented in steps, over a maximum of 3 years, depending on affordability of contributions as determined by the administering authority. This will be notified to employers as part of the valuation process. However, where a surplus exists or where there has been a reduction in contributions paid in respect of an employer's deficit at the valuation, the Fund would not consider it appropriate for any increase in contributions paid in respect of future accrual of benefits to be implemented in steps.
- As part of the process of agreeing funding plans with individual employers, the Fund will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities.
- It is acknowledged by the Fund that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Fund therefore would be willing to use its discretion to accept an evidence-based affordable level of contributions for the organisation for the three years 2023/2026. Any application of this option is at the ultimate discretion of the Fund officers and Section 151 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.
- For those bodies identified as having a weaker covenant, the Fund will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans.
- Notwithstanding the above principles, the Fund, in consultation with the Fund Actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

- On the cessation of an employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment (see Employers Leaving the Fund below).

## **FUNDING FOR NON-ILL HEALTH EARLY RETIREMENT COSTS**

Employers are required to meet all costs of early retirement strain (i.e. the increase in liability caused by paying a member's benefits early) by immediate capital payments into the Fund.

## **FUNDING FOR ILL HEALTH RETIREMENT COSTS**

Should a member retire on ill health grounds, this will normally result in a funding strain for that employer (i.e. increased liability). The size of any funding strain will depend on how the cost of that ill health retirement compares with the expected cost built in the actuarial assumptions for that employer. The actual cost will also depend on the level of any benefit enhancements awarded (which depend on the circumstances of the ill health retirement) and also how early the benefits are brought into payment.

With the exception of any employers that have elected to take up ill-health liability insurance, the contributions payable over 2023/26 include an allowance for ill-health retirement costs (alongside those for voluntary early retirements). Where an ill-health retirement occurs, no additional contributions will be due immediately from the employer although any funding strain or profit will emerge following the subsequent actuarial valuation through increased/reduced deficit, depending on the difference in the funding cost of the ill health retirement (on the actuarial valuation assumptions) and the expected cost built into the contributions payable.

For those employers who have elected to take out ill-health liability insurance, they have the option to reduce their certified primary contribution rate by the ill health allowance included at the actuarial valuation. The employer will pay an additional premium to the insurer. Where an ill-health retirement occurs, no additional contributions will be due immediately from the employer and a payment will be received from the insurer. Any funding strain or profit will emerge following the subsequent actuarial valuation through increased/reduced deficit, depending on the difference in the updated funding cost of the ill health retirement (on the actuarial valuation assumptions) and the payment received from the insurer.

## **EMPLOYERS LEAVING THE FUND**

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

Where an employer with a guarantor (including where there is a Pass Through arrangement – see Appendix C) leaves the Fund, the termination assessment will be calculated using a valuation funding basis which will take account of the exiting employer's investment pot. Further details are set out in the Termination Policy in Appendix D.

The residual assets and liabilities and hence any surplus or deficit will normally transfer back to the guarantor but in circumstances where an exiting employer is expected to still be responsible for the termination deficit or surplus, an exit payment/exit credit may be payable from/to the exiting employer.

Where there is a surplus and a risk sharing arrangement is in place the Administering Authority will decide whether an exit credit may be payable. This is subject to representation (as required under the Regulations from 20 March 2020) from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor. If representation is not made to the satisfaction of the Fund, then the surplus will not be paid directly to the exiting employer following cessation (despite any other agreements that may be in place).

A similar approach will be taken where there is a deficit, where the default would be to collect the exit payment in the absence of the representation from the interested parties.

The information that will be required by the Fund from employers to make a determination on whether an exit credit should be paid where a risk sharing arrangement is in place or guarantee will be supplied to the interested parties at the appropriate time. A determination notice will be provided alongside the termination assessment from the Fund Actuary. The notice will cover the following information and process steps:

- Details of the employers involved in the process (e.g., the exiting employer and guarantor).
  - Details of the admission agreement, commercial contracts and any amendments to the terms that have been made available to the Administering Authority, and all other information provided to the Administering Authority and considered as part of the decision-making process. A key factor will be whether an exiting employer would have been responsible for a deficit.
  - The final termination certification of the exit credit by the Fund Actuary.
  - The Administering Authority's determination based on the information provided.
  - Details of the appeals process in the event that a party disagrees with the determination and wishes to make representations to the Administering Authority
- Further information on the process for making a formal representation is available in the Fund's "Making a formal representation for an exit credit payment" document.

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

Where an employer with no guarantor leaves the Fund and leaves liabilities in the Fund, the termination assessment will be calculated using a discount rate based on a minimum risk investment strategy and a more prudent life expectancy assumption. Further details are set out in the Termination Policy in Appendix D. For the avoidance of doubt this will include an appropriate provision for potential costs of the McCloud case remedy as per the approach set out in this FSS.



- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 6 months of completion of the cessation assessment by the Fund Actuary).
- In the case of a deficit, the Fund would require the exiting employer to pay the exit payment to the Fund as a lump sum cash payment (unless agreed otherwise by the Fund at their sole discretion) following completion of the termination process and in line with the Regulations.
- The Fund can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Fund Actuary and, for example, may adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers.

At the discretion of the Administering Authority, repayment plans over an agreed period or a Deferred Debt Agreement may be agreed subject to the Fund's policy in relation to flexibilities in recovering exit payments.

Further detail is available in the Termination Policy in **Appendix D**.

## **6. Link to investment policy and the Investment Strategy Statement (ISS)**

The results of the 2022 valuation show the liabilities to be [100]% covered by the current assets.

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

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

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

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out this valuation it would not be appropriate to make any allowance for growth assets out-performance or any adjustment to market implied inflation assumption due to supply/demand distortions in the bond markets. This would result in a real return versus CPI inflation of negative 1.4% per annum at the valuation date. On this basis of assessment, the assessed value of the Fund's liabilities at the valuation would have been significantly higher, resulting in a funding level of 58%. This is a measure of the level of reliance on future investment returns i.e. level of investment risk being taken.

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

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

Based on the investment strategy in the ISS and the Fund Actuary's assessment of the return expectations for each asset class, this leads to an overall best estimate average expected return of 3.3% per annum in excess of CPI inflation as at the valuation date. For the purposes of setting funding strategy however, the Fund believes that it is appropriate to take a margin for prudence on these return expectations (i.e. to use an assumption that has a greater than 50% chance of being achieved) and this is expected under the Regulations and guidance. This margin, however, has been adjusted to take account of the risk management strategies implemented to reduce the volatility of returns within the investment strategy. In isolation, this allows a lower margin for prudence to be used than would otherwise be the case if these risk management strategies were not in place.

## RISK MANAGEMENT

In the context of managing various aspects of the Fund's financial risks, the Fund has implemented a number of risk management techniques. The principal aim of these risk management techniques is to effectively look to provide more certainty of contribution outcomes within reasonable parameters.

In particular:

- Equity Protection - the Fund has implemented protection against potential falls in the equity markets via the use of derivatives. The aim of the protection is to provide further stability (or even a reduction) in employer deficit recovery contributions (all other things equal) in the event of a significant equity market fall (although it is recognised that it will not protect the Fund in totality). Further information in relation to the equity protection arrangement is available within the Fund's Investment Strategy Statement and Committee papers.
- Investment 'pots' – the Fund implemented alternative investment strategies with differential levels of investment risk with effect from 1 April 2020. The aim is to provide greater control over employers' exposure to investment risk (see Appendix F for further information). The pot an employer sits in will be reflected in the relevant employer's asset share, funding basis and contribution requirements.

## CLIMATE CHANGE

An important part of the risk analysis underpinning the funding strategy will be for the Actuary to identify the impact of climate change transition risk (shorter term) and physical risks (longer term) on the potential funding outcomes. In terms of the current valuation, an analysis of different climate change scenarios at the Whole Fund level is being undertaken relative to the baseline position assuming that the funding assumptions are played out on a best estimate basis. The projections are meant to illustrate the different elements of risk under three climate change scenarios based on the current strategic allocation. The scenarios are not meant to be predictors of what may happen and are only a small subset of a very wide range of scenarios that could arise depending on the global actions taken in relation to climate change. In future the actions taken (both historically and in future) by the Fund in relation to making its asset portfolio more sustainable will ultimately be set out in the separate Taskforce for Climate Change (TCFD) reports and analysis of the asset portfolio adopting the same (or similar (but not necessarily the same)) scenarios although this can be over a different time period.

The analysis will consider a projection of the funding levels under the scenarios considered which are designed to illustrate the transition and physical risks over different periods depending on what actions are taken globally on climate change.

The key metrics are the relative impact on the funding level over the different time periods as this illustrates the impact of climate related market shocks on the funding plan and the analysis will provide the Fund with additional information regarding the resilience of the funding strategy and adequacy of prudence margins. Whilst the scenarios being considered are only three out of a considerable range of potential outcomes, it shows that climate change can have far reaching effects on the Fund.

