Funding Strategy Statement

Introduction:

1. This is the Funding Strategy Statement (FSS) of the Surrey Pension Fund, which is administered by Surrey County Council. This statement updates the FSS that was published in March 2008 following receipt of the 2007 actuarial valuation results and consultation with scheme employers and the Fund Actuary (Hymans Robertson LLP).
2. This statement reflects the discussions between the Administering Authority, scheme employers and Hymans Robertson LLP during the 2010 actuarial valuation process, and is effective from 31 March 2011.
3. The FSS is reviewed in detail at least every three years in line with triennial actuarial valuations being carried out. The next full review is due to be completed by 31 March 2014.
4. The FSS forms part of a framework which includes:

a) the LGPS Regulations (Regulation 76A and 77 of the 1997 Regulations and Regulations 35-37 of the LGPS (Administration) Regulations 2008 are particularly relevant);
b) the Rates and Adjustments Certificate, which can be found appended to the Fund Actuary's latest triennial actuarial valuation report;
c) the Statement of Investment Principles (SIP)
d) the Fund's governance statement and governance compliance statement

5. All of the above mentioned documents are publicly available with the latter three documents published on the Surrey County Council website at www.surreycc.gov.uk.
6. This is the framework within which the Fund's actuary carries out triennial valuations to set contribution rates for individual scheme employers 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.

Purpose of the Funding Strategy Statement:

7. The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 came into effect on 1 April 2004. The Regulations provided the statutory framework within which LGPS administering authorities were required to prepare a first Funding Strategy Statement (FSS) by 31 March 2005.

   The Department for Communities and Local Government (CLG) has stated that the purpose of the funding strategy 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 requirement to maintain as nearly constant employer contribution rates as possible; and
   - to take a prudent longer-term view of funding those liabilities.

8. The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that these will be individually desirable but conflicting objectives that need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the FSS, it must remain

a single strategy for the Administering Authority to implement and maintain.

This statement aims therefore to set out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employer contributions and prudence in the funding basis.

Background to the Surrey Pension Fund:

9. As at 31 March 2010 the total value of the Pension Fund was £1.94bn and in 2009/2010 employer contributions into the pension fund amounted to £106.6m. Employee contributions amounted to £32.3m.

10. There are over 70 employers involved in the Surrey Pension Fund. The largest employers, in terms of the number of active members and monetary contributions to the Pension Fund, are Surrey County Council, the Borough and District Councils, Surrey Police Authority and the University of Surrey.

11. The level of contributions into the fund to be paid by each employer is determined by the triennial actuarial valuation. The 2010 actuarial valuation has determined the level of contributions to be paid by employers during the period 1 April 2011 to 31 March 2014.

12. Officers of Surrey CC received the preliminary results of the valuation in October 2010. Results were circulated to all employers by early January 2011. This allowed employers to comment on, or query, assumptions or individual results and to ensure that any changes in contribution rates could be incorporated into the budget setting process for 2011/2012.

13. This activity was key to ensuring that the requirement of consulting with relevant interested parties on the Funding Strategy and actuarial valuation process could take place.

The aims and purpose of the Pension Fund:

14. The **aims** of the Fund are to:

    - enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies
    - manage employers' liabilities effectively
    - ensure that sufficient resources are available to meet all liabilities as they fall due
    - maximise the returns from investments within reasonable risk parameters.

15. 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 scheme benefits, transfer values, costs, charges and expenses, as defined in the Local Government Pension Scheme Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

Responsibilities of key parties:

16. Surrey County Council, as Administering Authority, will:

- collect employee and employer contributions
- invest surplus monies in accordance with the relevant regulations
- ensure that cash is available to meet liabilities as and when they fall due
- manage the actuarial valuation process in consultation with Hymans Robertson LLP, the Fund Actuary
- prepare and maintain a Funding Strategy Statement (FSS) and a Statement of Investment Principles (SIP), both after proper consultation with interested parties, and
- monitor all aspects of the Fund's performance and funding and amend the FSS/SIP as appropriate.

17. Individual employers in the Fund will:

- deduct contributions from employees' pay correctly
- pay all contributions, including their own as determined by Hymans Robertson LLP, promptly by the due date
- exercise discretions within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain, and
- notify Surrey County Council promptly of all changes to membership, or as may be proposed, which affect future funding.

18. Hymans Robertson LLP, the Fund Actuary, will:

- prepare actuarial valuations, including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS, and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.

Solvency issues and target funding levels:

19. Surrey County Council, as Administering Authority, prudentially seeks to achieve full funding.

20. The Fund actuary is required to report on the "solvency" of the whole fund at least every three years. 'Solvency" for ongoing employers is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund Actuary's *ongoing funding basis*. This quantity is known as a funding level.

21. The Fund Actuary agrees the financial and demographic assumptions to be used for each such valuation with the Administering Authority. The fund operates the same target funding level for all other employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see below).

