

Surrey Pension Fund: Funding Strategy Statement

1 Funding Strategy Statement

- 1.1 This is the Funding Strategy Statement (FSS) of the Surrey Pension Fund (“the Fund”), which is administered by Surrey County Council, (“the Administering Authority”).
- 1.2 It has been prepared by the Administering Authority in collaboration with the Fund’s actuary, Hymans Robertson LLP, and after consultation with the Fund’s employers and investment adviser. It is effective from 1 April 2014.

2 Surrey Pension Fund

- 2.1 The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the UK. The Administering Authority runs the LGPS Fund for the Surrey area, to ensure it:
 - receives the correct contributions from employees and employers, and any transfer payments;
 - invests the contributions appropriately, with the aim that the Fund’s assets grow over time with investment income and capital growth;
 - uses the assets to pay Fund benefits to the members (when they retire, for the rest of their lives), and to their dependants (when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.
- 2.3 The regulatory requirements for a FSS are set out in [Appendix A](#).
- 2.3 The roles and responsibilities of the key parties involved in the management of the Fund are summarised in [Appendix B](#).
- 2.4 Key risks and controls are set out in [Appendix C](#).
- 2.5 Detailed descriptions relating to employer contributions are given in [Appendix D](#).
- 2.6 Actuarial assumptions are provided in [Appendix E](#) and a glossary in [Appendix F](#).

3 Need for a Funding Strategy Statement

- 3.1 Employees’ benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but not all, and certainly with no guarantee. Employees’ contributions are fixed in those Regulations, at a level which covers only part of the cost of the benefits. Therefore, employers pay the balance of the cost of delivering the benefits to members and their dependants.
- 3.2 The FSS is a framework within which the Fund’s actuary carries out triennial valuations. It focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:
 - affordability of employer contributions,
 - transparency of processes,
 - stability of employers’ contributions, and

- prudence in the funding basis.

3.3 The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies. The FSS forms part of a framework of which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate, confirming employer contribution rates for the next three years (see the appendix to the formal valuation report);
- the Fund's policies on admissions, cessations and bulk transfers;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service;
- the Fund's Statement of Investment Principles; and
- the Fund's Governance Statement and Governance Compliance Statement.

4 Stakeholders

- 4.1 Members of the Fund (current/former employees, or dependants): the Fund needs to be sure it is collecting and holding enough money so that benefits are always paid in full currently and into the future;
- 4.2 Employers of the Fund (or those considering joining the Fund): an employer will want to know how contributions are calculated, that these are fair by comparison to other employers in the Fund, and in what circumstances they might need to pay more. Note that the FSS applies to all employers participating in the Fund;
- 4.3 Elected members whose council participates in the Fund: a member will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- 4.4 Council tax payers: the council will seek to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

5 Objectives of the FSS

- 5.1 The FSS sets out the objectives of the Fund's funding strategy:
- To achieve and then maintain a funding target that requires assets equal to 100% (ongoing basis) of the present value of benefits based on completed service including provision for the effects of future salary growth and inflation up to retirement;
 - To ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due;
 - To ensure that employer contribution rates are stable where appropriate;
 - To minimise the long-term cash contributions which employers need to pay, by recognising the link between assets and liabilities, and adopting an investment strategy which balances risk and return, thus minimising the costs borne by stakeholders;
 - To reflect the different characteristics of employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its liabilities over future years; and

- To use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

6 Calculating a contribution rate?

6.1 Employer contributions are normally made up of two elements:

- the estimated cost of future benefits being built up from year to year, referred to as the “*future service rate*”; plus
- an adjustment for the difference between the assets built up to date and the value of past service benefits, referred to as the “*past service adjustment*” or “past deficit recovery”. If there is a deficit, the past service adjustment will be an increase in the employer’s total contribution; if there is a surplus there may be a reduction in the employer’s total contribution. Any past service adjustment will aim to return the employer to full funding over an appropriate period (the “deficit recovery period”).

6.2 An employer’s “funding level” is defined as the ratio of:

- the market value of the employer’s share of assets, to
- the value placed by the actuary on the benefits built up to date for the employees and ex-employees (the “liabilities”). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

6.3 If this is less than 100%, then the employer has a shortfall, which is the employer’s deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value. A larger deficit will give rise to higher employer contributions. If a deficit recovery is spread over a longer period then the annual employer cost is lower.

