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Greater Gwent (Torfaen) Pension Fund

Funding Strategy Statement April 2023

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1 Welcome to the Greater Gwent (Torfaen) Pension Fund's funding strategy statement

This document sets out the funding strategy statement (FSS) for the Greater Gwent (Torfaen) Pension Fund ("the Fund").

The Fund is administered by Torfaen County Borough Council ("the Administering Authority"). The Administering Authority has delegated responsibility for the management of the Fund to the Pensions Committee, who in turn delegate day to day functions to senior officers. The Fund's senior officers have worked with the Fund actuary, Hymans Robertson, to prepare this FSS which in turn has been approved by the Pensions Committee with effect from 13th March 2023.

There's a regulatory requirement for Torfaen County Borough Council to prepare an FSS. You can find out more about the regulatory framework in [Appendix A](#). If you have any queries about the FSS, contact pensions@torfaen.gov.uk

1.1 What is the Greater Gwent (Torfaen) Pension Fund?

The Fund is part of the Local Government Pension Scheme (LGPS). You can find more information about the LGPS at www.lgpsmember.org. The Administering Authority runs the Fund on behalf of participating employers, their employees, and current and future pensioners. You can find out more about roles and responsibilities in [Appendix B](#).

1.2 What are the funding strategy objectives?

The funding strategy objectives are to:

- take a prudent long-term view to secure the regulatory requirement for long-term solvency, with sufficient funds to pay benefits to members and their dependants
- use a balanced investment strategy to minimise long-term cash contributions from employers and meet the regulatory requirement for long-term cost efficiency
- where appropriate, ensure stable employer contribution rates
- reflect different employers' characteristics to set their contribution rates, using a transparent funding strategy
- use reasonable measures to reduce the risk of an employer defaulting on its pension obligations.

1.3 Who is the FSS for?

The FSS is mainly for employers participating in the Fund, because it sets out how money will be collected from them to meet the Fund's obligations to pay members' benefits.

Different types of employers participate in the Fund:

Scheduled bodies

Employers who are specified in a schedule to the LGPS regulations, including councils and employers like further education establishments. Scheduled bodies must give employees access to the LGPS if they can't accrue benefits in another pension scheme, such as another public service pension scheme.

Designating employers

Employers like town and community councils can join the LGPS through a resolution. If a resolution is passed, the Fund can't refuse entry. The employer then decides which employees can join the scheme.

Admission bodies

Other employers can join through an admission agreement. The Fund can set participation criteria for them and can refuse entry if the requirements aren't met. This type of employer includes contractors providing outsourced services like cleaning or catering to a scheduled body.

Some existing employers may be referred to as **community admission bodies** (CABs). CABs are employers with a community of interest with another scheme employer. Others may be called **transferee admission bodies** (TABs), that provide services for scheme employers. These terms aren't defined under current regulations but remain in common use from previous regulations.

1.4 How does the funding strategy link to the investment strategy?

The funding strategy sets out how money will be collected from employers to meet the Fund's obligations. Contributions, assets, and other income are then invested according to an investment strategy set by the Administering Authority. You can find a copy of the investment strategy statement on the Pension Fund's website.

The funding and investment strategies are closely linked. The Fund must be able to pay benefits when they are due – those payments are met from a combination of contributions (through the funding strategy) and asset returns and income (through the investment strategy). If investment returns or income fall short the Fund may need to increase contributions paid by employers in order to bridge the gap.

1.5 Does the funding strategy reflect the investment strategy?

The funding policy is consistent with the investment strategy. Future investment return expectations are set with reference to the investment strategy, including a margin for prudence which is consistent with the regulatory requirement that LGPS fund's take a 'prudent longer-term view' of funding liabilities (see [Appendix A](#))

1.6 How is the funding strategy specific to the Greater Gwent (Torfaen) Pension Fund?

The funding strategy reflects the specific characteristics of the fund employers and its own investment strategy.

2 How does the fund calculate employer contributions?

2.1 Calculating contribution rates

Employee contribution rates are set by the LGPS regulations.

Employer contributions are made up of two elements:

- **the primary contribution rate** – contributions payable towards future benefits
- **the secondary contribution rate** – the difference between the primary rate and the total employer contribution (usually linked to a historical funding deficit that has emerged in the Fund)

The primary rate also includes an allowance for the fund's expenses.

The fund actuary uses a model to project each employer's asset share over a range of future economic scenarios. The contribution rate takes each employer's assets into account as well as the projected benefits due to their members. The value of the projected benefits is worked out using employer membership data and the assumptions in [Appendix D](#).

The total contribution rate for each employer is then based on:

- **the funding target** – how much money the fund aims to hold for each employer
- **the time horizon** – the time over which the employer aims to achieve the funding target. The maximum permissible time horizon for employers is 20 years which is in line with professional advice and regulations
- **the likelihood of success** – the proportion of modelled scenarios where the funding target is met

This approach takes into account the maturing profile of the membership when setting employer contribution rates.