The Actuary applies a nuanced approach to understand what is/is not priced into the markets in terms of transition and physical risks. They include assumptions about what is currently priced into markets, and later price in shocks when the markets account for future impacts (both physical and transition impacts). The three climate shock scenarios being considered are:

1. Rapid Transition - there is a sudden divestment across multiple securities in 2025 to align portfolios to the Paris Agreement goals, this will have disruptive effects on financial markets with sudden repricing followed by stranded assets and a sentiment shock. Average temperature increase stabilises at 1.5°C around 2050.
2. Orderly Transition - political and social organisations act quickly and predictably to implement the recommendations of the Paris Agreement to limit global warming to below 2°C. This scenario includes additional economic damage consistent with 1.8°C of average temperature rise – peaking in 2070.
3. Failed Transition - The world fails to meet the Paris Agreement goals and global warming reaches 4.3°C above pre-industrial levels by 2100. Physical climate impacts cause large reductions in economic productivity and increasing impacts from extreme weather events.

The actuarial assumptions (versus the best estimate) include a level of prudence which implicitly allows for the climate risk and other risks to support future contribution stability and the Actuary has concluded that the level of prudence is currently sufficient in the context of the scenarios considered. However, any climate related impacts will potentially put significant stress on the funding plan, especially when taken into account with other risk factors so the analysis will be further developed and be monitored over time. A summary of the output of the analysis will be set out in the Fund Actuary's report on the valuation.

Other risks (e.g. longevity) will also be considered in future analysis but are expected to have a much lower impact than the financial market impacts. The expected impact on asset returns under different scenarios and timeframes will be shown in more detail in the separate [TCFD](#) reports.

## 7. Identification of risks and countermeasures

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

The Fund has been advised by the Fund Actuary that the greatest risk to the funding level is the investment risk inherent in the predominantly equity-based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that assumed in the long term. The Fund Actuary's formal valuation report includes quantification of some of the major risk factors. The risk mitigations are set out in the Fund's separate risk register which is included in the Committee papers.

### **FINANCIAL**

The financial risks are as follows:-

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

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

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

## DEMOGRAPHIC

The demographic risks are as follows:-

- Future unanticipated changes in life expectancy (longevity)
- Potential strains from ill health retirements, over and above what is allowed for in the valuation assumptions (or level of ill-health insurance protection, where relevant)
- Unanticipated acceleration of the maturing of the Fund resulting in materially negative cashflows and shortening of liability durations

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

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

Whilst regulatory procedures are in place to ensure that ill-health retirements are properly controlled, employing bodies also need to recognise that unforeseen costs for them will arise in the event that the number of ill-health retirements were to exceed the assumptions made. Early retirements for reasons of redundancy and efficiency do not normally affect the solvency of the Fund because they are the subject of a direct charge.

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

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

## REGULATORY

The key regulatory risks are as follows:-

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

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

## **GOVERNANCE**

The Fund has done as much as it believes it reasonably can to enable employing bodies and Fund members (via their representatives on the Pensions Committee and Pension Board) to make their views known to the Fund and to participate in the decision-making process. Previous versions of this FSS were consulted on prior to being approved at a Pensions Committee meeting, a practice that is being continued with this version.

Governance risks are as follows:-

- The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated
- Fund unaware of structural changes in employer's membership (e.g., large fall in employee numbers, large number of retirements) with the result that contribution rates are set at too low a level
- Fund not advised of an employer closing to new entrants, something which would normally require an increase in contribution rates
- An employer ceasing to exist with insufficient funding or adequacy of a bond
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements, and
- Changes in the Committee membership.

For these risks to be minimised much depends on information being supplied to the Fund by the employing bodies. Arrangements are strictly controlled and monitored, but in most cases the employer, rather than the Fund as a whole, bears the risk.

## 8. Monitoring and review

The Fund has taken advice from the Fund Actuary in preparing this FSS and has consulted with the employers participating in the Fund.

The Fund will monitor the progress of the funding strategy and, if considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example, if there:

- Has been a significant change in market conditions, and/or deviation in the progress of the funding strategy.
- Have been significant changes to the Fund membership, or LGPS benefits e.g., resolution of the McCloud remedy.
- Have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy.
- Have been any significant special contributions paid into the Fund.
- Has been a change in Regulations or Guidance which materially impacts on the policies within the funding strategy.

When monitoring the funding strategy, if the Fund considers that any action is required, the relevant employers will be contacted. In the case of admitted bodies, there is statutory provision for rates to be amended between valuations and this will be considered in conjunction with the employer affected and any associated guarantor of the employer's liabilities (if relevant).

The structure and make-up of the investment pots will also be periodically reviewed between valuations based on the size and maturity of the liabilities within each pot. This will also allow for any movements of employers between the pots due to changes in funding position, covenant and also at the request of an employer.

A full review of this FSS will occur no less frequently than every 3 years, to coincide with completion of a full actuarial valuation.

### **Review of contributions**

In line with the Regulations, the Administering Authority has the ability to review employer contributions between valuations. The Administering Authority and employers now have the following flexibilities:

The Administering Authority may review the contributions of an employer where there has been a significant change to the liabilities of an employer.

The Administering Authority may review the contributions of an employer where there has been a significant change in the employer's covenant.

An employer may request a review of contributions from the Administering Authority if they feel that either point 1 or point 2 applies to them and undertake to meet the costs.



Further information is set out within the policy in Appendix G.

### **The McCloud judgment**

The Government have confirmed that this judgment will result in a remedy being implemented for the LGPS. Whilst proposals to address the specific discrimination have been set out in a written ministerial statement on 13 May 2021, the changes have not yet been made to the Regulations. However, the Department for Levelling Up, Housing & Communities (DLUCH) issued [guidance](#) which sets out how the McCloud case should be included within the 2022 valuation.

# Appendix A

## ACTUARIAL METHOD AND ASSUMPTIONS

### METHOD

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

## FINANCIAL ASSUMPTIONS – SOLVENCY FUNDING TARGET

### Investment return (discount rate)

The discount rates for the investment pots have been derived based on the expected return on the Fund assets based on the long-term strategy set out in the Investment Strategy Statement (ISS). The discount rates include appropriate margins for prudence. When assessing the appropriate discount rate consideration has been given to the returns in excess of CPI inflation (as derived below) for the Growth and Medium pots and in excess of Gilt yields for the Cautious pot.

These real returns will be reviewed from time to time based on the investment pot strategy, market outlook and the Fund's overall risk metrics. The discount rates will be reviewed as a matter of course at the time of a formal valuation or a formal employer rate review.

### Growth investment pot

For employers in the Growth investment pot the discount rate at the valuation has been derived based on an assumed return of  $\{1.5\}$ % per annum above CPI inflation i.e. a real return of  $\{1.5\}$ % per annum and a total discount rate of  $\{4.60\}$ % per annum.

### Medium investment pot

For employers in the Medium investment pot the discount rate at the valuation has been derived based on an assumed return of  $\{1.25\}$ % per annum above CPI inflation i.e. a real return of  $\{1.25\}$ % per annum and a total discount rate of  $\{4.35\}$ % per annum.

### Cautious investment pot

For employers in the Cautious investment pot the discount rate at the valuation has been derived based on an assumed return of  $\{0.75\}$ % per annum above Gilt yields and a total discount rate of 2.45% per annum.

## **Inflation**

The inflation assumption will be taken to be the investment market's expectation for Retail Prices Index (RPI) inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Fund's accrued liabilities, but subject to the following two adjustments:

- 1 an allowance for supply/demand distortions in the bond market is incorporated, and
- 2 an adjustment due to retirement pensions being increased annually by the change in the Consumer Prices Index rather than the Retail Prices Index (reflecting the profile and duration of the whole Fund's accrued liabilities and 2030 RPI reform).

The overall reduction to RPI inflation to arrive at the CPI inflation assumption at the valuation date is 0.8% per annum. This adjustment to the RPI inflation assumption will be reviewed from time to time to take into account any market factors which affect the estimate of CPI inflation. The change will then be implemented for the policies set out in this statement. [The inflation assumption can be different in relation to the termination policy to reflect the required prudence based on the Actuary's advice.](#)

## **Salary increases**

In relation to benefits earned prior to 1 April 2014 (and 2014 to 2022 McCloud underpin), the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long-term salary increase assumption allowance has been made for expected short term pay restraint for some employers as budgeted in their financial plan. The assumption used for an employer will be notified to them separately as part of the discussions but typically will be a minimum of [4]% per annum until 31 March 2026.

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

## **Pension increases/Indexation of CARE benefits**

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g., some Guaranteed Minimum Pensions where the LGPS is not currently required to provide full indexation). For members in pensionable employment, their CARE benefits are also indexed by CPI although this can be less than zero i.e. a reduction in benefits, whereas for pension increases this cannot be negative, as pensions cannot be reduced.

## **DEMOGRAPHIC ASSUMPTIONS**

### **Mortality/Life Expectancy**

The mortality in retirement assumptions are based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the

experience of the Fund. The mortality tables used are set out below, with a loading reflecting LGPS experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Fund Actuary. A specific mortality assumption has also been adopted for current members who retire on the grounds of ill health. For all members, it is assumed that the trend in longevity seen over recent time periods (as evidenced in the 2021 CMI analysis) will continue in the longer term and as such, the assumptions build in a level of longevity 'improvement' year on year in the future in line with the CMI 2021 projections and a long-term improvement trend of 1.75% per annum.

