Report to: **Pension Committee**

Date of meeting: **16 March 2020**

By: **Chief Finance Officer**

Title: **Triennial Valuation 2019, Funding Strategy Statement and Investment Strategy Statement**

Purpose: **To seek input and approval to the Fund's revised strategy statements and draft 2019 Valuation report**

RECOMMENDATIONS: The Pension Committee is recommended to:

1) consider and approve the draft 2019 Valuation report (Appendix 1);

2) approve the revised Funding Strategy Statement, to become effective from 1 April 2020 (Appendix 2); and

3) approve the revised Investment Strategy Statement, to become effective from 1 April 2020 (Appendix 3).

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1. Background

1.1 It is the responsibility of East Sussex County Council, acting in its capacity as Administering Authority to the East Sussex Pension Fund (the Fund)., to prepare, publish and maintain the Fund's Funding Strategy Statement and Investment Strategy Statement. These documents have been reviewed alongside the 2019 Valuation.

1.2 The 2019 Valuation of the Fund on a triennial basis is a regulatory requirement and is used to determine contribution rates payable by participating employers for the period commencing 1 April 2020. The valuation is carried out under Regulation 62 of the Local Government Pension Scheme Regulations 2013 ("the Regulations"). The Fund Actuary has now prepared the 2019 Valuation report which records the high-level outcomes of the actuarial valuation.

2. Triennial Valuation 2019 report

2.1 The Pension Committee meetings of September 2019 and November 2019 received update reports and presentations from the Fund Actuary setting out the initial 2019 whole fund valuation results and draft employer contributions (with particular focus on the Major Authorities' contribution rates in the Fund). The initial results showed a current whole fund funding level of 108% (i.e. where the market value of assets of the Fund is compared against a value of the benefits accrued by all members in the Fund to date) and employer contribution rates which were (on average) expected to slightly reduce. These were approved by the Pension Committee alongside the Fund's revised draft Funding Strategy Statement.

2.2 Working alongside the Fund Actuary, Fund Officers have now completed the consultation period with employers around the revised Funding Strategy Statement and their individual results and contribution rates. This included a well-attended Employer Forum on 29th November, where a presentation was received from the Fund Actuary.

2.3 The Fund Actuary has now drafted the 2019 Valuation report which records the high-level outcomes of the actuarial valuation, including the value of the assets and liabilities of the Fund as at 31 March 2019 and the required rate of employers' contributions to the Fund for the period from 1 April 2020 to 31 March 2023 (set out in the Rates and Adjustments certificate). The report is provided in Appendix 1. Please note at the time of writing (early February) there were a small number of employer contribution rates which were still to be finalised. Therefore, the draft report

does not include the Rates and Adjustments certificate or the total employer contributions the Fund can expect to receive over the three years from 1 April 2020.

2.4 This report must be published no later than by 31 March 2020.

3. Funding Strategy Statement (FSS)

3.1 Under the Regulations, all Local Government Pension Scheme (LGPS) funds have a statutory obligation to produce a Funding Strategy Statement (FSS). The Fund reviews the FSS at least every three years alongside the valuation but also from time-to-time when required. The current version of the FSS was approved by this Committee on February 2019 following updates required as a result of the introduction of "exit credits" becoming available to exiting employers.

3.2 The revised FSS was approved in draft form by the Pension Committee in November 2019. Following this approval, the draft version was issued to all participating employers for consultation alongside their individual results and contribution rates in November 2019. This consultation ended on 17th January 2020. No comments on the contents of the FSS were received from employers for consideration.

3.3 Since the draft version of the revised FSS was approved by the Pension Committee, Ministry of Housing Communities and Local Government (MHCLG) has published its response to the consultation last year on the exit credit regime that was introduced into the LGPS in May 2018 (NB an exit credit is the funding surplus remaining at the end of an employer's participation in the Fund). These amendments will come into force on 20 March 2020.

3.4 A key change from the amendments is the provision of a new discretionary power to the Fund to decide if an exit credit should be payable to an exiting employer. The Fund's decision should take account of:

i. *The extent to which the employer's assets are in excess of its liabilities* – this is not contentious for the Fund as our actuary tracks each employer's assets and liabilities (unless a pass-through arrangement is in place)

ii. *The proportion of the excess of assets which has arisen because of the value of employer's contributions* – the initial regulations had unintentionally enabled some short-term employers to leave funds with large exit credits (due mainly to strong growth on the assets that were transferred from letting authorities). In some cases, across the LGPS, exit credits have been large and have even dwarfed any contributions made by the contractor. This amendment now allows the Fund to consider whether or not to restrict future exit credits to growth only on the money paid by employers.