The fund may permit the prepayment of employer contributions in specific circumstances. Requests for this will be evaluated on a case-by-case basis.

2.2 The contribution rate calculation

Table 2: contribution rate calculation for individual or pooled employers

Type of employer	Scheduled bodies			CABs and designating employers		TABs*
Sub-type	Local authorities, police, fire	Colleges & universities		Open to new entrants	Closed to new entrants	(all)
Funding target**	Ongoing	Ongoing		Ongoing	Low-risk	Contractor exit basis, assuming fixed-term contract in the fund
Minimum likelihood of success	70%	70%		70%	70%	50%
Maximum time horizon	20 years	20 years		20 years	Future working lifetime subject to cap of 20 years. Horizon of up to 20 years may be used in certain circumstances	Three years in line with actuarial valuation cycle
Primary rate approach	The contributions must be sufficient to meet the cost of benefits earned in the future with the required likelihood of success at the end of the time horizon					
Secondary rate	Percentage with monetary floor	Monetary amount		Monetary amount	Monetary amount	Monetary amount
Stabilised contribution rate?	Yes	No		No	No	No
Treatment of surplus	Covered by stabilisation arrangement	Contributions kept at primary rate		Preferred approach: contributions kept at primary rate. Reductions may be permitted by the Administering Authority		Reduce contributions by spreading the surplus over the remaining contract term
Phasing of contribution changes	Covered by stabilisation arrangement	None		None	None	None

* Employers participating in the fund under a pass-through agreement will pay a contribution rate as agreed between the contractor and letting authority

** See [Appendix D](#) for further information on funding targets.

2.3 Making contribution rates stable

Making employer contribution rates reasonably stable is an important funding objective. This has been considered when putting together this funding strategy across all employers.

The Fund adopts an explicitly stabilised approach to setting contributions for certain employers, which keeps contribution variations within a pre-determined range from year-to-year.

After taking advice from the Fund actuary, the Fund believes the stabilisation mechanism continues to be a prudent longer-term strategy.

Table 1: current stabilisation approach

Type of employer	Local authorities and Police
Maximum contribution increase per year	+1% of pay
Maximum contribution decrease per year	-1% of pay

Stabilisation criteria and limits are reviewed during the valuation process. The Administering Authority may review them between valuations to respond to membership or employer changes.

2.4 Reviewing contributions between valuations

The Fund may amend contribution rates between formal valuations in line with its policy on contribution reviews which provides further rationale for the need for a review. The purpose of any review is to establish the most appropriate level of contributions which may lead to an increase or decrease in contributions.

2.5 Administering Authority discretion

Individual employers may be affected by circumstances not easily managed within the FSS rules and policies. If this happens, the Administering Authority may adopt alternative funding approaches on a case-by-case basis.

Additionally, the Administering Authority may allow greater flexibility to the employer's contributions if added security is provided. Flexibility could include things like a reduced contribution rate, extended time horizon, or permission to join a pool. Added security may include a suitable bond, a legally binding guarantee from an appropriate third party, or security over an asset.

The Fund will consider requests to prepay employer contributions and will evaluate each request on its own merits.

3 What additional contributions may be payable?

3.1 Pension costs – awarding additional pension and early retirement on non ill-health grounds

If an employer awards additional pension as an annual benefit amount, they pay an additional contribution to the fund as a single lump sum. The amount is set by guidance issued by the Government Actuary's Department (GAD) and updated from time to time. This guidance can be accessed on GAD's website.

If an employee retires before their normal retirement age on unreduced benefits, employers may be asked to pay additional contributions called strain payments.

Employers typically make strain payments as a single lump sum, though strain payments may be spread if the Administering Authority agrees:

Type of Employer	Timeframe
Major employing bodies	Up to 5 years
CABs and designating employers	Up to 3 years
TABs	Contract end or triennial valuation date, whichever is sooner

3.2 Pension costs – early retirement on ill-health grounds

If a member retires early because of ill-health, their employer is responsible for the funding strain, which may be a large sum. Funding strains are not payable immediately but are reflected in the contributions calculated at the next actuarial valuation.

The Administering Authority does not offer any arrangement to mitigate the risk of ill-health strain leading to large contribution increases. Individual employers should make their own arrangements if they are concerned about this risk.

4 How does the Fund calculate assets and liabilities?

4.1 How are employer asset shares calculated?

The Fund adopts a cashflow approach to track individual employer assets.

Each employer participating in the Fund has a notional share of the total assets, which is assessed annually by the actuary. The actuary starts with assets from the previous year-end, adding cashflows paid in/out and investment returns to give a new year-end asset value. The Fund actuary makes a simplifying assumption that all cashflow and investment returns are paid uniformly over the year. This assumption means that the sum of all employers' asset values is slightly different from the whole Fund asset total at the same date. This minimal difference is split between employers in proportion to their asset shares at each valuation.