As an indication of impact, assumed life expectancies at age 65 are:

<b>Membership Category</b>	<b>Male Life Expectancy at 65</b>	<b>Female Life Expectancy at 65</b>
Pensioners	22.1	24.3
Actives aged 45 now	23.7	26.4
Deferreds aged 45 now	23.3	25.9

For example, a male pensioner, currently aged 65, would be expected to live to age 87.1. Whereas a male active member aged 45 would be expected to live until age 88.7. This is a reflection of the expected improvement in life expectancy over the next 20 years in the assumptions above.

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

### **Commutation**

It has been assumed that, on average, 75% of retiring members will take the maximum tax-free cash available at retirement. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up regardless of age.

### **Other Demographics**

Following an analysis of Fund experience carried out by the Fund Actuary, the incidence of ill health retirements, death before retirement, withdrawal rates and the proportions married/civil partnership has been reviewed. The outcome of this analysis is that the assumptions for death before retirement, withdrawal and the proportions married/civil partnership have been updated in line with the recommendations from the Actuary. The assumption for ill health retirements remains in line with the assumption adopted for the last valuation. In addition, no allowance will be made for the future take-up of the 50:50 option. Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate.

### **Expenses**

Expenses are met out of the Fund, in accordance with the Regulations. This is allowed for by adding 0.4% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

## **Discretionary Benefits**

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

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

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

As future accrual contributions are paid in respect of benefits built up in the future, the Primary Rate should take account of the market conditions applying at future dates, not just the date of the valuation and a slightly higher expected return from the investment strategy has been assumed. This reflects the future liabilities for which these contributions will be paid have a longer average duration than the past service liabilities as they relate to active members only, and therefore, these contributions will be invested for a longer period.

## **FINANCIAL ASSUMPTIONS – FUTURE ACCRUAL**

The financial assumptions in relation to future accrual of benefits are not specifically linked to investment conditions as at the valuation date itself, and the following overall assumed real discount rates apply for each investment pot:

### **Growth investment pot**

For employers in the Growth investment pot, the financial assumptions in relation to future service (i.e. the primary rate) are based on an overall assumed real discount rate of  $\{2.00\}$ % per annum above the long-term average assumption for consumer price inflation of  $\{3.10\}$ % per annum. This leads to a discount rate of  $\{5.10\}$ % per annum.

### **Medium investment pot**

For employers in the Medium investment pot, the financial assumptions in relation to future service (i.e. the primary rate) are based on an overall assumed real discount rate of  $\{1.75\}$ % per annum above the long-term average assumption for consumer price inflation of  $\{3.10\}$ % per annum. This leads to a discount rate of  $\{4.85\}$ % per annum.

### **Cautious investment pot**

For employers in the Cautious investment pot the discount rate at the valuation has been derived based on an assumed return of  $\{0.75\}$ % per annum above Gilt yields and a total discount rate of  $\{2.45\}$ % per annum.

## **EMPLOYER ASSET SHARES**

The Fund is a multi-employer pension Fund that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is

necessary to make some approximations in the timing of cashflows and allocation of investment returns when deriving the employer asset share.

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

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

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

**SUMMARY OF KEY WHOLE FUND ASSUMPTIONS USED FOR CALCULATING FUNDING TARGET AND COST OF FUTURE ACCRUAL (THE “PRIMARY RATE”) FOR THE 2022 ACTUARIAL VALUATION**

Long-term yields	
Market implied RPI inflation	[3.90]% p.a.
Solvency Funding Target financial assumptions	
Investment return/Discount Rate (Growth pot)	[4.60]% p.a.
Investment return/Discount Rate (Medium pot)	[4.35]% p.a.
Investment return/Discount Rate (Cautious pot)	[2.45]% p.a.
CPI price inflation	[3.10]% p.a.
Long Term Salary increases*	[4.60]% p.a.
Pension increases/indexation of CARE benefits	[3.10]% p.a.
Future service accrual financial assumptions	
Investment return/Discount Rate (Growth pot)	[5.10]% p.a.
Investment return/Discount Rate (Medium pot)	[4.85]% p.a.
Investment return/Discount Rate (Cautious pot)	[2.45]% p.a.
CPI price inflation	[3.10]% p.a.
Long Term Salary increases	[4.60]% p.a.
Pension increases/indexation of CARE benefits	[3.10]% p.a.

\*Short term salary increases may also apply, and each employer will be notified of this separately. Typically this is a total pay increase of [4]% p.a. until 31 March 2026.

### Life expectancy assumptions

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

<b>Current Status</b>	<b>Retirement Type</b>	<b>Mortality Table</b>
Annuitant	Normal health	106% S3PMA_CMI_2021 [1.75%]
Annuitant	Normal health	100% S3PFA_M_CMI_2021 [1.75%]
Annuitant	Dependant	129% S3PMA_CMI_2021 [1.75%]
Annuitant	Dependant	114% S3DFA_CMI_2021 [1.75%]
Annuitant	Ill health	134% S3IMA_CMI_2021 [1.75%]
Annuitant	Ill health	182% S3IFA_CMI_2021 [1.75%]
Annuitant	Future dependant	129% S3PMA_CMI_2021 [1.75%]
Annuitant	Future dependant	114% S3DFA_CMI_2021 [1.75%]
Active	Normal health	110% S3PMA_CMI_2021 [1.75%]
Active	Normal health	99% S3PFA_M_CMI_2021 [1.75%]
Active	Ill health	242% S3IMA_CMI_2021 [1.75%]
Active	Ill health	321% S3IFA_CMI_2021 [1.75%]
Deferred	All	117% S3PMA_CMI_2021 [1.75%]
Deferred	All	106% S3PFA_M_CMI_2021 [1.75%]
Active / Deferred	Future dependant	126% S3PMA_CMI_2021 [1.75%]
Active / Deferred	Future dependant	114% S3DFA_CMI_2021 [1.75%]

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

## Appendix B

### EMPLOYER DEFICIT RECOVERY CONTRIBUTIONS AND SURPLUS OFFSET PLANS

If the funding level of an employer is above or below 100% at the valuation date (i.e. the assets of the employer are more or less than the liabilities), an adjustment plan needs to be implemented such that the secondary contributions for each employer can be calculated. This adjustment plan requires a period over which to recover the deficit or run off any surplus i.e. the recovery period.

It is one of the Fund's key objectives that an employer will target 100% funding (e.g. full solvency) over an agreed period to maintain sustainability of contributions in the longer term subject to the affordability of the participating employers given other competing cost pressures, dependent on the Administering Authority's view of the employer's covenant and risk to the Fund. Based on the advice of the Actuary the assumptions and parameters in the FSS have been determined to try to achieve this but there is no guarantee that contributions will remain sustainable at future valuations. Employers therefore need to consider the balance between affordability of contributions in the short term and sustainability of contributions in the longer term (at subsequent actuarial valuations) in the context of their budgets now and in the future when determining the level of contributions. This could lead to an employer deciding to pay more than the minimum contributions determined under the FSS which would support future sustainability/stability of contributions at future valuations.

Deficit recovery contributions or surplus offsets will normally be expressed as £s amounts (with the exception of the Town and Parish Council's group where total contributions will be paid as a % of pensionable pay), and it is the Fund's objective that any funding deficit is eliminated within a timeframe determined by the Fund given its view on the participating employer's covenant and associated risk of delayed or non-payment to the Fund

Recovery periods will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. This will determine the minimum contribution requirement and employers will be free to select any shorter deficit recovery period and higher contributions if they wish, including the option of prepaying the deficit recovery contributions in one lump sum either on annual basis or a one-off payment.

The approach to the determination of recovery periods is summarised below:



If an employer is in deficit:

<b>Category</b>	<b>Default Recovery Period</b>	<b>Derivation</b>
Fund Employers	12 years	Determined by reducing the period from the preceding valuation by at least 3 years (where appropriate)
Open Admitted Bodies	12 years	Determined by reducing the period from the preceding valuation by at least 3 years
Closed Employers	Lower of 12 years and the future working lifetime of the membership, subject to a minimum of 3 years	Determined by reducing the period from the preceding valuation and the membership of the employer
Employers with a limited participation in the Fund	Determined on a case-by-case basis, subject to a minimum of 3 years	Length of expected period of participation in the Fund

If an employer is in surplus:

<b>Category</b>	<b>Default Recovery Period</b>	<b>Derivation</b>
Fund Employers	15 years	Determined as the same period adopted for the last valuation
Open Admitted Bodies	15 years	Determined as the same period adopted for the last valuation
Closed Employers	Higher of 15 years and the future working lifetime of the membership	Determined by the membership of the employer
Employers with a limited participation in the Fund	Determined on a case-by-case basis, subject to a minimum of 3 years	Length of expected period of participation in the Fund

In determining the actual recovery period to apply for any particular employer or employer grouping, the Fund may take into account some or all of the following factors:

- The size of the funding surplus or deficit,
- The business plans of the employer,
- The assessment of the financial covenant of the employer, and security of future income streams,
- Any contingent security available to the Fund or offered by the employer such as guarantor or bond arrangements, charge over assets, etc.