iii. *Any representations made by the exiting employer and its letting authority/guarantor* – the intention behind this is to allow any risk-sharing arrangements that sit behind an employer's participation to be taken into account. The Government has said however that there is no onus on the Fund to 'enquire into the precise risk sharing arrangements adopted'. Instead, it will be left to the employer and letting authority/guarantor to explain why the arrangements made by them make payment of an exit credit more or less appropriate. There is a risk that the Fund could get caught up in the middle of arguments between employers over commercial terms that were agreed outside the Fund, leading to higher actuarial, legal and internal management costs, and of course delays to the settlement of cessation valuations. It is worth noting that the amending regulations force the Fund to notify how it intends to deal with the exit credit to both parties ahead of any payment.

iv. *Any other relevant factors* – this gives a lot of power to the Fund to take into account whatever factor it feels is relevant in its decision. The Fund will need to ensure that it

applies this power consistently over time and provide justification to the employer and letting authority/guarantor about why any factors have been taken into account.

3.5 In addition, the amendments have extended the maximum time period by which an exit credit must be paid to an employer from three to six months.

3.6 In addition to making allowance for the exit credit amendments, since the November 2019 approved draft, the following minor changes have been made:

- Adding flexibility to allow Major Authorities to have their secondary contribution rates certified as either % of pay or monetary amounts;
- Incorporating the Fund's updated Cessation policy as an appendix to the FSS; and
- Updating the effective date, consultation dates and officer contact details.

3.7 The final version of the revised FSS, which includes revisions to allow for the amendments to the exit credit regime outlined above on page 16-17 and within the updated Cessation Policy, has been prepared in collaboration with the Fund Actuary. This is provided in Appendix 2.

4 Investment Strategy Statement (ISS)

4.1 There is a statutory requirement to maintain an Investment Strategy Statement (ISS) that reflects the Fund's governance and investment arrangements. The changes that have been made to the ISS reflect:

- the recommendations made by William Bourne in his 'Investment Governance Review' paper that was approved by the Committee at the November meeting; and
- the Investment Beliefs section set out in Appendix 2 of the ISS has also been expanded to evidence where the beliefs are implemented in either the working of the Committee or the Fund's investment strategy and structure.

4.2 The update document is provided in Appendix 3.

5. Conclusion and reasons for recommendations

5.1 The Fund Officers have been working with their advisors to progress the review of the Fund's strategy statements alongside the 2019 Valuation. The revised FSS and ISS are recommended for approval. Once approved, the Funding and Investment strategy statements will become effective from 1 April 2020.

5.2 The Fund Actuary has drafted the 2019 Valuation report including contribution rates payable by participating employers for the period commencing 1 April 2020. This draft report is recommended for approval. The report will then be published no later than 31 March 2020.

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HYMANS ROBERTSON

East Sussex Pension Fund

DRAFT Actuarial valuation as at 31 March 2019

Valuation report

February 2020

Contents

1 Introduction

Background to the actuarial valuation

We have been commissioned by East Sussex County Council ("the Administering Authority") to carry out an actuarial valuation of the East Sussex Pension Fund. ("the Fund") as at 31 March 2019 as required under Regulation 62 of the Local Government Pension Scheme Regulations 2013 ("the Regulations").

The actuarial valuation is a risk management exercise with the purpose of reviewing the current funding plans and setting contribution rates for the Fund's participating employers for the period from 1 April 2020 to 31 March 2023. This report summarises the outcomes of the valuation and the underlying advice provided to the Administering Authority throughout the valuation process.

This summary report is the culmination of other communications in relation to the valuation, in particular:

- Our 2019 valuation toolkit which sets out the methodology used when reviewing funding plans:
- Our "Setting the discount rate" and "Salary growth assumption" papers (dated 01 February 2019) which discuss the valuation assumptions;
- Our Initial Results Report dated 16 September 2019 which outlines the whole fund results and inter-valuation experience;
- The Funding Strategy Statement which details the approach taken to adequately fund the current and future benefits due to members.

Reliances and Limitations

This report has been prepared for the sole use of East Sussex County Council in its role as Administering Authority of the Fund to provide an actuarial valuation of the Fund as required under the Regulations. It has not been prepared for any other third party or for any other purpose. We make no representation or warranties to any third party as to the accuracy or completeness of this report, no reliance should be placed on this report by any third party and we accept no responsibility or liability to any third party in respect of it.

The totality of our advice complies with the Regulations as they relate to actuarial valuations.

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with where material:

- TAS 100 – Principles for technical actuarial work;
- TAS 300 – Pensions.

[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work.

Use of this report by other parties

This report is addressed to the Administering Authority of the Fund only. We appreciate that other parties may also seek information about the 2019 valuation process and methodology. We would encourage such parties to refer to the following publicly available documents for further information:

- The Fund's Funding Strategy Statement;
- The Fund's Investment Strategy Statement;
- Published meeting papers and minutes for the quarterly meetings of the Fund's Pensions Committee.