6.4 The Fund’s actuary is required by the Regulations to report the *Common Contribution Rate*, for all employers collectively at each triennial valuation, combining the *future service rate and the past service adjustment outlined above*. This is based on actuarial assumptions about the likelihood, size and timing of benefit payments to be made from the Fund in the future, as outlined in [Appendix E](#).

6.5 The Fund’s actuary is also required to adjust the *Common Contribution Rate* for circumstances specific to each employer. It is this adjusted contribution rate which the employer is actually required to pay, and the rates for all employers are shown in the Fund’s Rates and Adjustments Certificate.

6.6 In effect, the *Common Contribution Rate* is a notional quantity, as it is unlikely that any employer will pay that exact rate. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific circumstances.

6.7 Details of the outcome of the 2013 Actuarial Valuation can be found in the formal 2013 valuation report, including an analysis at Fund Level of the *Common Contribution Rate*. Further details of individual employer contribution rates can also be found in the formal report.

- 6.8 Employer covenant and likely term of membership are considered when setting contributions. Any costs of non ill-health early retirements must be paid by the employer. If an employer is approaching the end of its participation in the Fund then its contributions may be amended appropriately, so that the assets meet (as closely as possible) the value of its liabilities in the Fund when its participation ends.
- 6.9 Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. The Fund Actuary will take account of the higher rate at subsequent valuations.

7 Different types of employer participating in the Fund

7.1 Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate. There are currently more employers in the Fund than ever before, a significant part of this being due to new academies.

7.2 In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: academy schools, contractors, housing associations, charities, etc.

7.3 The LGPS Regulations define various types of employer as follows:

- **Scheduled bodies:** councils and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so called because they are specified in a schedule to the LGPS Regulations. It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such academies, as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as "Scheduled Bodies", the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion over whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the Department for Communities and Local Government (DCLG) regarding the terms of academies' membership in LGPS Funds. Employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.
- **Admission bodies:** other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer: **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer: **transferee admission bodies** ("TAB"). CABs will include housing associations and charities and TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund's admissions policy are not met.

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

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

7.5 It should also be borne in mind that:

- The Fund provides invaluable financial security to local families, namely, retired local community employees, and to their families after their death;
- The benefits are enshrined in statutory legislation with no local discretion to vary the structure;
- The Fund must have assets available to meet retirement and death benefits, which in turn means that employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants);
- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result; and
- Council contributions to the Fund should be at a suitable level, to protect the interests of current and future council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in the future; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

7.6 Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees. For instance, where an employer is considered relatively low risk then the Fund may permit greater smoothing of contributions (such as stabilisation or a longer deficit recovery period relative to other employers) which will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come, and that lower levels of contributions now may mean higher contributions in the future.

7.7 On the other hand, an employer whose risk assessment indicates a less strong covenant will generally be required to pay higher contributions (for instance, with a more prudent funding basis or a shorter deficit recovery period). This is because of the higher probability that at some point it may fail to meet its pension contributions, with its deficit then falling to other Fund employers.

7.8 The Fund actively seeks employer input, including to its funding arrangements, through various means: see [Appendix A \(A2\)](#). More detailed descriptions relating to employer contributions are given in [Appendix D](#).

8 Calculating contributions for individual employers

8.1 A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of methods which the Administering Authority may permit to improve the stability of employer contributions. These include, where circumstances permit:-

- capping of employer contribution rate changes within a pre-determined range (“stabilisation”)
- the use of extended deficit recovery periods (up to a maximum of 20 years)
- the phasing in of contribution rises or reductions
- the pooling of contributions amongst employers with similar characteristics
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

8.2 The Administering Authority recognises that there may occasionally be circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case-by-case basis for employers.

8.3 Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than the theoretical contribution rate. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the choice of method,
- lower contributions in the short term may generate lower investment returns over the long term. Thus, deferring a certain amount of contribution will lead to higher contributions in the long-term, and
- it will take longer to reach full funding, all other things being equal.