#### **OTHER FACTORS AFFECTING THE EMPLOYER DEFICIT RECOVERY CONTRIBUTIONS**

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

It is acknowledged by the Fund that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with affordability issues that could seriously affect their ability to function in the future. The Fund therefore may in some cases be willing to use its discretion to accept an evidence based affordable level of contributions for such organisations for the three years 2023/26. Any application of this option is at the ultimate discretion of the Fund officers and Section 151 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.

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

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

# Appendix C

## ADMISSION POLICY

### INTRODUCTION

This document details the Fund's policy on the methodology for assessment of ongoing contribution requirements and admissions into the Fund. It supplements the general policy of the Fund as set out in the FSS.

- Admission bodies are required to have an “admission agreement” with the Fund. In conjunction with the Regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.
- Scheme Employers have a statutory right to participate in the LGPS and their staff therefore can become members of the LGPS at any time, although some organisations (Part 2 Scheme Employers) do need to designate eligibility for its staff.

A list of all current employing bodies participating in the Fund is kept as a live document and will be updated by the Fund as bodies are admitted to or leave the Fund.

### ENTRY TO THE FUND

Unless agreed otherwise by the Fund, prior to admission to the Fund, an Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Fund. If the risk assessment and/or bond amount is not to the satisfaction of the Fund (as required under the LGPS Regulations) it will consider and determine whether the admission body must pre-fund for termination with contribution requirements assessed using the minimum risk methodology and assumptions. Some aspects that the Fund may consider when deciding whether to apply a minimum risk methodology are:

- Uncertainty over the security of the organisation's funding sources e.g. the body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves.
- If the admitted body has an expected limited lifespan of participation in the Fund.
- The average age of employees to be admitted and whether the admission is closed to new joiners.

In order to protect other Fund employers, where it has been considered undesirable to provide a bond, a guarantee must be sought in line with the LGPS Regulations.

At the discretion of the Fund, where an admission is in respect of 10 or less LGPS posts the Admitted Body will be admitted to the Fund on a 'Pass Through' basis where the Admitted Body's ongoing contribution requirements are agreed between the Letting Employer and the Admitted Body, without an individual contribution assessment being carried out.

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

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

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

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

### **LGPS REGULATIONS 2013: SCHEDULE 2 PART 3, PARA 8**

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

- (a) a person who funds the admission body in whole or in part;
- (b) in the case of an admission body falling within the description in paragraph 1(d), the Scheme employer referred to in that paragraph;
- (c) a body that is providing or will provide a service or assets in connection with the exercise of a function of a Scheme employer as a result of—
  - (i) the transfer of the service or assets by means of a contract or other arrangement,

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

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

(d) a person who—

(i) owns, or

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

(iii) which is a provider of probation services under section 3 of the Offender Management Act 2007 (power to make arrangements for the provision of probation services) or a person with whom such a provider has made arrangements under subsection (3)(c) of that section.

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

#### **ADMITTED BODIES PROVIDING A SERVICE**

Generally Admitted Bodies providing a service (including those admitted on a Pass-Through basis) will have a guarantor within the Fund that will stand behind the liabilities. Accordingly, in general, the minimum risk approach to funding and termination will not apply for these bodies.

As above, the Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Fund. This assessment would normally be based on advice in the form of a "risk assessment report" provided by the Fund Actuary. As the Scheme Employer is effectively the ultimate guarantor for these admissions to the Fund it must also be satisfied (along with the Fund) over the level (if any) of any bond requirement. Where bond agreements are to the satisfaction of the Fund, the level of the bond amount will be subject to review on a regular basis. In the case of an Admission Body admitted on a Pass-Through basis, the requirement to carry out an assessment of the level of risk on premature termination of the contract may be waived at the agreement of the Fund and the Letting Employer who act as guarantor to the Admission Body.

In the absence of any other specific agreement between the parties, deficit recovery periods for Admitted Bodies will be set in line with the Fund's general policy as set out in the FSS.

Any risk sharing arrangements agreed between the Scheme Employer and the Admitted Body will be documented in the commercial agreement between the two parties and not the admission agreement.

In the event of termination of the Admitted Body, any orphan liabilities in the Fund will be subsumed by the relevant Scheme Employer. Please see the Fund's Termination Policy for further details.

An exception to the above policy applies if the guarantor is not a participating employer within the Fund, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the Fund the Fund may in this case treat the admission body as pre-funding for termination, with contribution requirements assessed using the minimum risk methodology and assumptions.

## **PRE-FUNDING FOR TERMINATION**

An employing body may choose to pre-fund for termination i.e. to amend their funding approach to a minimum risk methodology and assumptions as detailed in the Fund's Termination Policy. This will substantially reduce the risk of an uncertain and potentially large exit payment being due to the Fund at termination. However, it is also likely to give rise to a substantial increase in contribution requirements, when assessed on the minimum risk basis.

For any employing bodies funding on such a minimum risk strategy a notional investment strategy will be assumed as a match to the liabilities. In particular, the employing body's notional asset share of the Fund will be credited with an investment return in line with the minimum risk funding assumptions adopted rather than the notional investment returns generated by the investment strategy for the employer's investment pot. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Fund or depending on any case specific circumstances.

## Appendix D

# Worcestershire Pension Fund



## **TERMINATION POLICY, FLEXIBILITIES FOR EXIT PAYMENTS AND DEFERRED DEBT AGREEMENTS**

### **INTRODUCTION**

This document details the Fund's policy on the methodology for assessment of exit payments in the event of the cessation of an employer's participation in the Fund, spreading exit payments and Deferred Debt Agreements (DDA). It supplements the general policy of the Fund as set out in the FSS.

This methodology will be reviewed on a regular basis, in light of changes in market conditions and any review of fiscal or monetary policy by the Government or Bank of England.

### **TERMINATION OF AN EMPLOYER'S PARTICIPATION**

Unless entering a DDA or where a Suspension Notice has been issued as the exiting employer is likely to have active members again within three years, an employer ceases to participate within the Fund when the last active member leaves the Fund. This includes where the employer ceases to be eligible for membership e.g. a contract with a local authority comes to an end or the employer chooses to voluntarily cease participation.

When an employing body ceases to participate within the Fund for any reason, employees may transfer their past service benefits to another employer, either within the Fund or elsewhere. If this does not happen the employees will retain pension rights i.e. either deferred benefits or immediate retirement benefits within the Fund.

The Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members except where there is a complete transfer of responsibility to another Fund or elsewhere.

### **TERMINATION ASSESSMENTS**

When an employing body ceases to participate within the Fund, the employer becomes an exiting employer under the Regulations and the Fund is then required to obtain an



actuarial valuation of liabilities in respect of the exiting employer's current and former employees along with a termination contribution certificate (a **termination assessment**). Any costs associated with the termination assessment will be payable by the exiting employer and will either be invoiced to the employer (or guarantor as appropriate) by the Fund or included by increasing the exit payment / reducing the exit credit by the appropriate amount.

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

If the exiting employer (including those admitted on a Pass-Through basis) has a guarantor within the Fund or a successor body exists to take over the exiting employer's liabilities, the Fund's policy is that the valuation funding basis will be used for the termination assessment unless the guarantor informs the Fund otherwise. The costs associated with the termination assessment will be charged directly to the exiting employer unless the guarantor directs otherwise.

The amount of exit payment which the exiting employer is required to pay (if any) will be determined in accordance with the commercial agreement.

The residual assets and liabilities, and hence any surplus or deficit will normally transfer back to the guarantor of the exiting employer. (For Admission Bodies, this process is sometimes known as the "novation" of the admission agreement.) This may, if agreed by the guarantor, constitute a complete amalgamation of assets and liabilities with those of the guarantor.

In circumstances where an exiting employer is expected to still be responsible for all or part of an exit payment, an exit credit may not be payable to the exiting employer. This is subject to representation by all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor, in particular any 'risk-sharing' agreements that may exist. In line with the amending Regulations (**The Local Government Pension Scheme (Amendment) Regulations 2020**) the parties will need to make representation to the Fund if they believe an exit credit should be paid outside the policy set out above, or if they dispute the determination of the Fund.

The information required by the Fund from an exiting employer to exercise its discretion on whether an exit credit should be paid where a guarantee or risk sharing arrangement is in place, and a representation has been made, will be supplied to the interested parties at the appropriate time. A determination notice will be provided alongside the termination assessment from the Fund Actuary. The notice will cover the following information and process steps:

- 1) Details of the employers involved in the process (e.g. the exiting employer and guarantor).
- 2) Details of the admission agreement, commercial contracts and any amendments to the terms that have been made available to the Administering Authority and considered as part of the decision-making process. A key factor will whether an employer is responsible for a deficit. This is subject to the information provided

and any risk sharing arrangements in place, as well as all other factors that the Administering Authority considers relevant.

- 3) The final termination certification of the exit credit by the Fund Actuary.
- 4) The Administering Authority's determination based on the information provided and all other relevant factors.
- 5) Details of the appeals process in the event that a party disagrees with the determination and wishes to make representations to the Administering Authority.