22. The overall solvency of the Fund at the 2010 valuation was 72%, which compares with 79% at the 2007 valuation.

23. The ongoing funding basis has traditionally been used for each

triennial valuation for all employers in the fund. This approach assumes a long-term participation in the Fund, and is described in the following sections.

24. In the circumstances where:
    - the employer is an Admission Body but not a Transferee Admission Body, and
    - the employer has no guarantor, and
    - the admission agreement is likely to terminate within the next 5 to 10 years or lose its last active member within that timeframe:

    the Administering Authority may vary the discount rate used to set the employer contribution rate. In particular, contributions may be set for an employer to achieve full funding on a more prudent basis (e.g. using 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 when a cessation valuation is carried out.

25. The Administering Authority also reserves the right to adopt the above approach in respect of those 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.

Contribution rates:

26. The employer's contribution rate consists of two elements:
    i. The ongoing rate, which provides for the year-by-year accrual of benefits for current employees
    ii. A lump sum in respect of past service liabilities, which is determined by an employer's share of the Fund deficit, liquidated over a specified number of years

Background and historical funding levels:

27. For many years up to 1989, legislation required that the Fund was adequate to meet all liabilities, i.e. was 100% solvent. In 1989 the regulations in force specified that the target level of funding need only be 75% of future liabilities, thereby leading to a reduction in costs that was intended to offset the impact of the new community charge system.

28. A further complexity arose in 1990 following the 1989 review. Prior to that year the employers' contribution had been set in two parts.
    i. A rate was set to provide for the basic benefits of the Scheme through the Fund
    ii. A further rate was set to meet the cost of pension increases and other non-statutory benefits on a "pay as you go" basis. Pension increases are the annual uprating of pensions in payment for cost of living.

29. Following the implementation of new regulations from 1 April 1990, the cost of inflation proofing both pension payments and deferred benefits was incorporated within the overall fund

and met through a single employers' contribution rate. This change resulted in a reduction in the solvency level and also to an overall reduction in employers' contributions.

30. Regulations issued by the Department of the Environment in 1992 specified a return to the former target funding level of 100%. Consequently, since April 1993, those employers with an excess of liabilities over assets ("past service deficiency") have been paying additional contributions into the Fund in order to return to 100% solvency over the remaining working lifetime of the members of the Fund.

31. The actuarial valuation as at 31 March 1998 determined that the fund was 75% funded, i.e. that the assets of the fund were sufficient to cover 75% of its liabilities. The reasons behind the funding level include those issues mentioned above, together with a change in the tax treatment of pension funds in 1997, which removed the ability for funds to claim credits on tax paid on dividends. This government policy change reduced the funding level of the Surrey Pension Fund by around 8%.

32. The overall funding level at 31 March 2001 remained broadly unchanged over the three year inter-valuation period (1998-2001), mainly because poor investment performance relative to the 1998 valuation assumptions offset the contributions being made toward liquidating the deficiency.

33. The funding level as at 31 March 2004 reduced to 68%. This was again because poor investment performance relative to the 2004 valuation assumptions offset the contributions being made toward the deficiency.

34. At the time of the 2004 valuation a number of ways of mitigating the impact of the increase in contribution rates resulting from the reduction in funding level were identified. Following consultation with fund employers and the Fund Actuary it was agreed to allow for the proposed abolition of the 'rule of 85' and to take credit for the additional return that the Fund was expected to generate as a result of being more heavily invested in equities after a change in investment strategy. In addition, the deficit recovery period was increased from 13 years to 20 years to reflect the increase in the remaining working life-time of active members.

35. The previous actuarial valuation, carried out as at 31 March 2007, saw the funding level increase to 79.3%. However, ongoing contribution rates increased as a result of the changes in the regulations governing the application of the LGPS, effective from 1 April 2008, the allowance for improvements in longevity and an increase in expected future salary and price inflation.

Ongoing funding basis:
Life expectancy

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

37. 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.

38. 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 "medium cohort" and a 1% p.a. minimum underpin to future reductions in mortality rates. The approach taken is considered reasonable in light of the long-term nature of the Fund and the assumed level of security that underpins members' benefits.

Financial assumptions:

38. Having analysed historic results and future projections of equity returns the Fund Actuary and the Administering Authority agreed that credit should be taken for the additional return that the Fund should generate due to being more heavily invested in equities. To ensure prudence it was assumed that this return would again be 1.6% p.a. more than that which may be achieved if the Fund was invested solely in government bonds. Applying a higher equity premium than 1.6% would result in a higher funding level and lower contribution rates but it is felt that it would be imprudent to do so. Similarly, applying a lower equity risk premium (say 1.25%) would result in a lower funding level and higher contribution rates but it is the intention of the Funding Strategy Statement to ensure that employer contribution rates should be kept as nearly constant as possible and at reasonable cost to the taxpayers and employing bodies.