Considering these papers alongside this valuation report will provide a more complete view of the Fund's funding strategy and decision-making process surrounding this. These documents are available on the Fund's website or on request.

2 Valuation approach

Employer contribution rates

The purpose of the valuation is to review the current funding strategy and ensure the Fund has a contribution plan and investment strategy in place that will enable it to pay members' benefits as they fall due.

Valuations for open defined benefit multi-employer pension funds such as the East Sussex Pension Fund are complex. Firstly, the time horizons are very long; benefits earned in the LGPS today will be paid out over a period of the next 80 years or more, and new members will continue to join in the future. Secondly, as they depend on unknowns such as future inflation and life expectancy, the actual value of future benefit payments is uncertain. Finally, to keep contributions affordable, the Fund invests in return seeking assets which have higher levels of future volatility.

Given the above and that the future cannot be predicted with certainty, employer contribution rates can only ever be an estimate. However, the valuation approach adopted uses an understanding of the Fund, and the uncertainties and risks discussed above, to quantify the likelihood of the contribution plan and investment strategy for each employer being sufficient to fund future benefits.

This is achieved in practice by following the process outlined below.

Step 1: The Fund sets a funding target (or funding basis) for each employer which defines the estimated amount of assets to be held to meet the future benefit payments.

Step 2: The Fund sets the funding time horizon over which the funding target is to be achieved.

Step 3: The Fund sets contributions that give a sufficiently high likelihood of meeting the funding target over the set time horizon.

These three steps are central to the "risk-based" approach to funding which is described in Guide 5 of our 2019 valuation toolkit[2].

The risk-based approach uses an Asset Liability Model (described in Guide 6) of the 2019 valuation toolkit) to project each employer's future benefit payments, contributions and investment returns into the future under 5,000 possible economic scenarios. Future inflation (and therefore benefit payments) and investment returns for each asset class (and therefore asset values) are variables in the projections. Further details of these variables are provided in Appendix B. The investment strategy underlying the projection of employer asset values is provided in Appendix A.

By projecting the evolution of an employer's assets and benefit payments 5,000 times, a contribution rate can be set that results in a sufficient number of the future projections being successful i.e. meeting the funding target by the funding time horizon.

The risk-based approach to setting employer contributions allows the Fund and its employers to understand and quantify the level of risk inherent in funding plans, something that is not possible using a single set of assumptions alone.

Further detail on the approach to calculating contributions for individual employers, including the parameters used in the three steps for each type of employer, is set out in the Funding Strategy Statement.

[2] https://www.hymans.co.uk/media/uploads/LGPS_2019_Valuation_Toolkit_Guides.pdf

Funding position as at 31 March 2019

The valuation also offers an opportunity to measure the Fund's funding position as at 31 March 2019. Whilst this measurement has limited insight into understanding the long term ability to be able to pay members' benefits, it is a useful summary statistic.

For the purposes of this valuation we have adopted a "mark to market" approach, meaning that the Fund's assets have been taken into account at their market value and the liabilities have been valued by reference to a single set of assumptions based on market indicators at the valuation date. These assumptions are detailed in Appendix B. As we have taken a market-related approach to the valuation of both the assets and the liabilities, we believe that they have been valued on a consistent basis.

Significant events

The figures in this report are based on our understanding of the benefit structure of the LGPS in England and Wales as at 31 March 2019. Details can be found at http://www.lgpsregs.org/.

McCloud ruling

The LGPS benefit structure is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. At the time of writing, the format and scope of any benefit changes in light of the McCloud ruling is still unknown. In line with the advice issued by the Scheme Advisory Board in May 2019, the following allowance has been made at the valuation for the McCloud ruling:

- Employer contribution rates: additional prudence in funding plans via an increase in the likelihood of success (step 3) when setting contribution rates;
- Measurement of funding position at 31 March 2019: no allowance.

Further details of the approach taken are set out in Section 2.7 of the Funding Strategy Statement.

Indexation and equalisation of Guaranteed Minimum Pensions (GMP)

As a result of the Government's introduction of a single-tier state pension (STP) there is currently uncertainty around who funds certain elements of increases on GMPs for members reaching State Pension Age after 6 April 2016.

As part of the introduction of STP, the Government confirmed that public service pension schemes, including the LGPS, will be responsible for funding all increases on GMP as an 'interim solution'. In their January 2018 consultation response, HM Treasury confirmed that the 'interim solution' will continue to remain in place up to 5 April 2021. Thereafter the Government's preferred approach is to convert GMP to scheme pension.

For the 2019 valuation, given the Government's preference for conversion to scheme benefits, we have assumed that all increases on GMPs for members reaching State Pension Age after 6 April 2016 will be paid for by LGPS employers. This has served to increase the value placed on the liabilities.