8.4 Table 1 summarises how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

Table 1: The different approaches used for different employers

Type of employer	Scheduled Bodies			Community Admission Bodies and Designating Employers		Transferee Admission Bodies
Sub-type	Local Authorities, Police	Colleges etc	Academies	Open to new entrants	Closed to new entrants	(all)
Basis used	Ongoing, assumes long-term Fund participation (see Appendix E)			Ongoing, but may move to “gilts basis” - see Note (a)		Ongoing, assumes fixed contract term in the Fund (see Appendix E)
Future service rate	Projected Unit Credit approach (see Appendix D – D.2)				Attained Age approach (see Appendix D – D.2)	Projected Unit Credit approach (see Appendix D – D.2)
Stabilised rate?	Yes - see Note (b)	No	No	No	No	No
Maximum deficit recovery period – Note (c)	20 years	20 years	20 years	Future working lifetime	Future working lifetime	Outstanding contract term
Deficit recovery payments – Note (d)	Monetary amount	Monetary amount	% of payroll	Monetary amount	Monetary amount	Monetary amount
Treatment of surplus	Covered by stabilisation arrangement	Preferred approach: contributions kept at future service rate. However, reductions may be permitted by the Administering Authority			Preferred approach: contributions kept at future service rate. However, contractors may be permitted to reduce contributions by spreading the surplus over the remaining contract term	
Phasing of contribution changes	Covered by stabilisation arrangement	At the discretion of the Administering Authority		None	None	None
Review of rates – Note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations					To be reviewed in last 3 years of contract
New employer	n/a	n/a	Note (g)	Note (h)		Notes (h) & (i)
Cessation of participation: cessation debt payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt principles applied would be as per Note (i) .			Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (i) .		Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising.

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Note (a) (Basis for CABs and Designating Employers closed to new entrants)

In the circumstances where:

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

the Administering Authority may vary the discount rate used to set employer contribution rate. In particular, contributions may be set for an employer to achieve full funding on a more prudent basis (e.g. using a discount rate set equal to gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

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

Note (b) (Stabilisation)

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

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

The current stabilisation mechanism applies to Surrey County Council, all District and Borough Councils and the Office of the Police and Crime Commissioner for Surrey.

This is subject to there being no material events which cause the employer to become ineligible, e.g., significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring).

On the basis of extensive modelling carried out for the 2013 valuation exercise, the stabilised details are as follows:

- Deficit contributions have been set to ensure that stabilised employers are paying no less than 80% by 2016/17 of deficit contributions calculated to ensure the Employer is fully funded in 20 years under the 2013 formal valuation assumptions.

- The future service component of the contribution rate has been fixed for all stabilised employers except the Office of the Police and Crime Commissioner for Surrey. This has been set at the market implied future service rate to ensure this employer is paying contributions above the assessed cost of benefits accruing.

The stabilisation criteria and limits will be reviewed at the 31 March 2016 valuation, to take effect from 1 April 2017. This will take into account the employer's membership profiles, the issues surrounding employer security, and other relevant factors.

Note (c) (Deficit Recovery Periods)

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2014 for the 2013 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example, where there were no new entrants.

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

For employers with no (or very few) active members at this valuation, the deficit should be recovered by a fixed monetary amount over a period to be agreed with the body or its successor, not to exceed 20 years.

The Administering Authority reserves the right to extend the deficit recovery period beyond that stated in Table 1 (not exceeding 20 years). This would be applied at the discretion of the Administering Authority subject to a satisfactory demonstration of employer security.

Note (d) (Deficit Recovery Payments)

Deficit recovery payments for each employer covering the three year period until the next valuation will generally be set as a monetary amount.

Note (e) (Phasing in of contribution changes)

All phasing is subject to the Administering Authority being satisfied as to the strength of the employer's covenant.

Note (f) (Regular Reviews)

Such reviews may be triggered by significant events including but not limited to:

- significant reductions in payroll,
- altered employer circumstances,
- Government restructuring affecting the employer's business, or
- failure to pay contributions or arrange appropriate security as required by the Administering Authority.

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

Note (g) (New Academy employers)

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

- a) The new academy will be regarded as a separate employer in its own right and will not be pooled with other employers in the Fund. The only exception is where the academy is part of a Multi Academy Trust (MAT) in which case the academy's figures will be calculated as below but can be combined with those of the other academies in the MAT;
- b) The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status;
- c) The new academy will be allocated an initial asset share from the ceding council's assets in the Fund. This asset share will be calculated using the estimated funding position of the ceding council at the date of academy conversion. The share will be based on the active members' funding level, having first allocated assets in the council's share to fully fund deferred and pensioner members. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion; and
- d) The new academy's initial contribution rate will be calculated using market conditions, the council funding position and, membership data, all as at the day prior to conversion.