39. The other financial assumptions used during the 2010 valuation are as follows:

	2007 % p.a.		2010 % p.a.	
	Nominal	Real	Nominal	Real
Gilt yield (base discount rate)	4.5%	1.3%	4.5%	1.2%
Asset Outperformance Assumption	1.6%		1.6%	
Discount Rate	6.1%		6.1%	
Pay increases[1]	4.7%	1.5%	5.3 %	2.0%
Pension Increases[2]	3.2%	-	3.3 %	-
Price inflation	3.2%	-	3.8%	-

[1]Pay for public sector employees will be frozen by Government until 2012, with a flat increase of £250 being applied to all those earning less than £21,000 pa. Although this "pay freeze" does not officially apply to local government employers, it has been suggested that they are expected to show similar restraint in respect of pay awards. Based on an analysis of the membership in LGPS funds, the average expected increase in pensionable pay across all employees should be around 1% pa for the next two years. Therefore the salary increase assumption at the 2010 valuation has been set to 1% pa for 2010/11 and 2011/12. After this point, the assumption will revert back to RPI plus 1.5% pa, as adopted for the previous valuation.

[2]The Chancellor of the Exchequer announced in his Emergency Budget on 22 June 2010 that the consumer prices index (CPI) rather than the retail prices index (RPI) will be the basis for future increases to public sector pensions in deferment and in payment. This proposed change has been allowed for in the valuation calculations as at 31 March 2010. At the previous valuation, we derived our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. At this valuation, we propose to adjust this market-derived rate downwards by 0.5% pa to allow for the "formula effect" of the difference between RPI and CPI. Basing pension increases on CPI rather than RPI will serve to reduce the value placed on the Fund's liabilities.

Future service contribution rates:

40. The future service element of the employer contribution rate is calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service.

41. 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. 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 lower discount rate (most usually for Admission Bodies in the circumstances outlined in paragraph 24).

42. 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 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:

i. Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits that employee members earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* of valuation with a one-year control period.

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 profile of employees matures (e.g. because of lower recruitment) the rate would rise.

ii. Employers that do not admit new entrants

Certain Admission Bodies have closed the scheme to new entrants. This is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as the membership ages.

To give more long-term stability to such employers' contributions, the Attained Age funding method is normally adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both future service rates will include expenses of administration to the extent that they are borne by the Fund and include an allowance for benefits payable on death in service and ill health retirement.

Adjustments for individual employers:

43. Adjustments to individual employer contribution rates are applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

    The combined effect of these adjustments for individual employers applied by the Fund Actuary relate to:

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

    over the period between each triennial valuation.

44. Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. 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.

45. The Fund Actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation when calculating the share of the Fund assets attributable to

each employer (see paragraph 48), 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.

Asset share calculations for individual employers:

46. The Administering Authority does not account for each employer's assets separately. The Fund's actuary is required to apportion the assets of the whole fund between the employers at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer. This 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 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 but not to audit standard.

47. The Administering Authority recognises the limitations in the process, but having regard to the extra administration cost of building in new protections, it considers that the Fund Actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

Stability of employer contributions:

48. 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 prudential strategies that the Administering Authority may deploy in order to maintain employer contribution rates at as nearly a constant rate as possible. These include, where circumstances permit:-

    a. capping of employer contribution rate increases / decreases within a pre-determined range ("Stabilisation")
    b. the use of extended deficit recovery periods
    c. the phasing in of contribution increases / decreases
    d. the pooling of contributions amongst employers with similar characteristics

Stabilisation:

49. There can be occasions when, despite the deployment of contribution stabilising mechanisms such as pooling, phasing and the extension of deficit recovery periods, the theoretical employer contribution rate is not affordable or achievable. This can occur in times of tight fiscal control or where budgets have been set in advance of new employer contribution rates being available.

50. In view of this possibility, the Administering Authority has commissioned the Fund Actuary to carry out extensive modelling to explore the long term effect on the Fund of capping future contribution increases. The results of this modelling indicate that it is justifiable to limit employer contribution rate changes to +1% / -1% of employers' contributions per annum from 1 April 2014, with fixed contributions until then, subject to the following conditions being met:
    - The Administering Authority is satisfied that the status of the employer merits adoption of a stabilised approach; and
    - there are no material events between now and 1 April 2011 which render the stabilisation unjustifiable.

51. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund actuary, believes that the results of the modelling demonstrate that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" and are therefore 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.

52. The Fund currently has a strong net cash inflow and can therefore take a medium to long term view on determining employer contribution rates to meet future liabilities through operating a fund with an investment strategy that reflects this long term view. It allows short term investment markets volatility to be managed so as not to cause volatility in employer contribution rates.