The Government have also stated that their preferred long term indexation solution of converting GMP to scheme pension will also meet the requirements of equalisation.

3 Valuation results

Employer contribution rates

The key objective of the Fund is to set employer contributions that are likely to be sufficient to meet both the cost of new benefits accruing and to address any funding surplus or deficit relative to the funding target over the agreed time horizon. A secondary objective is to maintain relatively stable employer contribution rates.

In order to meet the above objectives, the methodology set out in Section 2 has been used to set employer contributions from 1 April 2020.

Employer contributions are made up of two elements:

a) the estimated cost of future benefits being built up each year, after deducting members' own contributions and including an allowance for the Fund's administration expenses. This is referred to as the "*Primary rate*", and is expressed as a percentage of members' pensionable pay; plus

b) an adjustment for the difference between the Primary rate above, and the total contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, the Secondary rate is in respect of benefits already accrued at the valuation date. The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The Primary rate and Secondary rate for every contributing employer in the Fund is set out in the Rates and Adjustments Certificate in Appendix C.

Each employer has been certified primary and secondary contributions that are appropriate for that employer's circumstances and which reflects that employer's experience. However, broadly speaking:

- Primary contribution rates have been subject to some upwards pressure as a result of a weaker outlook for future investment returns and the additional prudence built into funding plans to allow for the McCloud ruling;
- Secondary contributions have decreased as employer assets have increased since 31 March 2016, reducing any extra contributions required in respect of benefits accrued to the valuation date. The impact of this on secondary contributions has been partially offset by the additional prudence built into funding plans to allow for the McCloud ruling.

The table below summarises the whole fund Primary and Secondary Contribution rates at this valuation. The Primary rate is the payroll weighted average of the underlying individual employer primary rates and the Secondary rate is the total of the underlying individual employer secondary rates, calculated in accordance with the Regulations and CIPFA guidance. The whole fund Primary and Secondary contributions calculated at the 2016 valuation of the Fund are shown for comparison.

TBC once all employer rates are confirmed

The Primary rate includes an allowance of 0.4% of pensionable pay for the Fund's expenses (0.4% at the 2016 valuation).

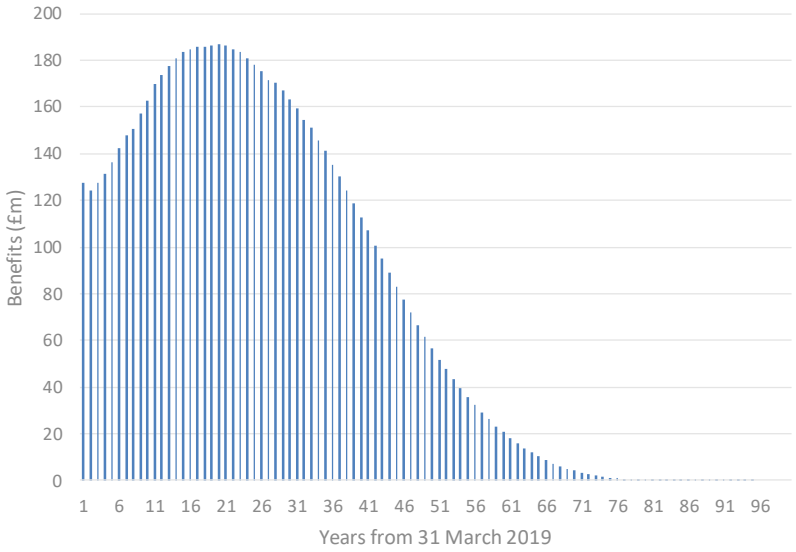
The average employee contribution rate is 6.4% of pensionable pay (6.1% at the 2016 valuation).

Funding position as at 31 March 2019

The funding position is a summary statistic often quoted to give an indication of the health of the fund. It is limited as it provides only a snapshot in time and is based on a single set of assumptions about the future. To measure the funding position at 31 March 2019, we compare the value of the Fund's assets on that

date against the expected cost (including an allowance for future investment returns) of all the future benefit payments accrued up to the valuation date (the liabilities).

The chart below details the projected future benefit payments based on the membership data summarised in Appendix A and the demographic, salary and benefit increases assumptions summarised in appendix B.