The Fund's policies on academies are subject to change in the light of any amendments to DCLG guidance. Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS.

Note (h) (New Admission Bodies)

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

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

For all new Transferee Admission Bodies, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis.

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

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

Note (i) (New Transferee Admission Bodies)

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

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

Employers which “outsource” have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. There are three different routes that such employers may wish to adopt. Clearly, as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) Pooling

Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which may be under the stabilisation approach.

ii) Letting employer retains pre-contract risks

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor’s contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) Fixed contribution rate agreed

Under this option the contractor pays a fixed contribution rate and doesn’t pay any cessation deficit.

Subject to an assessment of the strength of the employer and appropriate safeguards in place, the Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from;

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

Note (j) (Admission Bodies Ceasing)

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

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

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

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

- a) Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in [Appendix E](#);
- b) Alternatively, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee. At its absolute discretion the Administering Authority may agree to recover any outstanding amount via an increase in the Awarding Authority's contribution rate, over an agreed period, outside any stabilisation mechanism in place;
- c) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

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

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

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a “gilts cessation basis” and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

Pooling Employers

- 8.5 The Administering Authority can give consideration to setting up pools for employers with very similar characteristics. This will always be in line with its broader funding strategy. With the advice of the Actuary, the Administering Authority allows smaller employers of similar types to pool their contributions in order to smooth out the effects of costly events, e.g., ill-health retirements or deaths in service.
- 8.6 Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants are not usually permitted to participate in a pool. Transferee Admission Bodies are usually also ineligible for pooling. Smaller admitted bodies may be pooled with the letting employer, provided all parties (particularly the letting employer) agree.
- 8.7 Employers who are permitted to enter (or remain in) a pool at the 2013 valuation will not normally be advised of their individual contribution rate unless agreed by the Administering Authority. Schools generally are also pooled with their funding Council. However there may be exceptions for specialist or independent schools. Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

Additional flexibility in return for added security

- 8.8 The Administering Authority may permit greater flexibility to the employer’s contributions if the employer provides added security to the satisfaction of the Administering Authority. Such flexibility includes a reduced rate of contribution, an extended deficit recovery period, or permission to join a pool with another body (e.g. the Local Authority).
- 8.9 Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value. The degree of flexibility given may take into account factors such as:
- the extent of the employer’s deficit;
 - the amount and quality of the security offered;
 - the employer’s financial security and business plan;
 - whether the admission agreement is likely to be open or closed to new entrants.

Non ill health early retirement costs

- 8.10 It is assumed that members' benefits are payable from the earliest possible retirement age without incurring a reduction to their benefit. It should be noted that the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014. Employers are required to pay additional contributions (strain) wherever an employee retires before attaining this age. Therefore the actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.
- 8.11 With the agreement of the Administering Authority the payment can be spread as follows:
- | | |
|---|----------------------|
| Major Employing bodies: | up to 5 years |
| Community Admission Bodies and Designating Employers: | up to 3 years |
| Academies: | up to 3 years |
| Transferee Admission Bodies: | payable immediately. |

Ill health early retirement costs

- 8.12 Admitted Bodies will usually have an 'ill health allowance'. Scheduled Bodies may have this also, depending on their agreement terms with the Administering Authority. The Fund monitors each employer's ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer may be charged additional contributions to cover the additional liability. For small employers, a single ill health retirement may result in a significant increase to liabilities.

Ill health insurance

- 8.13 If an employer provides satisfactory evidence to the Administering Authority of a current insurance policy covering ill health early retirement strains, then:
- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged, and
 - there is no need for monitoring of allowances.
- 8.14 The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy has ceased.
- 8.15 Currently, the Fund has agreed in principle to the taking out of ill health insurance in respect of all fund employers. Work is underway to implement this.

Employers with no remaining active members

- 8.16 In general, an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:
- The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro rata basis at successive formal valuations;

- The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation, the remaining assets would be apportioned pro rata by the Fund's actuary to the other employers in the Fund in proportion to each employer's assets.

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

9 Investment Strategy

9.1 The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy. The Investment strategy is set by the administering authority, after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (SIP), which is available to members and employers.

9.2 The investment strategy is set for the long-term, but is reviewed regularly. Normally, a full review is carried out after each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile. The same investment strategy is currently followed for all employers.

Link between funding strategy and investment strategy

9.3 The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa. Therefore, the funding and investment strategies are inextricably linked.