53. The LGPS regulations require the longer term funding objectives to be to achieve and maintain assets to meet the projected accrued liabilities. The role of the Fund Actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements. The approach to the actuarial valuation, and key assumptions used at each triennial valuation form part of the consultation undertaken with the FSS.

Deficit recovery periods:

54. The Administering Authority instructs the actuary to adopt specific deficit recovery periods for all employers when calculating their contributions. The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table overleaf:

	Maximum Length of Recovery Period
Statutory bodies with tax raising powers	20 years
Academies	20 years
Admission bodies with funding guarantees	20 years
Private contractors admitted under Best Value Regulations	The remaining contract period
All other types of employer	A period equivalent to the remaining working lifetime of active members

55. This *maximum* period is used in calculating each employer's *minimum* contributions. And employers may opt to pay higher regular contributions than these minimum rates. The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2011 for 2010 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 to improve the stability of contributions.

56. Following the completion of the 2010 valuation, some employers may have a funding level greater than 100%. These employers will have a choice not afforded to many other employers in the fund. Any employers deemed to be in surplus may be permitted to reduce their contributions below the cost of accruing benefits, by spreading the surplus element over the maximum periods shown above for deficits in calculating their minimum contribution. However if they take the full benefit of their surplus re-payments then their ability to withstand future adverse shocks in the 2013 valuation will be diminished. Employers should consider carefully whether or not to take the full benefit of their current surplus. It is recommended that employers in surplus do not reduce their contribution rate from the rate certified at the 2007 valuation.

Phasing of contribution rates:

57. Transferee Admission Bodies are not eligible for phasing in of contribution rises. Other employers may opt to phase in contribution rises as follows:

- for employers contributing at or above its future service rate in 2010/11, phasing in the rise in employer contributions over a period of three years;
- for employers contributing at less than its future service rate in 2010/11 the employer should at least pay its future service rate in 2011/12.

58. Any contribution reductions will be subject to the 'stabilisation mechanism' set out in paragraph 49 for public sector bodies. Other bodies (including Transferee Admission Bodies) can take the reduction with immediate effect.

59. Employers that are permitted, and elect to use, a longer deficit spreading period than was used at the 2007 valuation or to phase-in contribution changes will be assumed to incur a

greater loss of investment returns on the deficit by opting to defer repayment. Thus, deferring paying contributions is expected to lead to higher contributions in the long-term (depending on the actual financial and demographic performance of the Fund relative to the valuation assumptions).

60. However any adjustment is expressed for different employers, the overriding principle is that the discounted value of the contribution adjustment adopted for each employer will be equivalent to the employer's deficit.

Pooled contributions:

61. With the advice of the Actuary the Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service.

62. Employers who are permitted to enter (or remain in) a pool at the 2010 valuation will be advised of their contribution rate and that it is subject to a pooling arrangement unless they seek in writing to be excluded from the pool.

63. Schools generally are also pooled with their funding Council. However there may be exceptions for specialist or independent schools such as Academies.

64. From time to time the Administering Authority may set up pools for employers with similar characteristics

Additional flexibility in return for added security:

65. Where the above methods for improving stability of employer contributions do not automatically apply, 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). 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.

66. 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.

Regular reviews:

67. The Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals. These intervals may be annual, in the case of Admitted Bodies and/or in the last few years of the employer's contract.

68. Such reviews may be triggered by 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.

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

Admitted bodies ceasing:

70. Admission Agreements for Transferee Admitted Bodies are assumed to expire at the end of the contract. Admission Agreements for other employers are generally assumed to be open-ended but can be terminated at any point subject to the terms of the agreement.

71. Notwithstanding the provisions of the Admission Agreement, the Administering Authority considers any of the following as triggers for the termination 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 Admitted Body;
- Any breach by the Admitted 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 Admitted Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admitted Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

72. If an Admitted Body's admission agreement is terminated, the Administering Authority will instruct the Fund Actuary to carry out a termination valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admitted Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admitted Body.

73. The approach adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

a) For Transferee Admitted Bodies, the assumptions applying at the contract end would normally be those used for an ongoing valuation to be consistent with those used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

b) For non Transferee Admitted Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in paragraph 40. Where such 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" with no allowance for potential future investment outperformance and with an allowance for further future improvements in life expectancy. This could give rise to significant payments being required.

c) For Admitted Bodies with guarantors, it may be possible to simply transfer the former Admitted 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.

74. Under 72(a) and 72(b), any shortfall would usually be levied on the departing Admitted Body as a lump sum payment unless there are alternative sources of funds such as guarantees or bonds in place.