Further information on the process for making a formal representation is available in the Fund's "Making a formal representation for an exit credit payment" document.

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

A termination assessment will be made based on a minimum risk funding basis. This is to protect the other employers in the Fund as, at termination, the employing body's liabilities will become orphan liabilities within the Fund, and there will be no recourse to it if a deficit emerges in the future (after participation has terminated).

- In the case of a surplus, the Fund pays any exit credit to the exiting employer following completion of the termination process (within 6 months of completion of the cessation assessment by the Fund Actuary).
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Fund at their sole discretion) following completion of the termination process.

The Fund can vary the treatment on a case-by-case basis at its sole discretion if circumstances warrant it taking into account the advice of the Fund Actuary.

The Fund currently groups Town and Parish Councils for contribution rate setting purposes. The Fund's policy is that, on termination of participation within the group, the termination assessment will be based on a simplified share of deficit/surplus approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit/surplus share as at the last actuarial valuation of the Fund, in proportion to the respective payrolls for the body and the group as a whole, and then adjusting to the date of exit. The share of deficit/surplus will be assessed based on the ongoing valuation funding basis for the group as a whole at the last actuarial valuation. The adjustment to the date of exit will normally be made in line with the funding assumptions adopted for the group as at the last actuarial valuation unless the Fund Actuary and Fund consider that the circumstances warrant a different treatment, for example, to allow for actual investment returns over the period from the last actuarial valuation to exit.

In addition, for some Multi-Academy Trusts (MAT), a grouped approach has been taken with individual academies within a Trust no longer being separately identifiable on the Fund's administration system or for funding or contribution purposes. On termination of participation of one of the academies within such a MAT, the termination assessment will be based on a simplified share of deficit/surplus approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit/surplus share as at the

last actuarial valuation of the Fund, in proportion to the respective payrolls for the employees of the exiting academy and the MAT as a whole, and then adjusting to the date of exit. The share of deficit/surplus will be assessed based on the ongoing valuation funding basis for the MAT as a whole at the last actuarial valuation. The adjustment to the date of exit will normally be made in line with the funding assumptions adopted for the MAT as at the last actuarial valuation unless the Fund Actuary and Fund consider that the circumstances warrant a different treatment, for example, to allow for actual investment returns over the period from the last actuarial valuation to exit.

Unless agreed otherwise by the Fund, any unfunded liability that cannot be reclaimed from the outgoing grouped body will be underwritten by the group/MAT and not all employers in the Fund. Following termination, the residual liabilities and assets in respect of that body will be subsumed by any guarantor body for the group, or in the absence of a guarantor, subsumed by the group/MAT.

Any costs associated with the termination assessment will be payable by the exiting employer and will either be invoiced to the employer by the Fund or included by increasing the exit payment / reducing the exit credit by the appropriate amount.

It is possible under certain circumstances that an employer can apply to transfer all assets and current and former employees' benefits to another LGPS Fund in England and Wales. In these cases, no termination assessment is required as there will no longer be any employer liabilities in the Fund. Therefore, a separate assessment of the assets to be transferred will be required. Any costs associated with the asset transfer will be payable by the exiting employer and will be invoiced to the employer by the Fund.

### **Allowing for the McCloud Judgment in termination valuations**

The Government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. When assessing a termination position a reasonable estimate for the potential cost of McCloud will be included within the termination assessment.

The allowance will be calculated in line with the treatment set out in the Funding Strategy Statement for all members of the outgoing employer using the termination assessment assumptions. For the avoidance of doubt, there will be no recourse for an employer with regard to McCloud once the final termination has been settled and payments have been made.

## **FUTURE TERMINATIONS**

In many cases, termination of an employer's participation is an event that can be foreseen, for example, because the organisation's operations may be planned to be discontinued and/or the admission agreement is due to cease. Under the Regulations, in the event of the Fund becoming aware of such circumstances, it can amend an employer's minimum contributions such that the value of the assets of the employing body is neither materially more nor materially less than its anticipated liabilities at the date it appears to the Fund that it will cease to be a participating employer. In this case, employing bodies are encouraged

to open a dialogue with the Fund to commence planning for the termination as early as possible. Where termination is disclosed in advance the Fund will operate procedures to reduce the sizeable volatility risks to the debt amount in the run up to actual termination of participation. For example, on agreement with the employer, by moving the employer to a lower risk funding basis or a notional minimum risk funding basis. The Fund will modify the employing body's approach in any case, where it might materially affect the finances of the Fund, or depending on any case specific circumstances.

## MINIMUM RISK TERMINATION BASIS

The minimum risk financial assumptions that applied at the actuarial valuation date (31 March 2022) are set out below in relation to any liability remaining in the Fund. These will be updated on a case-by-case basis, with reference to prevailing market conditions at the relevant employing body's cessation date.

Minimum risk assumptions	31 March 2022
Discount Rate	1.70% p.a.
CPI inflation	{3.10}% p.a.
Pension increases/indexation of CARE benefits	{3.10}% p.a.

These financial assumptions will be reviewed ~~on an ongoing basis to allow for changes in market conditions along with any structural or legislative changes and any review in fiscal or monetary policy by the Government or the Bank of England~~ from time to time (see [below](#)).

All demographic assumptions will typically be the same as those adopted for the 2022 actuarial valuation, except in relation to the life expectancy assumption. Given the minimum risk financial assumptions do not protect against future adverse demographic experience a higher level of prudence will be adopted in the life expectancy assumption. This will be ~~reviewed~~ considered from time to time to allow for any material changes in life expectancy trends and will be formally reassessed at the next valuation.

The termination basis for an outgoing employer will include an adjustment to the assumption for longevity improvements over time by increasing the rate of improvement in mortality rates to 2.25% p.a. from 1.75% used in the 2022 valuation for ongoing funding and contribution purposes.

## REVIEW OF THE TERMINATION POLICY

As set out above, for employers without a guarantor, the financial assumptions are currently related to the yields on Government debt (known as Gilts) adjusted based on actuarial advice. The principle of the termination policy and the assumptions used is to ensure (as far as possible) there is sufficient monies to pay all the benefits due in relation to the "orphan" members of the outgoing employer as otherwise the remaining

employers would later have to fund this via their contributions at subsequent valuations. This is why the Fund take a more cautious view as set out in this policy. For other employers the policy is to use the appropriate ongoing funding assumptions if the orphaned liabilities are to be wholly subsumed by a guarantor in the Fund (once any exit payment is paid to/from the employer depending on the circumstances).

The policy and assumptions will be reviewed as a matter of course at each actuarial valuation but will also be reviewed regularly or in times of extreme events, such as a material shift in market conditions or shift in economic/fiscal policy, which will affect the assets or liabilities of the exiting employer. This is to ensure that the approach remains appropriate, given the risk associated with funding the orphaned liabilities left behind by an exiting employer is being passed to other Fund employers, and ultimately the tax payer. This means that the assumptions (both financial and demographic) can be changed if circumstances warrant it and this could mean that the discount rate may not be linked to the market yield on gilts in future or that the inflation assumption is further adjusted. An exiting employer would be informed of any change (and the rationale for the change) and the policy would be updated from time to time.

## **POLICY IN RELATION TO SPREADING EXIT PAYMENTS AND DEFERRED DEBT PAYMENTS (DDA)**

The Fund's policy for spreading exit payments (referred to as payment plans) is as follows:

- 1) The default position is for exit payments to be paid immediately in full (adjusted for interest where appropriate) unless there is a risk sharing arrangement in place with a guaranteeing employer in the Fund whereby the exiting employer is not responsible for any exit payment. In the case of an exit credit the determination process set out above will be followed.
- 2) Exit payment spreading and DDAs will always be discussed with employers, whether at the employer's request or not. However, spreading an exit payment, or a DDA will only be agreed at the discretion of the Administering Authority, subject to the policy in this Appendix.

If an employer wants the Fund to agree to spread an exit payment or a DDA, they must make a request in writing covering the reasons for such a request. The Administering Authority will assess whether the full exit payment is affordable, and whether it is in the interest of the Fund to adopt either of the approaches. In making this assessment the Administering Authority will consider the covenant of the employer and also whether any security is required and available to back the arrangements (see further below).

Any costs (including necessary actuarial, legal and covenant advice) associated with assessing this will be borne by the employer and will be invoiced to the employer by the Fund or added to the contribution plan (for a DDA) or exit payment (where the exit payment is to be spread).

The following policy and processes will be followed in line with the principles set out in the [statutory guidance](#) dated 2 March 2021.

## **POLICY FOR SPREADING EXIT PAYMENTS**

The following process will determine whether an employer is eligible to spread their exit payment over a defined period.