If an employee moves from one employer to another within the Fund, assets equal to the cash equivalent transfer value (CETV) will move from the original employer to the receiving employer's asset share. This adjustment is carried out as part of each actuarial valuation.

Alternatively, if employees move when an outsourced contract begins, the fund actuary will calculate assets linked to the value of the liabilities transferring (see section 4).

4.2 How are employer liabilities calculated?

The fund holds membership data for all active, deferred and pensioner members. Based on this data and the assumptions in [Appendix D](#), the fund actuary projects the expected benefits for all members into the future. This is expressed as a single value – the liabilities – by allowing for expected future investment returns.

Each employer's liabilities reflect the experience of their own employees and ex-employees.

4.3 What is a funding level?

An employer's funding level is the ratio of the market value of asset share against liabilities. If this is less than 100%, the employer has a shortfall: the employer's deficit. If it is more than 100%, the employer is in surplus. The amount of deficit or surplus is the difference between the asset value and the liabilities value.

Funding levels and deficit/surplus values measure a particular point in time, based on a particular set of future assumptions. While this measure is of interest, for most employers the main issue is the level of contributions payable. The funding level does not directly drive contribution rates. See section 2 for further information on how rates are determined.

5 What happens when an employer joins the Fund?

5.1 When can an employer join the Fund

Employers can join the Fund if they are a new scheduled body or a new admission body. New designated employers may also join the Fund if they pass a designation to do so.

On joining, the Fund will determine the assets and liabilities for that employer within the Fund. The calculation will depend on the type of employer and the circumstances of joining.

A contribution rate will also be set. This will be set in accordance with the calculation set out in Section 2, unless alternative arrangements apply (for example, the employer has agreed a pass-through arrangement).

5.2 New admission bodies as a result of outsourcing services

New admission bodies usually join the Fund because an existing employer (usually a scheduled body like a council) outsources a service to another organisation (a contractor). This involves TUPE transfers of staff from the letting employer to the contractor. The contractor becomes a new participating employer in the Fund for the duration of the contract and transferring employees remain eligible for LGPS membership. At the end of the contract, employees typically revert to the letting employer.

Liabilities for transferring active members will be calculated by the Fund actuary as at the day before the outsourcing occurs. New contractors will be allocated an asset share equal to the value of the transferring liabilities. The admission agreement may set a different initial asset allocation, depending on contract-specific circumstances.

There is flexibility for outsourcing employers when it comes to pension risk potentially taken on by the contractor but any decision to outsource should be communicated to the Fund at the earliest opportunity. You can find more details on outsourcing options from the Administering Authority.

5.3 Other new employers

There may be other circumstances that lead to a new admission body entering the Fund, for example, the establishment of a wholly owned subsidiary company by a Local Authority. Calculation of assets and liabilities on joining and a contribution rate will be carried out allowing for the circumstances of the new employer.

New designated employers may also join the Fund. These are usually town and community councils. Contribution rates will be set using the same approach as other designated employers in the Fund.

5.4 Risk assessment for new admission bodies

Under the LGPS regulations, a new admission body must assess the risks it poses to the Fund if the admission agreement ends early, for example, if the admission body becomes insolvent or goes out of business. In practice, the Fund actuary assesses this because the assessment must be carried out to the Administering Authority's satisfaction.

After considering the assessment, the Administering Authority may decide the admission body must provide security, such as a guarantee from the letting employer, an indemnity, or a bond.

This must cover some or all of the:

- strain costs of any early retirements if employees are made redundant when a contract ends prematurely
- allowance for the risk of assets performing less well than expected
- allowance for the risk of liabilities being greater than expected

- allowance for the possible non-payment of employer and member contributions
- admission body's existing deficit.

The Fund's admissions policy is detailed here - <https://www.gwentpensionfund.co.uk/media/kfqltxs/employer-guide-to-policy-and-requirements-for-admitted-body-status.pdf>

5.5 What happens if an employer has a bulk transfer of staff?

Bulk transfer cases will be looked at individually, but generally:

- the Fund won't pay bulk transfers greater in value than either the asset share of the transferring employer in the Fund, or the value of the liabilities of the transferring members, whichever is lower
- the Fund won't grant added benefits to members bringing in entitlements from another Fund, unless the asset transfer is enough to meet the added liabilities
- the Fund may permit shortfalls on bulk transfers if the employer has a suitable covenant and commits to meeting the shortfall in an appropriate period, which may require increased contributions between valuations.