75. In the event that the Fund is not able to recover the required payment in full directly from the Admitted Body or from any bond, indemnity or guarantor, then:

i) in the case of Transferee Admitted Bodies the Awarding Authority will be liable for future deficits and contributions arising. At its absolute discretion, the Administering Authority may agree to recover any outstanding amounts via an increase in the Awarding Authority's contribution rate over an agreed period, outside any stabilisation mechanism in place.

ii) in the case of other Admitted Bodies where there is no guarantor, the unpaid amounts fall to be shared amongst all of the employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

76. As an alternative to 74(ii) above, where the ceasing Admitted Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admitted 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 valuation basis: deficit recovery payments would be derived from this cessation amount. This approach would be monitored as part of each triennial valuation and 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.

Early retirement costs:
Non ill health retirements

77. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill health. Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining the age at which the valuation assumes that benefits are payable. With the agreement of the Administering Authority the payment can be spread as follows:
    - Major Employing bodies - up to 5 years
    - Community Admitted Bodies - up to 3 years
    - Transferee Admitted Bodies - payable immediately.

78. However, due to the current difficult economic conditions and cuts in budgets, the Administering Authority may permit alternative repayment terms for a temporary period: for the most secure employers only (i.e. those who are precepting and eligible for the stabilisation mechanism), the Fund will allow the option of repayment of early retirement strain costs over a longer period. In practice this will be effected by:
    - assessing at the end of each financial year the additional liabilities arising from early retirements in that year,
    - converting these into an additional contribution rate expressed as a percentage of payroll (based on a 20 year deficit recovery period). This is paid in addition to the stabilised contribution rate.

79. It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to any of their benefit and without requiring their employer's consent to retire. The additional costs of premature retirement are calculated by reference to these ages (NB the relevant age may be different for different periods of service, following the benefit changes from April 2008).

Ill health monitoring:

80. Admitted Bodies will usually have an 'ill health allowance'; Scheduled Bodies may have this also, depending on their agreement terms with the Administering Authority. Under these circumstances, the Fund monitors each employer's, or pool of employers, 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 will be charged additional contributions on the same basis as apply for non ill-health cases. Details will be included in each separate Admission Agreement.

Ill health insurance:

81. 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;
    - there is no need for monitoring of allowances.

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

The 2010 valuation results:

83. The following table summarises the main results of the 2010 valuation together with comparative figures for the previous valuation:

	2007 Valuation	2010 Valuation
Active Members		
Number of active members	25,358	28,651
Total Annual Pensionable Pay	£540.2m	£665.4m
Average Pensionable Pay	£21,307	£23,226
Deferred Pensions		
Number of Deferred Pensioners	20,737	25,659
Total annual value of deferred pensions payable in future	£25.2m	£30.4m
Pensioners and Widow(er)s		
Number of pensioners	15,896	17,999
Total annual pensions payable	£62.6m	£78.2m
Average pension in payment	£3,937	£4,347
Value of Liabilities	£2,218.8m	£2,698.9m
Market Value of the Fund	£1,759.3m	£1,944.4m
Deficit	£459.6m	£754.5m
Solvency Level of the Fund	79%	72%
Employer Average Contribution Rate		
Future Service	14.70%	16.30%
Past Service Deficit	6.20%	8.90%
Total Employer Rate	20.90%	25.20%

84. The resultant employer contribution rates applicable from 1 April 2011 are shown in Annexe A, together with deficit recovery periods agreed for all employers in the Fund. This is a statement of the minimum contributions to be paid by each employer and employers can pay additional amounts toward the deficit.

85. Historically, tax raising bodies have preferred to express the deficit recovery contributions as a monetary amount rather than as a percentage of payroll. This is to ensure that any large

reductions in payroll do not result in lower than expected contributions to the fund deficit. For the 2010 valuation, deficit recovery contributions for the majority of employing bodies are being expressed as a monetary amount (rather than a percentage of payroll). Academy schools that have been admitted to the Fund subsequent to the valuation are the only exception and will pay deficit contributions expressed as a percentage of payroll until the 2013 valuation results are implemented.

Links to the Fund's investment policy set out in the Statement of Investment Principles:

86. The county council is the designated statutory body responsible for administering the Surrey Pension Fund on behalf of the constituent Scheduled and Admitted Bodies. The council is responsible for setting investment policy, appointing suitable persons to implement that policy and carrying out regular reviews and monitoring of investments.

87. The Fund's Statement of Investment Principles is a formal statement of how the county council carries out these responsibilities. The latest effective SIP is published on Surrey County Council's website.

88. The Pension Fund Board, having regard to funding levels, cash needs and risk tolerance, determines the overall Fund asset mix. The Fund has had a customised benchmark in place since the 2000 asset-liability modelling (ALM) study.