- 1) The Administering Authority will request updated financial information from the exiting employer including management accounts showing expected financial progression of the organisation and any other relevant information to use as part of their covenant review. If this information is not provided, then the default policy of immediate payment will apply.
- 2) Once this information has been provided, the Administering Authority (in conjunction with the Fund Actuary, covenant and legal advisors where necessary) will review the covenant of the employer to determine whether it is in the interests of the Fund to allow them to spread the exit payment over a period of time. Depending on the length of the period and also the amount of the exit payment, the Fund may request security to support the payment plan before entering into an agreement to spread the exit payment.
- 3) The payment plan could include non-uniform payments e.g. a lump sum up front followed by a series of payments over the agreed period. The payments required will include allowance for interest on late payment.
- 4) The initial process to determine whether an exit payment should be spread may take up to 6 months from receipt of data, so it is important that employers who request to spread exit payment notify the Fund in good time.
- 5) If it is agreed that the exit payment can be spread then the Administering Authority will engage with the exiting employer regarding the following:
  - a) The spreading period that will be adopted (this will be subject to a maximum of 5 years).
  - b) The initial and annual payments due and how these will change over the period
  - c) The interest rates applicable and the costs associated with the payment plan devised.
  - d) The level of security required to support the payment plan (if any) and the form of that security e.g. bond, escrow account, etc.
  - e) The responsibilities of the exiting employer during the exit payment spreading period including the supply of updated information and events which would trigger a review of the situation.
  - f) The views of the Fund Actuary, covenant, legal and any other specialists necessary
  - g) The covenant information that will be required on a regular basis to allow the payment plan to continue.
  - h) Under what circumstances the payment plan may be reviewed or immediate payment requested (e.g. where there has been a significant change in covenant or circumstances).

- 6) Note that proposed exit payment spreading will always be discussed with the employer, whether at the employer's request or not. Once the Administering Authority has reached its decision, the arrangement (where applicable) will be documented, and any supporting agreements will be included.

## DEFERRED DEBT ARRANGEMENT

As opposed to paying the exit payment (immediately or spread over an agreed period of time) an employer may request to utilise the "Deferred Debt Agreement" (DDA) facility at the sole discretion of the Administering Authority. This would be at the request of the employer in writing to the Administering Authority. An employer who enters into a DDA will continue to participate in the Fund with no contributing members.

The following process will determine whether the Fund will agree to enter into a DDA:

- 1) The Administering Authority will request updated financial information from the employer including management accounts showing expected financial progression of the organisation. If this information is not provided, then a DDA will not be entered into by the Administering Authority.
- 2) Once this information has been provided, the Administering Authority will firstly consider whether it would be in the best interests of the Fund and employers to enter into such an arrangement with the employer. This decision will be based on a covenant review of the employer to determine whether the exit payment that would be required if the arrangement was not entered into is affordable at that time (based on advice from the Fund Actuary, covenant and legal advisor where necessary).
- 3) The initial process to determine whether a DDA should apply may take up to 6 months from receipt of the required information so an employer who wishes to request that the Administering Authority enters into such an arrangement needs to make the request in advance of the potential exit date.
- 4) If the Administering Authority's assessment confirms that the potential exit payment is not affordable, the Administering Authority will engage in discussions with the employer about the potential format of a DDA using the template Fund agreement which will be based on the principles set out in the Scheme Advisory Board's separate [guide](#). As part of this, the following will be considered:
  - What security the employer can offer whilst the employer remains in the Fund. In general, the Administering Authority won't enter into a DDA unless they are confident that the employer can support the arrangement on an ongoing basis. Provision of security may also result in a review of the recovery plan and other funding arrangements.
  - The investment strategy that would be applied to the employer e.g. the growth, medium or cautious pot strategy which could support the arrangement.



- Whether an upfront cash payment should be made to the Fund initially to reduce the potential future exit payment.
- What the updated Secondary rate of contributions would be required up to the next valuation.
- The financial information that will be required on a regular basis to allow the employer to remain in the Fund and any other monitoring that will be required.
- The advice of the Fund Actuary, covenant, legal and any other specialists necessary.
- The responsibilities that would apply to the employer while they remain in the Fund.
- What conditions would trigger the implementation of a revised deficit recovery plan and subsequent revision to the Secondary rate of contributions (e.g. provision of security).
- The circumstances that would trigger a variation in the length of the DDA (if appropriate), including a cessation of the arrangement e.g. where the ability to pay contributions has weakened materially or is likely to weaken in the next 12 months. Where an agreement ceases an exit payment (or credit) could become payable. Potential triggers may be the removal of any security or a significant change in covenant assessed as part of the regular monitoring.
- Under what circumstances the employer may be able to vary the arrangement e.g. a further cash payment or change in security underpinning the agreement.

The Administering Authority will make a final decision on whether it is in the best interests of the Fund to enter into a DDA with the employer and confirm the terms that are required.

- 5) For employers that are successful in entering into a DDA, contribution requirements will continue to be reviewed as part of each actuarial valuation or in line with the DDA in the interim if any of the agreed triggers are met.
- 6) The costs associated with the advice sought and drafting of the DDA will be borne by the employer and will be invoiced to the employer by the Fund or included in the contribution plan (depending on the circumstances).

# Appendix E

## COVENANT ASSESSMENT AND MONITORING POLICY

An employer's covenant underpins its legal obligation and ability to meet its financial responsibilities now and in the future. The strength of covenant depends upon the robustness of the legal agreements in place and the likelihood that the employer can meet them. The covenant effectively underwrites the risks to which the Fund is exposed, including underfunding, longevity, investment and market forces.

An assessment of employer covenant focuses on determining the following:

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

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

## RISK CRITERIA

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

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

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

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

## **ASSESSING EMPLOYER COVENANT**

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

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

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

## **FREQUENCY OF MONITORING**

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

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

## **COVENANT RISK MANAGEMENT**

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

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

## Appendix F

# Worcestershire Pension Fund



### INVESTMENT POT RISK MANAGEMENT POLICY

In the context of managing aspects of the Fund's financial risks, the Fund has implemented a range of "investment" pots for employers (with effect from 1 April 2020) which exhibit different levels of investment risk based on alternative underlying investment strategies. The three available investment pots are called:

- The Growth pot;
- The Medium pot; and
- The Cautious pot

This strategy will be reviewed periodically as part of the governance of the Fund's overall risk management framework. This policy should be considered alongside the Fund's Covenant Assessment and Monitoring Policy

### INVESTMENT STRATEGIES

The current Fund investment strategy will apply to the "Growth pot". The "Medium pot" and "Cautious pot" will provide reduced levels of investment risk, which may be appropriate particularly for those employers that are considering leaving the Fund.

The strategic allocation for the Fund as a whole and for each of the investment pots is set out in the Investment Strategy Statement.

The investment strategy underlying each investment pot will be reviewed formally at each actuarial valuation along with the overall Fund investment strategy. This will also allow for any movements of employers between the investment pots due to changes in funding position, covenant and also at the request of an employer.

In addition, a high-level health check will be performed annually allowing for market changes and outlook as well as underlying changes in the maturity and profile of the liabilities of the employers within each pot. However, a formal review may be undertaken

mid-valuation if there is a material shift of employers between pots and/or material shift in the funding position in order to more efficiently manage the overall risk.

The investment pots will be managed within the overall Fund investment strategy as far as possible. If any investment options are unavailable, and are deemed to be desirable, then the Fund will consider obtaining access to these options through the LGPS Central Limited pool or potentially directly.

## **EMPLOYER ALLOCATIONS**

The allocations of employers to investment pots will be reviewed in detail alongside the actuarial valuation every 3 years. The Fund will take into account the following employer factors when considering overall risk and allocating an employer to a specific pot:

- Employer type e.g. tax raising body, academy, admitted body.
- Employer ongoing covenant strength incl. any guarantee or security.
- Employer size, maturity and funding position.
- Employer status e.g. open/closed to new members and objectives.

If, based on a covenant assessment carried out by the Fund, an employer is deemed to have a weak covenant, or is expected to exit the Fund in the near future, the Fund reserves the right to move an employer (typically following discussions with that employer) into either the Medium or Cautious investment pot to provide some protection against deterioration in funding position for the employer and the Fund as a whole. Any orphaned liabilities, once an employer exits the Fund, will generally be automatically moved into the Cautious investment pot as these liabilities have no sponsoring employer and are ultimately underwritten by all employers within the Fund.

As part of a triennial valuation, any employer can elect to move to a lower risk investment strategy to reduce their level of investment risk exposure and the potential volatility in their future funding position.

The choice of investment pot will be reflected in each employer's asset share, funding basis and contribution requirements. It dictates the financial assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is determined based on the notional investment strategy for the relevant investment pot's investment strategy. This is expressed as an expected return over CPI for the Growth and Medium pots and as an expected return of Gilt yields for the Cautious pot.

The above employer factors will be monitored regularly between actuarial valuations and the allocation to a specific investment pot may be reviewed between actuarial valuations in the following circumstances:

- Material change in certain types of employers' funding position
- Material change in an employer's status or covenant

- Request from an employer to move investment pots, subject to the agreement of the Fund.

## Appendix G

# Worcestershire Pension Fund



### REVIEW OF EMPLOYER CONTRIBUTIONS BETWEEN VALUATIONS

In line with the Regulations that came into force on 23rd September 2020, the Administering Authority has the ability to review employer contributions between valuations. The Administering Authority and employers now have the following flexibilities:

- 1) The Administering Authority may review the contributions of an employer where it appears likely to the Administering Authority that there has been a significant change to the liabilities of an employer.
- 2) The Administering Authority may review the contributions of an employer where it appears likely to the Administering Authority that there has been a significant change in the employer's covenant.
- 3) An employer may request a review of contributions from the Administering Authority if they feel that either point 1 or point 2 applies to them. The employer would be required to pay the costs of any review following completion of the calculations and is only permitted to make a maximum of two requests between actuarial valuation dates (except in exceptional circumstances and at the sole discretion of the Administering Authority).