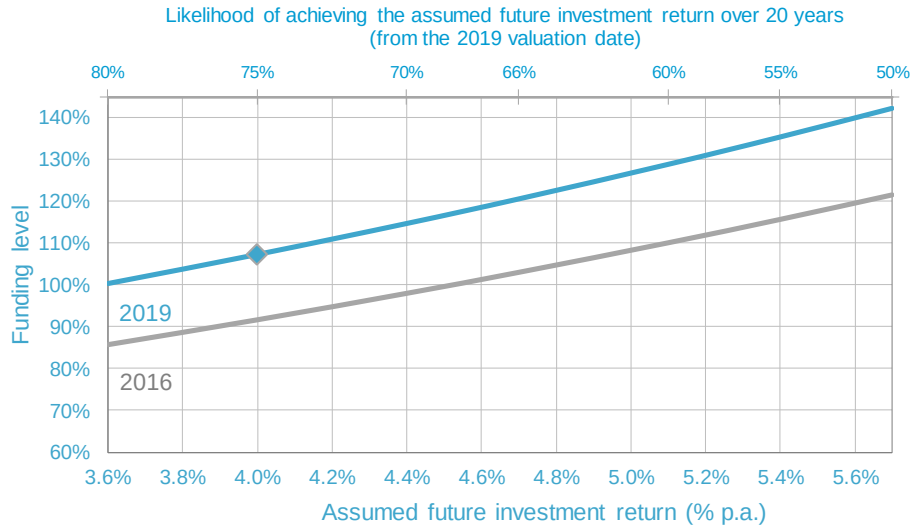


Using an assumption about the future investment return generated from the Fund's assets then allows a value to be placed on these payments in today's money; the liabilities. The higher the assumed investment return, the lower the liability value and therefore the higher the funding level.

The value placed on the liabilities is extremely sensitive to the investment return assumption. Based on the Fund's current investment strategy (detailed in Appendix A) and the same model used in the contribution rate calculations, it is estimated that:

- There is a 50% likelihood of the Fund's investments achieving at least an annual return of 5.7% p.a. over the next 20 years;
- There is a 70% likelihood of the Fund's investments achieving at least an annual return of 4.4% p.a. over the next 20 years; and
- There is an 80% likelihood of the Fund's investments achieving at least an annual return of 3.6% p.a. over the next 20 years.

The following chart shows how the funding level varies with the future investment return assumption (blue line). For comparison, the funding level associated with the same choice of investment return assumption at the 2016 valuation is also shown (grey line).



From this chart, we can see that:

- Regardless of the investment return assumption used, there has been a genuine improvement in the funding position at 31 March 2019 compared to the last valuation, reflecting an increase in the assets held today per pound of benefit to be paid out in future;
- The funding position would be 100% if future investment returns were around 3.6% p.a. (at 2016, the investment return would have needed to be 4.5% p.a.). The likelihood of the Fund's assets yielding at least this return is around 80%;
- If future investment returns were 5.7% p.a. then the Fund currently holds sufficient assets to meet 142% of the accrued liabilities. The likelihood of the Fund's assets yielding at least this return is 50%. 142% can therefore be considered the "best estimate funding position".

Reported funding position

The valuation outputs are more meaningful when stakeholders can understand the likelihood, and hence the level of prudence, attached to them. The above chart does this for the measurement of the funding position.

However, there is still a requirement to report a single funding position at 31 March 2019. This reported position must include a margin of prudence.

For the purpose of reporting a funding level and an associated funding surplus/deficit for the 2019 valuation, an investment return of 4.0% p.a. has been used. It is estimated that the Fund's assets have a 75% likelihood of achieving this return.

The resulting funding position is as follows:

Valuation Date	31 March 2016	31 March 2019
Past Service Liabilities	**(£m)**	**(£m)**
Employees	994	1,061
Deferred Pensioners	604	736
Pensioners	1,414	1,588
Total Liabilities	**3,012**	**3,386**
Assets	**2,771**	**3,633**
Surplus / (Deficit)	**(240)**	**247**
Funding Level	**92%**	**107%**

There has been an improvement in the reported funding level since 31 March 2016 from 92% to 107% and a change in the funding deficit from £240m to a surplus of £247m.

A breakdown of the key factors that have influenced the reported funding position from 31 March 2016 to 31 March 2019 are detailed below.

Projection of the funding position

The progression of the funding position will depend on various factors including future asset performance, economic conditions and membership movements. If the financial and demographic assumptions made at this valuation are borne out in practice, and there are no changes to the valuation assumptions, we project that the funding level at the 2022 valuation date will be approximately 107%. This allows for contributions to be paid as described in Appendix 3.