The identification of risks and counter-measures:

89. The County Council recognises that there are certain risks that may impact on this FSS. The risks and measures to be taken to counter these risks include:

Financial 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.	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Analyse progress at three yearly valuations for all employers. Inter-valuation roll-forward to liabilities between formal valuations subject to market experience.
Inappropriate long-term investment strategy.	Set Fund-specific benchmark, informed by Asset-Liability modelling of liabilities. Consider measuring performance relative to bond-based target, absolute returns or a Liability Benchmark Portfolio and not relative to indices.
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	Inter-valuation monitoring, as above. Some investment in bonds helps to mitigate this risk.
Active investment manager under-performance relative to benchmark.	The Investment Management Agreement (between SCC and the fund manager) clearly states the Customer's expectations in terms of performance targets. Investment manager performance is reviewed on a quarterly basis. The Pension Fund Board is positioned to move quickly if it is felt that targets will not be met.
Pay and price inflation significantly more than anticipated.	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Inter-valuation monitoring, as above, gives early warning. Some investment in index-linked bonds also helps to mitigate this risk. Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer serving employees.
Effect of possible increase in employer's contribution rate on service delivery and admission scheduled bodies.	Seek feedback from employers on scope to absorb short-term contribution rises. Mitigate impact through deficit spreading and phasing in of contribution rises.

Demographic Risks	Summary of Control Mechanisms
Pensioners living longer.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund actuary monitors combined experience of around 50 funds to look for early warnings of lower pension amounts ceasing than assumed in funding. The council encourages any employers concerned at costs to promote later retirement culture. Each one-year rise in the average age at retirement would save roughly 5% of pension costs.
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.
Deteriorating patterns of early retirements.	Employers are charged the extra capital cost of non ill health requirements following each individual decision. Employer ill health requirement experience is monitored.
A company admitted to the Fund as an admission body may become financially unviable.	A surety bond is required to cover the potential risk of the admitted body becoming insolvent and the value of this surety or bond is reviewed regularly to ensure it provided adequate cover for the financial risks involved.
Ill-health retirements significantly more than anticipated.	Monitoring of each employer's ill-health experience on an ongoing basis. The employer may be charged additional contributions if this exceeds the ill-health assumption built in.
Reductions in payroll causing insufficient deficit recovery payments.	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: For employers in the stabilisation mechanism, may be brought out of that mechanism to permit appropriate contribution increases. For other employers, review of contributions is permitted in general between valuations and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.

Regulatory Risk	Summary of Control Mechanisms
Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees.	Surrey CC considers all consultation papers issued by the Government and comments where appropriate. The results of the Hutton review are not expected to affect the Fund until after the 2013 valuation, and so will be incorporated at that time. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.
Changes to national pension requirements and/or HMRC rules e.g. changes arising from the Hutton Review of public sector pensions.	

Governance 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).	Employers are required to inform Surrey CC of any significant changes in membership numbers on a timely basis. Surrey CC monitors employer contributions on a monthly basis and queries any obvious variations. Employers are required to produce a year-end report on membership numbers. The council carries out in depth movement analysis on an annual basis. The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations. Deficit contributions are expressed as monetary amounts (see Annexe A).
Administering Authority not advised of an employer closing to new entrants.	This is only relevant to employers with an admission agreement (scheduled and resolution bodies cannot close the scheme to new entrants). It is a requirement of the admission agreement that Surrey CC is informed if the employer closes to new members.
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.	In addition to Surrey CC monitoring membership movements on a quarterly basis, it requires employers with Transferee Admission Agreements to inform it of forthcoming changes.
An employer ceasing to exist with insufficient funding or adequacy of a bond.	Surrey CC 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: 1. Seeking a funding guarantee from another scheme employer, or external body, where possible. 2. Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. 3. Vetting prospective employers before admission. 4. Where permitted under the regulations requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed. 5. Reviewing bond or guarantor arrangements at regular intervals. 6. Reviewing contributions if thought appropriate.

Consultation and publication:

90. This is the third Funding Strategy Statement for the Surrey Pension Fund. This updates the Funding Strategy Statement that was published following the 2007 actuarial valuation and reflects discussions between the Administering Authority, Hymans Robertson LLP and scheme employers during the 2010 actuarial valuation process.

91. The Administering Authority consulted the employers in the Fund on the funding strategy in the run up to the publication of the first strategy in 2005, the second strategy in 2008 and once again throughout the 2010 actuarial valuation process.

92. Draft valuation results were circulated to all employers by early January 2011. This allowed employers to comment on, or query, assumptions or individual results and to ensure that any changes in contribution rates could be incorporated into the budget setting process for 2011/2012.

93. The funding strategy is posted on Surrey CC's website, together with a copy of the Fund Actuary's report on the actuarial valuation. All employers will be sent a link to the website so that they can access the reports.