6 What happens when an employer leaves the Fund?

6.1 What is a cessation event?

Triggers for considering cessation from the Fund are:

- the last active member stops participating in the Fund.
 - The Administering Authority, at their discretion, can defer acting for up to three years by issuing a suspension notice. That means cessation won't be triggered if the employer takes on one or more active members during the agreed time.
 - In all cases the Administering Authority expects employers to communicate any decision to exit the scheme, or where LGPS membership continues to fall, so that appropriate planning and arrangements can be made to minimise the risk to both the Fund and the scheme employer of a sudden exit.
- employers who close to new entrants will face the inevitable prospect of eventual exit from the scheme and will therefore trigger a cessation at a future point in time. The employer may have their funding strategy changed by the Administering Authority, as advised by the Fund actuary, to prepare for their eventual exit from the scheme. The purpose of a change in funding strategy will be to minimise the risk of exit with a cessation deficit owing to the Fund and this could be achieved by adopting the low-risk basis as their funding target for contribution-setting purposes.
- insolvency, winding up or liquidation of the admission body
- a breach of the agreement obligations that isn't remedied to the fund's satisfaction
- failure to pay any sums due within the period required
- failure to renew or adjust the level of a bond or indemnity, or to confirm an appropriate alternative guarantor
- termination of a deferred debt arrangement (DDA).

If no DDA exists, the Administering Authority will instruct the fund actuary to carry out a cessation valuation to calculate if there is a surplus or a deficit when the employer leaves the fund.

6.2 What happens on cessation?

The Administering Authority must protect the interests of the remaining Fund employers when an employer leaves the Fund. The actuary aims to protect remaining employers from the risk of future loss. The funding target adopted for the cessation calculation is below. These are defined in [Appendix D](#).

- (a) Where there is no guarantor, cessation liabilities and a final surplus/deficit will usually be calculated using a low-risk basis, which is more prudent than the ongoing participation basis. The low-risk exit basis is defined in [Appendix D](#).
- (b) Where there is a guarantor, the guarantee will be considered before the cessation valuation. Where the guarantor is a guarantor of last resort, this will have no effect on the cessation valuation. Otherwise, the cessation may be calculated using the same basis that was used to calculate liabilities (and the corresponding asset share) on joining the fund.
- (c) Depending on the guarantee, it may be possible to transfer the employer's liabilities and assets to the guarantor without crystallising deficits or surplus. This may happen if an employer can't pay the contributions due and the approach is within the terms of the guarantee.

If the Fund can't recover the required payment in full, unpaid amounts will be paid by the related letting authority (in the case of a ceased admission body) or shared between the other Fund employers. This may require an

immediate revision to the rates and adjustments certificate or be reflected in the contribution rates set at the next formal valuation. The prospect of an employer leaving the Fund with an unaffordable cessation debt is considered a last resort by the Administering Authority and all reasonable steps will be taken to reduce this possibility as far as possible as part of the funding approach taken.

There are fees incurred in carrying out a cessation valuation. Fees and other costs are at the employer's expense and are deducted from the cessation surplus or added to the cessation deficit. This improves efficiency by reducing transactions between employer and Fund.

The cessation policy is available on the Pension Fund's website.

6.3 How do employers repay cessation debts?

If there is a deficit, full payment will usually be expected in a single lump sum or:

- spread over an agreed period if the employer enters into a debt spreading agreement (DSA);
- if an exiting employer enters into a deferred debt agreement (DDA), it stays in the fund and pays regular contributions until its funding level improves sufficiently that it is in surplus or can pay off the deficit. Payments are reassessed at each formal valuation.

The employer flexibility on exit policy is included in the cessation policy mentioned above.

6.4 What happens if there is a surplus?

If the cessation valuation shows the exiting employer has more assets than liabilities the Administering Authority will decide how much (if any) will be paid back to the employer based on actuarial advice which considers:

- the surplus amount
- the proportion of the surplus due to the employer's contributions (where this is possible to establish)
- any representations (like risk sharing agreements or guarantees) made by the exiting employer and any employer providing a guarantee or some other form of employer assistance/support
- any other relevant factors.

The exit credit policy is included in the cessation policy mentioned above.

6.5 What if an employer has no active members?

When employers leave the Fund because their last active member has left, they may pay a cessation debt, receive an exit credit, or enter a DSA. In the first two cases they have no further obligation to the Fund and either:

- a) their asset share runs out before all ex-employees' benefits have been paid. The other fund employers will be required to contribute to the remaining benefits.
- b) the last ex-employee or dependant dies before the employer's asset share is fully run down. The surplus will be shared between the other employers in the fund.

In both cases the fund actuary will effectively attribute the surplus/deficit to the other fund employers at the next actuarial valuation based on their share of the fund assets.

7 What are the statutory reporting requirements?

7.1 Reporting regulations

The Public Service Pensions Act 2013 requires the Government Actuary's Department to report on LGPS funds in England and Wales after each formal valuation, in what's usually called a Section 13 report. The report should include confirmation that employer contributions are set at the right level to ensure the fund's solvency and long-term cost efficiency.