Change in the surplus/deficit position	Assets (£m)	Liabilities (£m)	Surplus / (Deficit) (£m)
Last valuation at 31 March 2016	**2,771**	**3,012**	**(240)**
Cashflows			
Employer contributions paid in	290		290
Employee contributions paid in	86		86
Benefits paid out	(376)	(376)	0
Net transfers into / out of the Fund*	(23)		(23)
Other cashflows (e.g. Fund expenses)	(5)		(5)
Expected changes in membership			
Interest on benefits already accrued		376	(376)
Accrual of new benefits		339	(339)
Membership experience vs expectations			
Salary increases greater than expected		21	(21)
Benefit increases less than expected		(1)	1
Early retirement strain (and contributions)	0	12	(12)
Ill health retirement gain		(5)	5
Early leavers greater than expected		0	0
Pensions ceasing greater than expected		(1)	1
Commutation less than expected		10	(10)
Other membership experience		10	(10)
Changes in market conditions			
Investment returns on the Fund's assets	890		890
Changes in future inflation expectations		95	(95)
Changes in actuarial assumptions			
Change in demographic assumptions (excl. longevity)		(5)	5
Change in longevity assumptions		(94)	94
Change in salary increase assumption		(18)	18
Change in discount rate		12	(12)
This valuation at 31 March 2019	**3,633**	**3,386**	**247**

* We have insufficient data to value the impact on the liabilities as a result of transfers in/out

Since the previous valuation, various events have taken place which affect the value placed on the liabilities, including:

- There is an interest cost of £376m. This is broadly three years of compound interest at 4.0% p.a. applied to the previous valuation liability value of £3,012m. The benefits that have been accrued to the valuation date are three years closer to payment at 31 March 2019 than they were at 31 March 2016, meaning there is less opportunity for future investment returns to help meet this cost. This serves to increase the value placed on the liabilities;
- The areas of membership experience that have had the greatest impact on the surplus/deficit position of the Fund are set out below, together with their impact on the liabilities:

	Expected	Actual	Difference	Impact on Liabilities
Pre-retirement experience				
Early leavers (no of lives)	6,164	10,952	4,788	Nil
Ill health retirements (no of lives)	189	136	(53)	Positive
Salary increases (p.a.)	3.2%	4.1%	0.9%	Negative
Post-retirement experience				
Benefit increases (p.a.)	2.1%	2.1%	(0.0%)	Broadly neutral
Pensions ceasing (£m)	7,478	7,658	180	Positive

- The changes to the longevity assumptions used for the valuation have resulted in a modest reduction in life expectancies. This has served to reduce the liabilities by £94m;
- The assumed rate of future CPI inflation has increased from 2.1% p.a. at 31 March 2016 to 2.3% p.a. at 31 March 2019. This has increased the value of the liabilities by £95m.

There has been a large increase in the value of the Fund's assets since the previous valuation because:

- The investment return on the Fund's assets for the period 31 March 2016 to 31 March 2019 was 33.0%. This has increased the value of the assets by £890m.

4 Sensitivity analysis

The results set out in this report are based on assumptions about the future. The actual cost of providing the benefits will depend on the actual experience of the Fund, which could be significantly better or worse than assumed. This section discusses the sensitivity of the results to some of the key assumptions.

Sensitivity of contribution rates to changes in assumptions

The approach to setting employer contribution rates mitigates the limitation of relying on one particular set of assumptions about the future by recognising the uncertainty around future investment returns and inflation. Therefore, there is no need to carry out additional analysis of the sensitivity of contribution rates to changes in financial assumptions.

The contribution rates are sensitive to changes in demographic assumptions. The results in this section in relation to the funding position can be broadly applied to the contribution rates.

Sensitivity of the funding position to changes in assumptions

The reported valuation funding position is based on one set of actuarial assumptions about the future of the Fund. If all of the assumptions made were exactly borne out in practice then the liability value presented in this report would represent the actual cost of providing benefits from the Fund as it stands at 31 March 2019.

Sensitivity of the funding position to future investment returns

The chart in Section 3 details how the funding position varies with the future assumed investment return.

Sensitivity of the funding position to future inflation

Pensions (both in payment and in deferment) in the LGPS increase annually in line with CPI. Furthermore, benefits accrued in the CARE scheme are revalued annually in line with CPI. If future CPI inflation is higher than the assumed rate of 2.3% then the cost of the benefits will be higher than we have set out in Section 3.

The table quantifies the impact on the funding position of varying the benefit increases and CARE revaluation (CPI) assumption below.

CPI Assumption	Surplus/(Deficit)	Funding Level
% pa	(£m)	%
2.1%	342	110%
2.3%	247	107%
2.5%	152	104%

Sensitivity of the funding position to life expectancy

The main area of demographic risk is people living longer than expected. If long term mortality rates fall at a rate of 1.5% p.a. (compared to the assumed 1.25% p.a.) then members will live slightly longer than we have assumed in this valuation. The impact on the funding position is detailed below.

Long term rate of improvement	Surplus/(Deficit)	Funding Level
% pa	(£m)	%
1.25%	247	107%
1.50%	222	107%

Other demographic risks to consider

There are other risk factors which would have an impact on the funding position. Examples of these include the level of ill health retirements, withdrawals from the scheme and take up of the 50:50 option. These are probably unlikely to change in such a way that would rank them as amongst the highest risks facing the Fund and therefore there has been no further quantification of their risk.