Funding strategy reflecting the Fund's investment strategy

9.4 In the opinion of the Fund actuary, the proposed funding strategy is consistent with the current investment strategy of the Fund. The asset outperformance assumption contained in the discount rate is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government.

9.5 However, in the short term, such as the triennial assessments at formal valuations, there is scope for considerable volatility with a material chance that in the short term and even medium term, asset returns will fall short of this target. The stability measures in place will dampen, but not remove, the effect on employers' contributions. The Fund does not hold a contingency reserve to protect it against the volatility of investments.

9.6 The Actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

- Prudence: the Fund should have a reasonable expectation of being fully funded in the long term;
- Affordability: how much employers can afford;

- Stewardship: the assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position;
- Stability: employers should not see significant moves in their contribution rates from one year to the next, and this will help to provide a more stable budgeting environment.

9.7 The key problem is that objectives can often conflict. For example, minimising the long term cost of the scheme, i.e., keeping employer rates affordable, is best achieved by investing in higher returning assets, e.g., equities. However, equities are also very volatile, which can conflict with the objective to have stable contribution rates.

9.8 Therefore a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling (a set of calculation techniques applied by the Fund's actuary), to model the range of potential future solvency levels and contribution rates.

9.9 The Actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach. The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes, struck an appropriate balance between the above objectives. In particular, the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Fund. Whilst the current stabilisation mechanism is to remain in place until 2017, it should be noted that this will need to be reviewed following the 2016 valuation.

Monitoring of overall funding position

9.10 The Administering Authority monitors the relative funding position, i.e., changes in the relationship between asset values and the liabilities regularly. It reports this to the Pension Fund Board meetings.

A1 Why does the Fund need a Funding Strategy Statement (FSS)?

The Department for Communities and Local Government (DCLG) has stated that the purpose of the FSS is:

- *“to establish a **clear and transparent fund-specific strategy** which will identify how employers’ pension liabilities are best met going forward;*
- *to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*
- *to take a **prudent longer-term view** of funding those liabilities.”*

These objectives are desirable individually, but may be mutually conflicting.

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2012) and to its Statement of Investment Principles.

This is the framework within which the Fund’s actuary carries out triennial valuations to set employers’ contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to “consultation with such persons as the authority considers appropriate”, and should include “a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers”.

In practice, the consultation process for this FSS was as follows:

- a) A draft version of the FSS has been issued to all participating employers in March 2014 for comment.
- b) Comments required within 30 days;
- c) Following the end of the consultation period, the FSS has been updated as required and then published in April 2014.

A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website at www.surreypensionfund.org
- A copy sent by post and mail to each participating employer in the Fund;
- A copy sent to the employee and pensioner Pension Fund Board representative;
- A copy included in the annual report and accounts of the Fund;
- Copies sent to investment managers and independent advisers;

- Copies made available on request.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2016.

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

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

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

A5 How does the FSS fit into other Fund documents?

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

These documents can be found on the web at www.surreypensionfund.org

Appendix B: Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to play their part.

B1 The Administering Authority should:-

- operate the Fund as per the LGPS Regulations;
- make proper arrangements for the effective governance of the Fund through the Surrey Pension Fund Board (SPFB);
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
- collect employer and employee contributions, and investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles (SIP) and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the Fund's actuary;
- prepare and maintain a FSS and a SIP, after consultation;
- notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the fund's performance and funding and amend the FSS/SIP as necessary and appropriate.

B2 The Individual Employer should:-

- deduct contributions from employees' pay correctly;
- liaise regularly with the Administering Authority to ensure correct data and records are held in respect of employees' benefits;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

B3 The Fund Actuary should:-

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

B4 Other parties:-

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

Appendix C: Key risks and controls

C1 Types of risk

The Administering Authority has an active risk management programme in place. The measures that it has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.	<p>Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing.</p> <p>Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.</p> <p>Analyse progress at three yearly valuations for all employers.</p> <p>Inter-valuation roll-forward of liabilities between valuations at whole Fund level.</p> <p>Review of advisor performance undertaken on an annual basis.</p>
Inappropriate long-term investment strategy.	<p>Overall investment strategy options considered as an integral part of the funding strategy. Use of asset liability modelling to measure four key outcomes.</p> <p>Chosen option considered to provide the best balance.</p> <p>Full training provided to Pension Fund Board members and officers.</p>
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	<p>Stabilisation modelling at whole Fund level allows for the probability of this within a longer term context.</p> <p>Inter-valuation monitoring, as above.</p> <p>Some investment in bonds helps to mitigate this risk.</p>