7.2 Solvency

Employer contributions are set at an appropriate solvency level if the rate of contribution targets a funding level of 100% over an appropriate time, using appropriate assumptions compared to other funds. Either:

- (a) employers collectively can increase their contributions, or the fund can realise contingencies to target a 100% funding level
- or
- (b) there is an appropriate plan in place if there is, or is expected to be, a reduction in employers' ability to increase contributions as needed.

7.3 Long-term cost efficiency

Employer contributions are set at an appropriate long-term cost efficiency level if the contribution rate makes provision for the cost of current benefit accrual, with an appropriate adjustment for any surplus or deficit.

To assess this, the Administering Authority may consider absolute and relative factors.

Relative factors include:

1. comparing LGPS funds with each other
2. the implied deficit recovery period
3. the investment return required to achieve full funding after 20 years.

Absolute factors include:

1. comparing funds with an objective benchmark
2. the extent to which contributions will cover the cost of current benefit accrual and interest on any deficit
3. how the required investment return under relative considerations compares to the estimated future return targeted by the investment strategy
4. the extent to which contributions paid are in line with expected contributions, based on the rates and adjustment certificate
5. how any new deficit recovery plan reconciles with, and can be a continuation of, any previous deficit recovery plan, allowing for fund experience.

These metrics may be assessed by GAD on a standardised market-related basis where the fund's actuarial bases don't offer straightforward comparisons.

Appendices

Appendix A – The regulatory framework

A1 Why do funds need a funding strategy statement?

The Local Government Pension Scheme (LGPS) regulations require funds to maintain and publish a funding strategy statement (FSS). According to the Department for Levelling Up, Housing and Communities (DLUHC) the purpose of the FSS is to document the processes the Administering Authority uses to:

- *establish a **clear and transparent fund-specific strategy** identifying how employers' pension liabilities are best met going forward*
- *support the regulatory framework to maintain **as nearly constant employer contribution rates as possible***
- *ensure the fund meets its **solvency and long-term cost efficiency** objectives*
- *take a **prudent longer-term view** of funding those liabilities.*

To prepare this FSS, the Administering Authority has used guidance by the Chartered Institute of Public Finance and Accountancy (CIPFA).

A2 Consultation

Both the LGPS regulations and most recent CIPFA guidance state the FSS should be prepared in consultation with “persons the authority considers appropriate”. This should include ‘*meaningful dialogue... with council tax raising authorities and representatives of other participating employers*’.

The consultation process was as follows:

- A draft version of the FSS and associated policies was issued to members of the Local Pension Board, members of the Pensions Committee and Investment Advisors on 11th November 2022
- A draft version of the FSS and associated policies was issued to scheme employers participating in the scheme inviting comments and feedback by 23rd December 2022 at midday
- Comments were requested in 42 days;
- Following the end of the consultation period the FSS was updated to reflect consultation feedback as set out above and published on the Fund's website, with appropriate approval by Pension Committee on 13th March 2023

A3 How is the FSS published?

The FSS is made available on the Pension Fund's website [Forms and Publications | Greater Gwent \(Torfaen\) Pension Fund \(gwentpensionfund.co.uk\)](https://www.gwentpensionfund.co.uk/Forms-and-Publications/Greater-Gwent-Torfaen-Pension-Fund).

With notification of the publication of the revised document sent by email to each participating employer in the Fund, members of the Local Pension Board, Independent Advisors, and Investment Managers.

A full copy linked from the annual report and accounts of the Fund with effect from 1st April 2023.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the valuation. Amendments may be made before then if there are regulatory or operational changes. Any amendments will be consulted on, agreed by the Pensions Committee, and included in the Committee meeting minutes.

A5 How does the FSS fit into the overall fund documentation?

The FSS is a summary of the fund's approach to funding liabilities. It isn't exhaustive – the fund publishes other statements like the statement of investment principles, investment strategy statement, governance strategy and communications strategy. The fund's annual report and accounts also includes up-to-date fund information.

You can see all fund documentation at [Forms and Publications | Greater Gwent \(Torfaen\) Pension Fund \(gwentpensionfund.co.uk\)](https://www.gwentpensionfund.co.uk/forms-and-publications)

Appendix B – Roles and responsibilities

B1 The Administering Authority:

- 1 operates the fund and follows all Local Government Pension Scheme (LGPS) regulations
- 2 manages any conflicts of interest from its dual role as Administering Authority and a fund employer
- 3 collects employer and employee contributions, investment income and other amounts due
- 4 ensures cash is available to meet benefit payments when due
- 5 pays all benefits and entitlements
- 6 invests surplus money like contributions and income which isn't needed to pay immediate benefits, in line with regulation and the investment strategy
- 7 communicates with employers so they understand their obligations
- 8 safeguards the fund against employer default
- 9 works with the fund actuary to manage the valuation process
- 10 provides information to the Government Actuary's Department so they can carry out their statutory obligations
- 11 consults on, prepares, and maintains the funding and investment strategy statements
- 12 tells the actuary about changes which could affect funding
- 13 monitors the fund's performance and funding, amending the strategy statements as necessary
- 14 enables the local pension board to review the valuation process.