Annexe A

Statement of MINIMUM contributions to be paid by participating employers

	Deficit Recovery Period	Percentage of payroll due	Additional Monetary Amount		
		1 April 2011 to 31 March 2014	1 April 2011 to 31 March 2012	1 April 2012 to 31 March 2013	1 April 2013 to 31 March 2014
	Yrs		£	£	£
Large Scheduled bodies					
Surrey County Council	20	14.8%	16,797,000	16,797,000	16,797,000
Surrey Police Authority	20	12.0%	1,026,000	1,026,000	1,026,000
Elmbridge Borough Council	17	14.5%	756,000	756,000	756,000
Epsom & Ewell Borough Council	20	15.5%	418,000	418,000	418,000
Guildford Borough Council	20	14.6%	1,483,000	1,483,000	1,483,000
Mole Valley District Council	20	15.5%	578,000	578,000	578,000
Reigate & Banstead Borough Council	20	15.2%	1,167,000	1,167,000	1,167,000
Runnymede Borough Council[2]	20	16.3%	362,000	362,000	362,000
Spelthorne Borough Council	20	15.8%	478,000	478,000	478,000
Surrey Heath Borough Council	20	15.7%	381,000	381,000	381,000
Tandridge District Council	20	16.5%	931,000	931,000	931,000
Waverley Borough Council	17	16.5%	1,009,000	1,009,000	1,009,000
Woking Borough Council	20	15.0%	1,360,000	1,360,000	1,360,000

Notes to Large Scheduled Bodies schedule:

1. All employers accepted the proposal to stabilise contributions at the rate in payment in 2010/2011.
2. Deficit recovery period increased from 17 to 20 years.

		Percentage of payroll due	Additional Monetary Amount		
	Deficit Recovery Period	1 April 2011 to 31 March 2014	1 April 2011 to 31 March 2012	1 April 2012 to 31 March 2013	1 April 2013 to 31 March 2014
Small Scheduled bodies	Yrs		£	£	£
Ash Parish Council	20	19.2%	5,202	6,819	8,437
Bisley Parish Council	20	18.6%	0	0	0
Bramley Parish Council	20	19.2%	147	328	510
Claygate Parish Council	20	18.7%	119	66	13
Compton Parish Council	20	17.9%	0	0	0
Cranleigh Parish Council	20	19.2%	3,531	3,674	3,818
East Horsley Parish Council	20	18.7%	106	63	21
Effingham Parish Council	20	18.7%	0	7	14
Epsom & Walton Downs Conservators	20	19.2%	6,526	6,639	6,753
Farnham Town Council	20	19.2%	4,419	11,002	17,585
Frensham Parish Council	20	18.7%	157	83	10
Godalming Town Council	20	19.2%	5,366	6,206	7,046
Godstone Parish Council	20	18.7%	62	39	17
Haslemere Town Council	20	18.7%	434	241	49
Horley Town Council	20	19.2%	3,006	4,178	5,349
Lingfield Parish Council	20	18.7%	0	6	11
Merton & Sutton Joint Cemetery Board	20	19.2%	5,440	6,497	7,554
Nonsuch Park Jt. Management Committee	20	19.2%	6,143	6,311	6,480
Send Parish Council	20	19.2%	452	757	1,062
Shere Parish Council	20	19.2%	1,250	1,853	2,456
Tongham Parish Council	20	19.2%	171	393	616
Valuation Tribunal Service	20	15.6%	9,000	10,000	11,000
Warlingham Parish Council	20	18.7%	39	23	7
West End Parish Council	20	18.7%	84	51	18
Windlesham Parish Council	20	19.2%	1,714	3,865	6,017
Witley Parish Council	20	19.2%	891	2,105	3,318
Worplesdon Parish Council	20	18.7%	331	179	27

Notes to Small Scheduled Bodies schedule:

1. The statement reflects the decision to permit phasing in of deficit recovery payment increases.

	Deficit Recovery Period	Percentage of payroll due	Additional Monetary Amount		
		1 April 2011 to 31 March 2014	1 April 2011 to 31 March 2012	1 April 2012 to 31 March 2013	1 April 2013 to 31 March 2014
	Yrs		£	£	£
Academies[1]					
Cleves	20	25.6%	n/a	n/a	n/a
Glyn School	20	22.3%	n/a	n/a	n/a
Sunbury Manor	20	22.4%	n/a	n/a	n/a
Weydon	20	19.3%	n/a	n/a	n/a
Blenheim High School	20	24.2%	n/a	n/a	n/a
Collingwood	20	21.6%	n/a	n/a	n/a
Epsom and Ewell High School	20	21.6%	n/a	n/a	n/a
Fullbrook School	20	26.3%	8,000	8,000	8,000
George Abbot	20	22.9%	n/a	n/a	n/a
Goldsworth School	20	24.1%	n/a	n/a	n/a
Hinchley Wood School	20	22.2%	n/a	n/a	n/a
Howard of Effingham	20	22.2%	n/a	n/a	n/a
Magna Carta	20	22.2%	n/a	n/a	n/a
Rodborough Technology College	20	24.5%	n/a	n/a	n/a
Rosebery School	20	28.4%	n/a	n/a	n/a
Rydens	20	19.4%	n/a	n/a	n/a
South Farnham	20	21.5%	n/a	n/a	n/a
Thamesmead	20	22.5%	n/a	n/a	n/a
The Beacon School	20	32.7%	n/a	n/a	n/a
The Raleigh	20	25.4%	n/a	n/a	n/a
Thomas Knyvett	20	22.2%	n/a	n/a	n/a
Woolmer Hill Technology College	20	27.7%	n/a	n/a	n/a