Where the funding position for an employer significantly changes solely due to a change in assets (or changes in actuarial assumptions), the Regulations do not allow employer contributions to be reviewed outside of a full valuation. However, changes in assets would be taken into account when considering if an employer can support its obligations to the Fund after a significant covenant change (see 2. above).

The Administering Authority will consult with the employer prior to undertaking a review of their contributions including setting out the reason for triggering the review.

For the avoidance of doubt, any review of contributions may result in no change and a continuation of contributions as per the latest actuarial valuation assessment. In the normal course of events, a contribution review would not be undertaken close to next actuarial valuation date, except in exceptional circumstances. For example:

- A contribution review due to a change in membership profile would not be undertaken in the 6 months leading up to the next valuation Rates and Adjustments Certificate.
- However, where there has been a material change in covenant, a review will be considered on a case-by-case basis to determine if a contribution review should take place and when any contribution change would be implemented. This will take into account the proximity of the actuarial valuation and the implementation of the contributions from that valuation.

## **SITUATIONS WHERE CONTRIBUTIONS MAY BE REVIEWED**

Contributions may be reviewed if any of the following scenarios appear likely to the Administering Authority. Employers will be notified if this is the case.

Consideration will also be given to the impact that any employer changes may have on the other employers and on the Fund as a whole, when deciding whether to proceed with a contribution review.

### **1) Significant changes in the employer's liabilities**

This includes but is not limited to the following scenarios:

- a) Significant changes to the employer's membership which will have a material impact on their liabilities, such as:
  - i. Restructuring of an employer
  - ii. A significant outsourcing or transfer of staff to another employer (not necessarily within the Fund)
  - iii. A bulk transfer into or out of the employer
  - iv. Other significant changes to the membership for example due to redundancies, significant salary awards, ill health retirements (for employers not using ill-health liability insurance) or, large numbers of withdrawals

In terms of assessing the triggers under a) above, the Administering Authority will only consider a review if the change in liabilities is expected to be more than 5% of the total of the employer's liabilities at the previous triennial funding valuation.

{Any review of the contributions will normally only take into account the impact of the change in liabilities (including, if relevant, any underfunding in relation to pension strain costs) both in terms of the Primary and Secondary rate of contributions}.



## 2) Significant changes in the employer's covenant

This includes but is not limited to the following scenarios:

- a) Provision of, or removal of, or impairment of, security, bond, guarantee or some other form of indemnity by an employer against their obligations in the Fund. For the avoidance of doubt, this includes provision of security to any other pension arrangement which may impair the security provided to the Fund.
- b) Material change in an employer's immediate financial strength or longer-term financial outlook (evidence should be available to justify this) including where an employer ceases to operate or becomes insolvent.
- c) The Fund becoming (or ceasing to be) subordinate behind other creditors of the employer such as banks or other pension funds.
- d) Where an employer exhibits behaviour that suggests a change in their ability and/or willingness to pay contributions to the Fund.

In some instances, a change in the liabilities will also result in a change in an employer's ability to meet its obligations.

Whilst in most cases the regular covenant updates requested by the Administering Authority will identify some of these changes, in some circumstances employers will be required to agree to notify the Administering Authority of any material changes. Where this applies, employers will be notified separately, and the Administering Authority will set out the requirements (an example of the notifiable events framework is set out in Appendix H).

Additional information will be sought from the employer in order to determine whether a contribution review is necessary. This may include annual accounts, budgets, forecasts and any specific details of restructure plans. Note that employers are required to support any reasonable information request to allow the Fund to effectively monitor changes in covenant. As part of this, the Administering Authority will take advice from the Fund Actuary, covenant, legal and any other specialist adviser.

In this instance, any review of the contributions would include consideration of the updated funding position both on an ongoing and termination basis (if applicable) and would usually allow for changes in asset values when considering if the employer can meet its obligations on both an ongoing and termination basis (if applicable). This could then lead to the following actions (see further comments below):

- The contributions changing or staying the same depending on the conclusion and/or;
- Security to improve the covenant to the Fund and/or;
- If appropriate, a change in the investment strategy for the employer.

## **PROCESS AND POTENTIAL OUTCOMES OF A CONTRIBUTION REVIEW**

Where one of the listed events occurs, the Administering Authority will enter into discussion with the employer to clarify details of the event and any intention to review contributions. Additional information will be sought from the employer in order to determine whether a contribution review is necessary. This may include annual accounts, budgets, forecasts and any specific details of an employer's restructuring plans. Ultimately, the decision to review contributions as a result of the above events rests with the Administering Authority after, if necessary, taking advice from their Fund Actuary, legal or a covenant specialist advisors.

This also applies where an employer notifies the Administering Authority of the event and requests a review of the contributions. The employer will be required to agree to meet any professional and/or administration costs associated with the review. The employer will be required to outline the rationale and case for the review through a suitable exchange of information prior to consideration by the Administering Authority.

The Administering Authority will consider whether it is appropriate to use updated membership data within the review (e.g. where the change in membership data is expected to have a material impact on the outcome) and whether any supporting information is required from the employer.

As well as revisiting the employer's contributions, as part of the review it is possible that other parts of the funding strategy will also be reviewed where the covenant of the employer has changed, for example the Fund will consider:

- Whether the employer's investment strategy remains appropriate or whether they should move to an alternative strategy (e.g. the Growth pot, Medium pot or Cautious pot) in line with the Funding Strategy Statement.
- Whether the Primary contribution rate should be adjusted to allow for any profile change and/or investment strategy change.
- Whether the Secondary contribution rate should be adjusted including whether the length of the deficit recovery period adopted at the previous valuation remains appropriate. The remaining deficit recovery period from the last valuation would be the maximum period adopted (except in exceptional and justifiable circumstances and at the sole discretion of the Administering Authority on the advice of the Fund Actuary).

The review of contributions may take up to 3 months from the date of confirmation to the employer that the review is taking place, in order to collate the necessary data.

Any change to an employer's contributions will be implemented at a date agreed between the employer and the Fund. The Schedule to the Rates and Adjustment Certificate at the last valuation will be updated for any contribution changes. As part

of the process the Administering Authority will consider whether it is appropriate to consult any other Fund employers prior to implementing the revised contributions. Circumstances where the Administering Authority may consider it appropriate to do so include where there is another employer acting as guarantor, then the guarantor would be consulted as part of the contribution review process.

The Administering Authority will agree a proportionate process for periodical ongoing monitoring and review following the implementation of the revised contributions. The Employer will be required to provide information to the Fund to support this, which will depend in part of the reasons for triggering the contribution review. This may, for example, be for an employer to be made to confirm annually that there has been no change to their circumstances that would have a detrimental impact on their covenant and in the interim, should any such change occur, the expectation is that they inform the Fund immediately, in line with the notification requirements in the above section.

## Appendix H

# Worcestershire Pension Fund



### NOTIFIABLE EVENTS FRAMEWORK

The Fund regularly monitors the covenant of its employers. Whilst in most cases the regular covenant updates will identify some of the key employer changes, in some circumstances, employers are required to notify the Administering Authority of any material changes. This is in keeping with the guide that The Scheme Advisory Board recently published ('A Guide for Administering Authorities') in which is recommended that Administering Authorities should include a notifiable events process within its policies.

It is considered to be in the best interests of the employer to inform the Fund of any notifiable events that occur. This will enable the Fund to work with the employer to find an effective solution, particularly in times of change or financial distress and keep the interests of the employer, the Fund, the members and a guarantor (if one exists) in mind. Early engagement is always more effective and efficient for all parties than retrospective steps.

By not informing the Fund of a notifiable event, it may be seen as a deliberate act to hide the information or delay the Fund from taking action. If the Fund becomes aware of an event that has not been openly communicated as part of this policy, they reserve the right to implement one or more of the actions set out below without the consent of the employer.

In the case of guaranteed employers this policy applies to both the employer and the guarantor.

A notifiable event is any event or circumstance that, in the judgement of the Fund, could materially affect one or more of the following:

- the employer's basis for continued participation in the Fund
- the employer's ability to pay its ongoing contributions to the Fund\*
- the employer's ability to pay its termination debt to the Fund in the event of ceasing to participate in the Fund\*

\* These conditions would also apply where an employer and the Fund has entered into a Deferred Debt Agreement allowing continued participation as a Deferred Employer with no contributing members.

This policy sets out a list of typical events that, if they apply, must be notified to the Fund within a reasonable time period. The list is not exhaustive and may be modified from time to time. The Fund would deem 10 working days to be reasonable in the majority of cases. In some cases, notification prior to the event occurring may be required and this is detailed within the relevant sections below. The Fund will ensure that all information is treated as confidential.

## **EVENTS THAT MUST BE NOTIFIED TO THE FUND**

The Fund considers any change that would be detrimental to either the employer's ability to finance their pension obligations or the ongoing viability of the employer to be 'material' and 'significant'.