B2 Individual employers:

- 1 deduct the correct contributions from employees' pay
- 2 pay all contributions by the due date
- 3 have appropriate policies in place to work within the regulatory framework
- 4 make additional contributions as agreed, for example to augment scheme benefits or early retirement strain
- 5 tell the Administering Authority promptly about any changes to circumstances, prospects or membership which could affect future funding.
- 6 make any required exit payments when leaving the fund.

B3 The fund actuary:

- 1 prepares valuations, including setting employers' contribution rates, agreeing assumptions, working within FSS and LGPS regulations and appropriately targeting fund solvency and long-term cost efficiency
- 2 provides information to the Government Actuary Department so they can carry out their statutory obligations
- 3 advises on fund employers, including giving advice about and monitoring bonds or other security
- 4 prepares advice and calculations around bulk transfers and individual benefits
- 5 assists the Administering Authority to consider changes to employer contributions between formal valuations

- 6 advises on terminating employers' participation in the fund
- 7 fully reflects actuarial professional guidance and requirements in all advice.

B4 Other parties:

- 1 internal and external investment advisers ensure the investment strategy statement (ISS) is consistent with the funding strategy statement
- 2 investment managers, custodians and bankers play their part in the effective investment and dis-investment of fund assets in line with the ISS
- 3 auditors comply with standards, ensure fund compliance with requirements, monitor and advise on fraud detection, and sign-off annual reports and financial statements
- 4 governance advisers may be asked to advise the Administering Authority on processes and working methods
- 5 internal and external legal advisers ensure the fund complies with all regulations and broader local government requirements, including the Administering Authority's own procedures
- 6 the Department for Levelling Up, Housing and Communities, assisted by the Government Actuary's Department and the Scheme Advisory Board, work with LGPS funds to meet Section 13 requirements.

Appendix C – Risks and controls

C1 Managing risks

The Administering Authority has a risk management programme and maintains a risk register which identifies financial, demographic, regulatory and governance risks.

Details of the key fund-specific risks and controls are below and be accessed through the risk register.

C2 Financial risks

Risk	Summary of control mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities and contribution rates 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>
Inappropriate long-term investment strategy.	<p>Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes.</p> <p>Chosen option considered to provide the best balance.</p>
Active investment manager under-performance relative to benchmark.	<p>Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.</p>
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 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	<p>An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in</p>

	contributions.
Orphaned employers give rise to added costs for the Fund	<p>The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.</p> <p>If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 0).</p>

C3 Demographic risks

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

C4 Regulatory risks

Risk	Summary of Control Mechanisms
Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform, legal judgements or the cost control mechanism.	<p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>The Administering Authority is monitoring the progress on the cost control mechanism and related legal challenges and will consider the impact in the 2022 valuation or at an interim valuation date if necessary.</p>
Time, cost and/or reputational risks associated with any MHCLG intervention triggered by the Section 13 analysis.	Take advice from Fund Actuary on position of Fund as at prior valuation, and consideration of proposed valuation approach relative to anticipated Section 13 analysis.
Changes by Government to particular employer participation in LGPS funds, leading to impacts on funding and/or investment strategies.	<p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.</p>

C5 Governance risks

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

Risk	Summary of Control Mechanisms
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>
An employer ceasing to exist with insufficient funding or adequacy of a bond.	<p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.</p> <p>The risk is mitigated by:</p> <p>Seeking a funding guarantee from another scheme employer, or external body, where-ever possible.</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.</p> <p>Reviewing contributions well ahead of cessation if thought appropriate.</p>
An employer ceasing to exist resulting in an exit credit being payable	<p>The Administering Authority regularly monitors admission bodies coming up to cessation</p> <p>The Administering Authority invests in liquid assets to ensure that exit credits can be paid when required.</p>

C6 Employer covenant assessment and monitoring

Many of the employers participating in the Fund, such as admitted bodies (including TABs and CABs), have no local tax-raising powers. The Fund assesses and monitors the long-term financial health of these employers to assess an appropriate level of risk for each employer's funding strategy.