Risk	Summary of Control Mechanisms
Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.
Pay and price inflation significantly more than anticipated.	<p>The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.</p> <p>Inter-valuation monitoring, as above, gives early warning.</p> <p>Some investment in index-linked bonds also helps to mitigate this risk.</p> <p>Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.</p>
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	An explicit stabilisation mechanism for eligible employers has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions through deficit spreading and phasing in of contributions.
Orphaned employers give rise to added costs for the Fund	<p>The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.</p> <p>If it occurs, the Actuary calculates the added cost spread pro rata among all employers.</p>

C3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation. The Fund also sets life expectancy assumptions using ClubVita, which is a specialised longevity company and provides life expectancy assumptions based on the profile of the Fund's own membership.

Risk	Summary of Control Mechanisms
<p>Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees leading to the possibility of there not being sufficient liquid funds available to pay liabilities as they fall due.</p>	<p>Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay for deficit contributions. Between valuations regularly monitor level of active members on both a total Fund basis and by individual employer. Regularly monitor how cash flow positive the Fund is. Regularly review investment strategy.</p>
<p>Deteriorating patterns of early retirements</p>	<p>Employers are charged the extra cost of non ill-health retirements following each individual decision.</p> <p>Employer ill health retirement experience is monitored. The Pension Fund Board decided to participate in ill health insurance at its meeting on 14 February 2014 and this procurement process is under way.</p>
<p>Reductions in payroll causing insufficient deficit recovery payments</p>	<p>In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:</p> <p>Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see <u>Note (b)</u> to Table 1.</p> <p>For other employers, review of contributions is permitted in general between valuations (see <u>Note (f)</u> to Table 1) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.</p>

C4 Regulatory risks

Risk	Summary of Control Mechanisms
<p>Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pension reform.</p>	<p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>The results of the most recent reforms have been built into the 2013 valuation. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.</p>

Failure to collect and account for contributions from employers and employees on time	Regular monthly monitoring and reconciliation of Fund contributions received, including a detailed analysis of individual employer contributions and employee contributions by pay banding. Robust debt management processes are in place to recover any late payments
Loss of funds through fraud or misappropriation	Procedures and processes are in place and applied in relation to eg: checking for "ghost" scheme members; multiple levels of authorisation for claims and fund payments plus secondary checking of lump sum payments. Procedures are documented and staff are trained and managed in carrying these out. The Fund's internal auditors carry out regular reviews.

C5 Governance risks

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	<p>The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.</p> <p>The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations</p> <p>Deficit contributions may be expressed as monetary amounts.</p>
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way	<p>The Administering Authority maintains close contact with its specialist advisers.</p> <p>Advice is delivered via formal meetings involving Elected Members, and recorded appropriately.</p> <p>Actuarial advice is subject to professional requirements such as peer review.</p>
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.	<p>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.</p> <p>Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.</p>

Risk	Summary of Control Mechanisms
<p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p>	<p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by:</p> <p>Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see <u>Notes (h)</u> and <u>(i)</u> to Table 1).</p> <p>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</p> <p>Vetting prospective employers before admission.</p> <p>Where permitted under the regulations requiring a bond to protect the Fund from various risks.</p> <p>Requiring new Community Admission Bodies to have a guarantor.</p> <p>Reviewing bond or guarantor arrangements at regular intervals (see <u>Note (f)</u> to Table 1).</p> <p>Reviewing contributions well ahead of cessation if thought appropriate (see <u>Note (a)</u> to Table 1).</p>
<p>Failure to comply with the Myners' Investment Principles</p>	<p>Compliance as detailed in the Statement of Investment Principles is kept under review.</p>
<p>Lack of relevant expertise, knowledge and skills at officer and member level in relation to administering the LGPS</p>	<p>Training needs assessments for the Administering Authority are carried out and an annual training plan produced and delivered. The Fund subscribes to the CIPFA Knowledge and Skills Framework for the LGPS and makes this information available to all members of the Pension Fund Board and relevant officers. Appropriately qualified external advisers and consultants are used as appropriate.</p>
<p>Failure to hold personal data securely and keep pension records up-to-date and accurate</p>	<p>Personal data and scanned documents relating to scheme members are maintained in an online system via individual password access for those that need to maintain and access this information. Procedures for maintaining pension records are documented and the process is monitored and managed within the Pensions Administration team. Procedures are regularly reviewed by the Fund's internal auditors.</p>

Appendix D: The calculation of Employer contributions

The calculations involve actuarial assumptions about future experience, and these are described in detail in [Appendix E](#).