Comment on sensitivity analysis

Note that the tables above show the effect of changes to each assumption in isolation. In reality, it is perfectly possible for the experience of the Fund to deviate from more than one of the assumptions simultaneously and so the precise effect on the funding position is therefore more complex. Furthermore, the range of assumptions shown here is by no means exhaustive and should not be considered as the limits of how extreme experience could actually be.

As of March 2020, the funding position is expected to have improved as a result of positive asset performance since 31 March 2019.

Other risks to consider

Regulatory, Administration and Governance risks

As well as financial and demographic risks, the Fund also faces:

- Regulatory risks – central government legislation could significantly change the cost of the scheme in the future; and
- Administration and governance risk – failures in administration processes could lead to incorrect data and inaccuracies in the actuarial calculations.

These risks are considered and monitored by the Fund as part of its ongoing risk management framework.

Resource and environment risks

The Fund is exposed to risks relating to future resource constraints and environmental changes. These risks may prove to be material.

Climate change is a complex issue for the Fund. Adverse future climate change outcomes will have an impact on future longevity, inflation, government and corporate bond yields and equity returns.

Whilst there has been no explicit increase in certified employer contribution related to climate change, these risks have been considered by the Administering Authority when assessing the output from contribution rate ('comPASS') modelling. These risks were explored further in our paper 'Climate change risk analysis' commissioned by the Administering Authority.

Risk management

Employers participating in the Fund are exposed to a number of risks. These include, but are not limited to:

- Investment risk;
- Market risks;
- Demographic risks;
- Regulatory risks;
- Administration and Governance risks;
- Resource and Environmental risks.

The Funding Strategy Statement has further details about these risks and what actions the Fund takes to monitor, mitigate and manage each one.

5 Final comments

The Fund's valuation operates within a broader framework, and this document should therefore be considered alongside the following:

- the Funding Strategy Statement, which in particular highlights how different types of employer in different circumstances have their contributions calculated;
- the Investment Strategy Statement, which sets out the investment strategy for the Fund;
- the general governance of the Fund, such as meetings of the Pensions Committee and Local Pension Board, decisions delegated to officers, the Fund's business plan, etc;
- the Fund's risk register; and
- the information the Fund holds about the participating employers.

Intervaluation employer events

New employers joining the Fund

Any new employers or admission bodies joining the Fund should be referred to the Fund Actuary to assess the required level of contribution. Depending on the number of transferring members the ceding employer's rate may also need to be reviewed.

Cessations and bulk transfers

Any employer who ceases to participate in the Fund should be referred to us in accordance with Regulation 62 of the Regulations.

Any bulk movement of scheme members:

- involving 10 or more scheme members being transferred from or to another LGPS fund; or
- involving 2 or more scheme members being transferred from or to a non-LGPS pension arrangement;

should be referred to us to consider the impact on the Fund.

Valuation frequency

Under the provisions of the LGPS regulations, the next formal valuation of the Fund is due to be carried out as at 31 March 2022 where contribution rates payable from 1 April 2023 will be set.

[SIGNATURE] [SIGNATURE]

Richard Warden Robert McInroy

Fellows of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

10 February 2020

Appendices

Appendix 1 – Data

Membership data as at 31 March 2019

A summary of the membership data provided by the Administering Authority for the purposes of the valuation at 31 March 2019 is shown below. The corresponding membership data from the previous valuation is also shown for reference.

Whole Fund Membership Data	Last Valuation 31 March 2016	This Valuation 31 March 2019
Employee members		
Number	23,156	22,718
Total Actual Pay (£000)	384,339	414,051
Average Age (liability weighted)	51.6	52.2
Future Working Lifetime (years)	8.9	8.5
Deferred pensioners		
Number	31,074	36,094
Total Accrued Pension (£000)	35,084	43,738
Average Age (liability weighted)	50.7	51.3
Pensioners		
Number	17,986	20,328
Total pensions in payment (£000)	90,167	102,766
Average Age (liability weighted)	67.8	68.6
Average duration of liabilities	17.0	17.4

Benchmark investment strategy

The following investment strategy, has been used to assess employer contribution rates and to set the future investment return assumption as at 31 March 2019:

% allocation	Current strategy
UK equities	30%
Overseas equities	35%
Infrastructure	1%
Private equity	6%
Total growth assets	72%
Index-linked gilts	5%
Cash	2%
High yield bonds	4%
Total protection assets	11%
Multi asset credit	7%
Property	10%
Total income generating assets	17%
Grand total	100%

Other data used in this valuation

We have also relied upon asset and accounting data from the Fund's published 2016/17, 2017/18 and 2018/19 Annual Report and Accounts. Employer level cashflow data was provided by the Administering Authority and reconciled against the information shown in these documents.