C7 Climate risk and TCFD reporting

The Fund recognises that climate risk has the potential to be significant to the organisation and society in general and has considered climate-related risks when setting the funding strategy. The Fund included climate scenario stress testing in the contribution modelling exercise for the local authority and police employers at the 2022 valuation. The modelling results under the stress tests were slightly worse than the core results but were still within risk tolerance levels, particularly given the severity of the stresses applied. The results provide assurance that the modelling approach does not significantly underestimate the potential impact of climate change and that the funding strategy is resilient to climate risks. The results of these stress tests may be used in future to assist with disclosures prepared in line with Task Force on Climate-Related Financial Disclosures (TCFD) principles.

The same stress tests were not applied to the funding strategy modelling for smaller employers. However, given that the same model is used for all employers and that the local authority employers make up the vast majority of the Fund's assets and liabilities, applying the stress tests to all employers was not deemed proportionate at this stage and would not be expected to result in any changes to the agreed contribution plans.

The Fund has a Responsible Investment Policy Framework and a separate Climate Change Policy, both of which were last agreed by Pensions Committee in March 2022.

Appendix D – Actuarial assumptions

The Fund's actuary uses a set of assumptions to determine the strategy, and so assumptions are a fundamental part of the funding strategy statement.

D1 What are assumptions?

Assumptions are used to estimate the benefits due to be paid to members. Financial assumptions determine the amount of benefit to be paid to each member, and the expected investment return on the assets held to meet those benefits. Demographic assumptions are used to work out when benefit payments are made and for how long.

The funding target is the money the Fund aims to hold to meet the benefits earned to date.

Any change in the assumptions will affect the funding target and contribution rate, but different assumptions don't affect the actual benefits the Fund will pay in future.

D2 What assumptions are used to set the contribution rate?

The Fund doesn't rely on a single set of assumptions when setting contribution rates, instead using Hymans Robertson's Economic Scenario Service (ESS) to project each employer's assets, benefits and cashflows to the end of the funding time horizon.

ESS projects future benefit payments, contributions and investment returns under 5,000 possible economic scenarios, using variables for future inflation and investment returns for each asset class, rather than a single fixed value.

For any projection, the Fund actuary can assess if the funding target is satisfied at the end of the time horizon.

Table: Summary of assumptions underlying the ESS, 31 March 2022

		Annualised total returns									CPI inflation	17y real yield
		Cash	Fixed Interest Gilts (long)	UK Equity	Global Equity	Property	Infr. Debt	Emerging Markets Equity	Multi Asset Credit	Private debt		
10y	16%ile	0.8%	-1.5%	-0.4%	-0.7%	-0.6%	-0.3%	-2.5%	1.7%	2.7%	-0.1%	-1.7%
	50%ile	1.8%	0.7%	5.7%	5.6%	4.4%	2.2%	5.8%	3.5%	6.0%	1.6%	-0.5%
	84%ile	2.9%	2.8%	11.6%	11.7%	9.5%	4.3%	14.4%	5.2%	9.2%	3.2%	0.7%
20y	16%ile	1.0%	-0.2%	1.7%	1.5%	1.4%	1.2%	0.1%	2.8%	4.3%	1.1%	-0.7%
	50%ile	2.4%	0.9%	6.2%	6.1%	5.0%	2.7%	6.3%	4.4%	6.8%	2.1%	1.1%
	84%ile	4.0%	2.0%	10.6%	10.8%	8.9%	4.2%	12.8%	6.0%	9.2%	3.2%	2.7%
40y	16%ile	1.2%	1.2%	3.2%	3.1%	2.6%	2.3%	2.1%	3.6%	5.5%	2.0%	-0.6%
	50%ile	2.9%	1.9%	6.7%	6.5%	5.5%	3.7%	6.8%	5.3%	7.7%	3.1%	1.3%
	84%ile	4.9%	2.8%	10.2%	10.2%	8.8%	5.1%	11.7%	7.1%	10.0%	4.4%	3.2%
Vol (1 yr)		2%	8%	18%	19%	15%	8%	26%	6%	10%	7%	

D3 What financial assumptions were used?

Future investment returns and discount rate

The Fund uses a risk-based approach to generate assumptions about future investment returns over the funding time horizon, based on the investment strategy.

The discount rate is the annual rate of future investment return assumed to be earned on assets after the end of the funding time horizon. The discount rate assumption is set as a margin above the risk-free rate.

Assumptions for future investment returns depend on the funding objective.

	Employer type	Margin above risk-free rate
Ongoing basis	All employers except transferee admission bodies and closed community admission bodies	2.2%
Low-risk exit basis	Community admission bodies closed to new entrants	0.4%
Contractor exit basis	Transferee admission bodies	Equal to the margin used to allocate assets to the employer on joining the Fund

Discount rate (for funding level calculation as at 31 March 2022 only)

For the purpose of calculating a funding level at the 2022 valuation the discount rate is based on the investment return expected to be achieved by the Fund's assets over the 20 years following the valuation, with a given likelihood. The resulting discount rates are as follows:

	Likelihood	Discount rate at 31 March 2022 (% pa)
Ongoing basis	70%	4.3%
Low-risk exit basis	90%	2.2%

Pension increases and CARE revaluation

Increases to pensions/deferred benefits and revaluation of CARE benefits are in line with the Consumer Price Index (CPI) and determined by the regulations.