D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

- a) the estimated cost of future benefits being accrued, referred to as the “future service rate”; plus
- b) an adjustment for the funding position of accrued benefits relative to the Fund’s solvency target, “*past service adjustment*”. If there is a surplus there may be a reduction in the employer’s contribution rate. If there is a deficit there will be an increase in the employer’s contribution rate, with the surplus or deficit spread over an appropriate period. The aim is to return the employer to full funding over that period.

The Fund’s actuary is required by the regulations to report the *Common Contribution Rate*¹, for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay; it is in effect an average rate across all employers in the Fund.

The Fund’s actuary is also required to adjust the Common Contribution Rate for circumstances which are deemed “peculiar” to an individual employer². It is the adjusted contribution rate which employers are actually required to pay. The sorts of “peculiar” factors which are considered are discussed below.

In effect, the *Common Contribution Rate* is a notional quantity. Separate future service rates are calculated for each employer together with individual past service adjustments according to employer-specific past service deficit spreading and increased employer contribution phasing periods.

D2 How is the Future Service Rate calculated?

The future service element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members’ **future** service in the Fund. This is based upon the cost (in excess of members’ contributions) of the benefits which employee members earn from their service each year.

The future service rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The calculation is on the “ongoing” valuation basis (see [Appendix E](#)), but where it is considered appropriate to do so the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a more prudent basis.

The approach used to calculate each employer’s future service contribution rate depends on whether or not new entrants are being admitted. Employers should note that it is only Admission Bodies and Designating Employers that may have the power not to automatically admit all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

¹ See LGPS (Administration) Regulations 36(5).

² See LGPS (Administration) Regulations 36(7).

a) Employers which admit new entrants

These rates will be derived using the “Projected Unit Method” of valuation with a one year period, i.e. only considering the cost of the next year’s benefit accrual and contribution income. If future experience is in line with assumptions, and the employer’s membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise over time.

b) Employers which do not admit new entrants

To give more long term stability to such employers’ contributions, the “Attained Age” funding method is normally adopted. This measures benefit accrual and contribution income over the whole future anticipated working lifetimes of current active employee members.

Both approaches include expenses of administration to the extent that they are borne by the Fund, and include allowances for benefits payable on death in service and ill health retirement.

D3 How is the Solvency / Funding Level calculated?

The Fund’s actuary is required to report on the “solvency” of the whole Fund in a valuation which should be carried out at least once every three years. As part of this valuation, the actuary will calculate the solvency position of each employer.

‘Solvency’ is defined to be the ratio of the market value of the employer’s asset share to the value placed on accrued benefits on the Fund actuary’s chosen assumptions. This quantity is known as a funding level.

For the value of the employer’s asset share, see D5 below.

For the value of benefits, the Fund actuary agrees the assumptions to be used with the Administering Authority – see Appendix E. These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer’s current and former employees, based on pensionable service to the valuation date only (i.e. ignoring further benefits to be built up in the future).

The Fund operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined.

D4 What affects a given employer’s valuation results?

- past contributions relative to the cost of benefits accrued;
- different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
- differences in the valuation basis on the value placed on the employer’s liabilities;
- different deficit/surplus spreading periods or phasing of contribution changes;
- differences between actual and assumed rises in pensionable pay;
- differences between actual and assumed increases to pensions in payment and deferred pensions;
- differences between actual and assumed retirements on grounds of ill-health from active status;
- differences between actual and assumed amounts of pension ceasing on death;
- additional costs of any non ill-health retirements relative to any extra payments made; over the period between each triennial valuation.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers, to the extent that employers in effect share the same investment strategy. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. The process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus".

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification. The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree. Consideration will be given to moving to a unitised fund in the medium term.

Appendix E: Actuarial assumptions

E1 What are the actuarial assumptions?

These are expectations of future experience used to place a value on future benefit payments (“the liabilities”). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants’ benefits.

Changes in assumptions will affect the measured value of future service accrual and past service liabilities, and hence the measured value of the past service deficit. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the “basis”. A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower liability values and lower employer costs. A more prudent basis will give higher liability values and higher employer costs.