	Deficit Recovery Period	Percentage of payroll due 1 April 2011 to 31 March 2014	Additional Monetary Amount 1 April 2011 to 31 March 2012	1 April 2012 to 31 March 2013	1 April 2013 to 31 March 2014
	Yrs		£	£	£
Colleges/Universities[2]					
Brooklands College	20	17.1%	83,284	124,142	165,000
East Surrey College	20	16.1%	63,919	103,596	144,000
Esher College3	20	16.7%	21,200	22,300	23,600
Godalming College	20	16.7%	9,664	18,132	26,600
Guildford College of FE & HE[3]	20	15.6%	440,000	463,000	488,000
NESCOT	20	16.6%	139,126	232,563	326,000
Reigate College	20	16.7%	10,158	19,029	27,900
Strodes College	20	16.7%	7,213	13,507	19,800
University for the Creative Arts	20	16.0%	307,372	440,686	574,000
University of Surrey	20	16.4%	492,277	822,639	1,153,000
Woking College	20	16.7%	4,021	7,561	11,100

Notes to Academies/Colleges/Universities Schedule:

1. For ease of administration, deficit contributions are to be recovered as a percentage of payroll for the period to 1 April 2014, hence there is no additional monetary amount.
2. Reflects the decision to permit phasing in of deficit contribution increases unless otherwise stated.
3. Reflects an employer decision not to phase in increases in deficit contributions.

	Deficit Recovery Period	1 April 2011 to 31 March 2014	1 April 2011 to 31 March 2012	1 April 2012 to 31 March 2013	1 April 2013 to 31 March 2014
	Yrs		£	£	£
Admitted bodies					
Ability Housing	n/a	21.5%	0	0	0
Accent Peerless Housing Group	7.9	18.8%	338,000	356,000	375,000
A2 Dominion Housing[1 3]	10.0	23.1%	178,000	187,000	197,000
Babcock 4S Ltd	7.2	20.2%	419,000	442,000	465,000
Carillion	5.9	21.1%	52,000	55,000	58,000
Childhood First[12]	5	24.3%	250,000	263,000	277,000
Care Quality Commission	6	21.0%	79,000	84,000	88,000
Elmbridge Housing Trust	6.6	20.0%	75,000	79,000	83,000
Fusion Lifestyle[1]	n/a	17.7%	0	0	0
George Burley & Sons	n/a	18.2%	0	0	0
Hanover Housing Association	7.9	18.1%	1,201,000	1,264,000	1,331,000
Mole Valley Housing Association	7.5	20.7%	50,000	52,000	55,000
Moor House School[1]	7.4	16.8%	169,000	179,000	188,000
Princess Alice Hospice[1]	4.5	19.2%	8,500	9,000	9,500
Raven Housing Trust	8.2	19.9%	100,000	105,000	111,000
Reigate Grammar School[12]	20	19.2%	94,000	99,000	104,000
Ringway	10	21.2%	2,000	2,000	2,000
Rosebery Housing Association	7.3	19.2%	11,000	11,500	12,000
Royal Grammar School, Guildford[12]	20	19.2%	54,500	57,000	60,000
SERCO	n/a	18.3%	0	0	0
Sir William Perkins's School[12]	20	19.2%	26,000	27,000	28,500
Skanska Construction UK	n/a	21.3%	0	0	0
Southern Alcohol Advisory Service[1]	9.4	15.5%	17,000	18,000	19,000
Surrey Association for Visual Impairment[1]	7	19.2%	97,000	102,000	108,000
Surrey Sports Park	n/a	10.9%	0	0	0
SWT Countryside Services Ltd[1]	8.8	22.1%	20,000	21,000	22,000
Waverley Hoppa Transport	6.3	19.4%	8,000	8,000	8,000
Woking Community Transport	7.3	19.2%	10,500	11,100	11,700

Notes to Admitted Bodies Schedule:

1. Denotes registered charity.

2. Deficit recovery period extended beyond the average remaining future working life to remaining future working life of the youngest active member. This recovery period will be revisited when the youngest active member leaves the employing body and the employer has been advised that higher deficit contributions may be required.

3. The employer is required to provide a bond to cover the difference between the actual contributions paid and the higher contributions that would be required if a lower deficit recovery period was used. If agreement on the adequacy of the bond is not in place by 30/6/2011 then the employer is required to pay the higher contributions.