The CPI assumption is based on Hymans Robertson's ESS model. The median value of expected CPI inflation from the ESS over the 20 years following the valuation was 2.7% pa on 31 March 2022.

Salary growth

The salary increase assumption at the latest valuation has been set to 0.5% above CPI pa plus a promotional salary scale.

D4 What demographic assumptions were used?

Demographic assumptions are best estimates of future experience. The Fund uses advice from Club Vita to set demographic assumptions, as well as analysis and judgement based on the Fund's experience.

Demographic assumptions vary by type of member, so each employer's own membership profile is reflected in their results.

Life expectancy

The longevity assumptions are a bespoke set of VitaCurves produced by detailed analysis and tailored to fit the Fund's membership profile.

Allowance has been made for future improvements to mortality, in line with the 2021 version of the continuous mortality investigation (CMI) published by the actuarial profession. The starting point has been adjusted by +0.25% to reflect the difference between the population-wide data used in the CMI and LGPS membership. The long-term rate of mortality improvements is assumed to be 1.5% pa.

The smoothing parameter used in the CMI model is 7.0. There is little evidence currently available on the long-term effect of Covid-19 on life expectancies. To avoid an undue impact from recently mortality experience on long-term assumptions, no weighting has been placed on data from 2020 and 2021 in the CMI.

Other demographic assumptions

Retirement in normal health	Members are assumed to retire at the earliest age possible with no pension reduction.
Promotional salary increases	Sample increases below
Death in service	Sample rates below
Withdrawals	Sample rates below
Retirement in ill health	Sample rates below
Family details	A varying proportion of members are assumed to have a dependant partner at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. After retirement the proportion is adjusted to reflect dependant mortality. Males are assumed to be 3 years older than females, and partner dependants are assumed to be opposite sex to members.
Commutation	65% of maximum tax-free cash
50:50 option	1% of members will choose the 50:50 option.

Males

Age	Salary scale	Incidence per 1000 active members per year						
		Death before retirement	Withdrawals		Ill-health tier 1		Ill-health tier 2	
	FT & PT	FT & PT	FT	PT	FT	PT	FT	PT
20	107	0.17	283.02	1000.00	0.00	0.00	0.00	0.00
25	120	0.17	186.94	751.84	0.00	0.00	0.00	0.00
30	134	0.20	132.64	533.36	0.00	0.00	0.00	0.00
35	145	0.24	103.63	416.68	0.10	0.07	0.02	0.01
40	152	0.41	83.44	335.37	0.16	0.12	0.03	0.02
45	158	0.68	78.37	314.94	0.35	0.27	0.07	0.05
50	162	1.09	64.61	259.32	0.90	0.68	0.23	0.17
55	162	1.70	50.87	204.31	3.54	2.65	0.51	0.38
60	162	3.06	45.34	182.02	6.23	4.67	0.44	0.33

Females

Age	Salary scale	Incidence per 1000 active members per year						
		Death before retirement	Withdrawals		Ill-health tier 1		Ill-health tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	107	0.10	246.70	514.11	0.00	0.00	0.00	0.00
25	120	0.10	166.00	345.88	0.10	0.07	0.02	0.01
30	134	0.14	139.15	289.90	0.13	0.10	0.03	0.02
35	145	0.24	120.10	250.12	0.26	0.19	0.05	0.04
40	152	0.38	99.95	208.09	0.39	0.29	0.08	0.06
45	158	0.62	93.28	194.16	0.52	0.39	0.10	0.08
50	162	0.90	78.64	163.52	0.97	0.73	0.24	0.18
55	162	1.19	58.68	122.13	3.59	2.69	0.52	0.39
60	162	1.52	47.29	98.31	5.71	4.28	0.54	0.40

D5 What assumptions apply in a cessation valuation following an employer's exit from the Fund?

Low-risk exit basis

Where there is no guarantor, the low-risk exit basis will apply.

The financial and demographic assumptions underlying the low-risk exit basis are explained below:

The discount rate is set in the same way as for ongoing employers with a more prudent (higher) likelihood of 90%. This corresponded to a discount rate of 2.2% pa on 31 March 2022.

All other assumptions are the same as for the ongoing basis.

Contractor exit basis

Where there is a guarantor (e.g., in the case of contractors where the local authority guarantees the contractor's admission in the Fund), the contractor exit basis will apply.

The financial and demographic assumptions underlying the contractor exit basis are equal to those set for calculating contributions rates. Specifically, the discount rate is set equal to the risk-free rate at the cessation date, plus a margin equal to that set to allocate assets to the employer on joining the Fund.