E2 What basis is used by the Fund?

The Fund’s standard funding basis is described as the “ongoing basis”, which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term, a more prudent basis applies: see [Note \(a\)](#) to Table 1.

E3 What assumptions are made in the ongoing basis?

a) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund’s investments. This “discount rate” assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds (“gilts”). There is, however, no guarantee that Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2013 and setting contribution rates effective from 1 April 2014, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.6% per annum greater than gilt yields at the time of the valuation (this is the same as that used at the 2010 valuation). In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

b) Salary growth

Pay for public sector employees is currently subject to restriction by the UK Government until 2016. Although this “pay freeze” does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards. Based on long term historical analysis of the membership in LGPS funds, the salary increase assumption at the 2013 valuation has been set to 0.5% above the retail prices index (RPI) per annum. This is a change from the previous valuation, which assumed a two year restriction at 1% per annum followed by longer term growth at RPI plus 1.5% per annum.

c) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. This change was allowed for in the valuation calculations as at 31 March 2010. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the “formula effect” of the difference between RPI and CPI. At this valuation, we have proposed a reduction of 0.8% per annum. This is a larger reduction than at 2010, which will serve to reduce the value placed on the Fund’s liabilities (all other things being equal).

d) Life expectancy

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

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

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with the CMI model of “medium cohort” and a 1.25% per annum minimum underpin to future reductions in mortality rates. This is a higher allowance for future improvements than was made in 2010.

The combined effect of the above changes from the 2010 valuation approach is to add around one year of life expectancy on average. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members’ benefits.

e) General

The same financial assumptions are adopted for all employers, in deriving the past service deficit and the future service rate. These calculated figures are translated in different ways into employer contributions, depending on the employer’s circumstances.

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

Actuarial assumptions/basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of liabilities . The main assumptions will relate to the discount rate , salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value.
Administering Authority	The council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
Admission Bodies	Employers which voluntarily participate in the Fund, so that their employees and ex-employees are members . There will be an Admission Agreement setting out the employer's obligations.
Common contribution rate	The Fund-wide future service rate plus past service adjustment . It should be noted that this will differ from the actual contributions payable by individual employers .
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.
Deficit	The shortfall between the assets value and the liabilities value. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which is assumed to be met by future contributions).
Deficit repair/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 past service adjustment (deficit repair contribution), and vice versa.
Designating Employer	Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund.
Discount rate	The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day allowing for future expected investment return. This is necessary to provide a liabilities value which is consistent with the present day value of the assets, to calculate the deficit . A lower discount rate gives a higher liabilities value, and vice versa. It is similarly used in the calculation of the future service rate and the common contribution rate .
Employer	An individual participating body in the Fund, which employs (or used to employ) members of the Fund. Normally the assets and liabilities values for each employer are individually tracked, together with its future service rate at each valuation .
Funding level	The ratio of assets value to liabilities value.

Future service rate	The actuarially calculated cost of each year's build-up of pension by the current active members , excluding members' contributions but including Fund administrative expenses. This is calculated using a chosen set of actuarial assumptions .
Gilt	A UK Government bond, ie, a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency.
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.
Letting employer	An employer which outsources or transfers a part of its services and 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. A letting employer will usually be a local authority, but can sometimes be another type of employer such as an Academy.
Liabilities	The actuarially calculated present value of all pension entitlements of all members of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the deficit . It is calculated on a chosen set of actuarial assumptions .
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. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Maturity	A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.
Members	Individuals who have built up (and still 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).
Past service adjustment	The part of the employer's annual contribution which relates to past service deficit repair.

Pooling	Employers may be grouped together for the purpose of calculating contribution rates, so that their combined membership and asset shares are used to calculate 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.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's members , ie current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its maturity also.
Rates and Adjustments Certificate	A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal valuation . This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.
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, academies, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).
Solvency	In a funding context, this usually refers to a 100% funding level , i.e., where the assets value equals the liabilities value.
Stabilisation	Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large tax-raising employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these.
Theoretical contribution rate	The employer's contribution rate, both future service rate and past service adjustment , which would be calculated on the standard actuarial basis , before any allowance for stabilisation or other agreed adjustment.
Valuation	An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is carried out every three years (last done as at 31 March 2013), but can be updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term gilt yields at that date.

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