Typical events that must be notified to the Fund include the following:

### **1) Significant changes in the employer's membership / liabilities**

This includes but is not limited to the following scenarios, where applicable:

- a) Significant changes to the employer's membership which will have a material impact on their liabilities, such as:
  - i. Restructuring of the employer involving significant changes in staffing
  - ii. A significant outsourcing or transfer of staff to another employer (not necessarily within the Fund)\*
  - iii. A bulk transfer of staff into the employer, or out of the employer to another pension scheme\*
  - iv. Other significant changes to the membership for example due to redundancies, significant salary awards, ill health retirements or large a number of member withdrawals\*
  - v. A decision which will restrict the employer's active membership in the future\*
- b) Two or more employers merging including insourcing and transferring of services\*
- c) The separation of an employer into two or more individual employers\*
- d) Concerns of fraudulent activity that may include pensions aspects

\*In these examples, the Fund requires prior notification of events at least 14 days before commencement of staff consultation regarding proposed changes to members' pensions. The Fund will ensure that all information is treated as confidential.

### **2) Significant changes to the employer covenant**

- i. Significant changes in the employer's financial strength / security

A material change in an employer's immediate financial strength or longer-term financial outlook. This includes but is not limited to the following scenarios (where applicable):

- a. An employer's forecasts indicate reduced affordability of contributions.
- b. A significant reduction in funding (e.g. reduction in grants, central government funding or other income stream)

- c. Provision of security to any other party including lenders and alternative pension arrangements
- d. Impairment of security, bond or guarantee provided by an employer to the Fund against their obligations
- e. The sale or transfer of significant assets, where the net book value or sale value exceeds 10% of the employer's net assets
- f. A material increase in gearing (i.e. taking on additional debt in order to finance its operations)
- g. The employer has defaulted on payments
- h. There has been a breach of banking (or other) covenant or the employer has agreed a waiver with the lender
- i. The employer's officers are seeking legal advice in the context of continuing to trade and/or potential wrongful trading
- j. An employer becomes insolvent

ii. A change in the employer's circumstances

This includes but is not limited to the following scenarios, where applicable:

- a. A merger of the employer with another organisation
- b. An acquisition by the employer of another organisation or relinquishing control
- c. An employer commences the wind down of its operations or ceases to trade
- d. A material change in the employer's business model
- e. A change in the employer's legal status (to include matters which might change qualification as a scheme employer under the LGPS Regulations)
- f. The employer becoming aware of material suspected / actual fraud or financial irregularity
- g. The employer becoming aware of material legal or court action against them
- h. There has been suspension or conviction of senior personnel
- i. Regulatory investigation and/or sanction by other regulators
- j. Loss of accreditation by a professional, statutory or regulatory body

In the examples set out above, the Fund requires prior notification of these events (e.g. at the time that there has been a decision in principle rather than once the event has happened). The Fund will ensure that all information is treated as confidential.

### **WHAT INFORMATION SHOULD BE PROVIDED TO THE FUND?**

The information required will vary depending on the situation that has arisen. The first step will be to email or call the Fund to notify them of the event that has occurred.

## **WHAT ACTION WILL THE FUND TAKE ONCE NOTIFIED?**

Where one of the listed events occurs, the Fund will enter into discussion with the employer to clarify details of the event. If necessary, advice will be taken from the Fund Actuary, legal or a covenant specialist advisors. Depending on the outcome of the Fund's review of the situation, potential actions that may be taken as a result are as follows:

- a. No further action required
- b. More detailed request for further information and ongoing monitoring
- c. The Fund will review the documentation provided and respond on next steps
- d. A review of employer contributions
- e. A review of the recovery period used to calculate secondary contributions
- f. A review of the employer's investment bucket
- g. A review of the termination position and discussions with the employer as to how this may be addressed
- h. A review of any deferred debt agreements if applicable

Employers will kept informed of all steps throughout the process.

# Appendix I

## GLOSSARY

### **50/50 Scheme:**

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

### **Actuarial valuation:**

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

### **Administering Authority:**

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

### **Admission bodies:**

A specific type of employer under the “LGPS” who do not automatically qualify for participation in the Fund but are allowed to join if they satisfy the relevant criteria set out in the Regulations.

### **Benchmark:**

A measure against which fund performance is to be judged.

### **Best estimate assumption:**

An assumption where the outcome has a 50/50 chance of being achieved.

### **Bonds:**

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

### **Career average revalued earnings scheme (CARE):**

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



**Cautious investment pot:**

An investment strategy linked to income generating assets which target a minimum return above gilt yields, allowing for default, reinvestment risk and any other reasonable margins of prudence deemed appropriate.

**Contingent assets:**

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

**Covenant:**

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

**CPI:**

Acronym standing for "Consumer Prices Index". CPI is a measure of inflation with a basket of goods that is assessed on an annual basis. The reference goods and services differ from those of RPI. These goods are expected to provide lower, less volatile inflation increases. Pension increases in the LGPS have been linked to the annual change in CPI since April 2011.

**CPIH:**

An alternative measure of CPI which includes owner occupiers' housing costs and Council Tax (which are excluded from CPI).

**Deferred Debt Agreement (DDA):**

A written agreement between the Administering Authority and an exiting Fund employer for that employer to defer their obligation to make an exit payment and continue to make contributions at the assessed Secondary rate until the termination of the DDA

**Deficit:**

The extent to which the value of the Fund's past service liabilities exceeds the value of the Fund's assets. This relates to assets and liabilities built up to date and ignores the future build-up of pension (which in effect is assumed to be met by future contributions). The deficit in relation to an employer is the extent to which the value of the past service liabilities for which the employer is liable exceeds the value of the appropriate part of the Fund's assets.

**Deficit recovery period:**

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

**Discount rate:**

The rate of interest used to convert a cash amount e.g. future benefit payments occurring in the future to a present value.

**Employer's cost of future accrual:**

The contribution rate payable by an employer, expressed as a % of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses.

**Employer's investment pot:**

The investment strategy which applies to an employer being either the Growth pot, the Medium pot or the Cautious pot.

**Employing bodies:**

Any organisation that participates in the LGPS, including admission bodies and Fund employers.

**Equities:**

Shares in a company which are bought and sold on a stock exchange.

**Equity protection:**

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

**Exit credit:**

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

**Exit payment:**

The amount payable by an exiting employer to the Fund in the case where the exiting employer is determined to be in deficit at the point of cessation based on a termination assessment by the Fund Actuary.

**Fund Actuary:** The Actuary appointed to the Fund as required under statute.

**Fund / Scheme employers:**

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

**Funding or solvency level:**

The ratio of the value of the Fund's assets and the value of the Fund's liabilities expressed as a percentage.

**Funding Strategy Statement (FSS):**

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

**Government Actuary's Department (GAD):**

The GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

**Growth investment pot:**

A predominantly growth asset biased investment strategy targeting long term additional outperformance above CPI inflation. Further information is available in the Investment Strategy Statement.

**Guarantee / guarantor:**

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

**Investment pot:**

This describes the portion of assets invested in one of the three investment strategies.

**Investment strategy:**

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

**Letting employer:**

An employer that outsources part of its services/workforce to another employer, usually a contractor. The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer.

**Liabilities:**

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

**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.

**Mandatory scheme employers:**

Employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Scheme Employers. For example, these include councils, colleges, universities and academies.

**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.

**Medium investment pot:**

An alternate investment strategy available to employers who wish to reduce investment risk to some extent compared to the Growth investment pot but still target long term additional outperformance above CPI inflation. Further information is available in the Investment Strategy Statement.

**Members:**

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

**Minimum risk basis:**

An approach where the discount rate used to assess the liabilities is determined based on the market yields of Government bond investments based on the appropriate duration of the liabilities being assessed, less an appropriate margin to reflect the risk being transferred from the employer to the Fund on termination. This is usually adopted when an employer is exiting the Fund.

**Orphan liabilities:**

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

**Pass through:**

Arrangement whereby the risks of participating in the LGPS are retained by the Letting Employer with the Admission Body's contributions being a reflection of the rate of the Letting Employer (subject to any specific adjustment required under the separate contractual arrangement).

**Percentiles:**

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

**Phasing/stepping of contributions:**

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

**Pooling:**

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

**Prepayment:**

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

**Present value:**

The value of projected benefit payments, discounted back to the valuation date.

**Primary rate:**

The contribution rate required to meet the cost of future accrual of benefits, ignoring any past service surplus or deficit but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer's covenant.

**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.

**Prudent assumption:**

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

**Rates and Adjustments Certificate:**

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

**Real return or real discount rate:**

A rate of return or discount rate net of (CPI) inflation.

**Recovery plan:**

A strategy by which an employer will make up a funding deficit over the deficit recovery period.

**Scheduled bodies:**

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

**Secondary rate:**

The adjustment to the Primary rate to arrive at the total contribution each employer is required to pay. It is essentially the additional contribution (or reduction in contributions) resulting from any deficit (or surplus) attributable to the employer within the Fund, plus any provision made by an employer in respect of the estimated cost of McCloud.