Comment on data quality

The results of the valuation are dependent on the quality of the data provided to us by the Administering Authority for the specific purpose of this valuation. We have carried out validations on the membership data provided to ensure it is fit for the purpose of the valuation. Further details can be found in our report issued to the Administering Authority entitled "Data report for 2019 valuation", dated 13 November 2019. We believe the membership data is fit for the purposes of this valuation.

Appendix 2 – Assumptions

Financial assumptions used to set employer contribution rates

Projection of assets and benefit payments

The approach to setting employer contribution rates does not rely on a single set of assumptions but involves the projection of an employer's future benefit payments, contributions and investment returns under 5,000 future economic scenarios. In this modelling, inflation (and therefore benefit payments) and investment returns for each asset class (and employer asset values) are variables and take different values in each projection.

The model underlying these projections is Hymans Robertson's proprietary economic model, the Economic Scenario Service (ESS). The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2019. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to simulated yields at that time horizon.

		Annualised total returns									
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Overseas Equity	Property	Corp Medium A	Inflation	17 year real yield	17 year yield
5 years	16th %'ile	-0.4%	-2.3%	-2.9%	-4.1%	-4.1%	-3.5%	-2.7%	1.9%	-2.5%	0.8%
	50th %'ile	0.7%	0.5%	0.3%	4.0%	4.1%	2.4%	0.8%	3.3%	-1.7%	2.1%
	84th %'ile	2.0%	3.3%	3.4%	12.7%	12.5%	8.8%	4.0%	4.9%	-0.8%	3.6%
10 years	16th %'ile	-0.2%	-1.8%	-1.3%	-1.5%	-1.4%	-1.5%	-0.9%	1.9%	-2.0%	1.2%
	50th %'ile	1.3%	0.0%	0.2%	4.6%	4.7%	3.1%	0.8%	3.3%	-0.8%	2.8%
	84th %'ile	2.9%	1.9%	1.7%	10.9%	10.8%	7.8%	2.5%	4.9%	0.4%	4.8%
20 years	16th %'ile	0.7%	-1.1%	0.1%	1.2%	1.3%	0.6%	0.7%	2.0%	-0.7%	2.2%
	50th %'ile	2.4%	0.3%	1.0%	5.7%	5.8%	4.3%	1.9%	3.2%	0.8%	4.0%
	84th %'ile	4.5%	2.0%	2.0%	10.3%	10.4%	8.1%	3.0%	4.7%	2.2%	6.3%
	Volatility (Disp) (1 yr)	1%	7%	10%	17%	17%	14%	11%	1%		

Funding target

At the end of an employer's funding time horizon, an assessment is made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). To value the cost of future benefits assumptions are made about the following financial factors:

- Benefit increases and CARE revaluation;
- Salary growth;
- Investment returns (the "discount rate").

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is not appropriate for every projection. Therefore, instead of using a fixed value, each assumption is set with reference to an economic indicator. The economic indicators used are:

Assumption	Economic Indicator
Benefit increases	Future CPI inflation expectations
CARE revaluation	Future CPI inflation expectations
Salary increases	As above plus 0.0% p.a.
Future investment returns	Prevailing risk free rate of return plus margin

The Fund has three funding bases which will apply to different employers depending on their type. Each funding basis uses a different margin in the future investment return assumption.

Funding Basis	Margin above risk-free rate
Ongoing participation	1.9%
Contractor exit	Same as used to allocate assets on joining the Fund
Gilts exit	0%

Financial assumptions used to assess the funding position

Salary and Benefit Increases

Financial Assumptions (p.a.)	31 March 2016	31 March 2019
Benefit increases and CARE revaluation (CPI)	2.1%	2.3%
Salary increases	2.6%*	2.3%**

*CPI plus 0.4% (geometrically)
**CPI plus 0.0%

Investment Return

The reported funding position is based on an assumed future investment return of 4.0%. The derivation of this assumption is set out in Section 3. The equivalent assumption at the 2016 valuation was 4.0%. This was derived in a different way, please see the 2016 valuation report for further details.

Demographic assumptions

The same demographic assumptions are used in setting contribution rates and assessing the current funding position.

Longevity

As the fund is a member of Club Vita, the baseline longevity assumptions are a bespoke set of Vita Curves that are tailored to fit the membership profile of the Fund. These curves are based on the data the Fund has provided us with for the purposes of this valuation.

We have also allowed for future improvements in mortality based on the CMI 2018 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a. for both women and men.

Longevity Assumptions	31 March 2016	31 March 2019
Baseline Longevity	Club Vita	Club Vita
Future Improvements	CMI2013, Peaked, 1.25% p.a. long term	CMI2018, Smoothed, 1.25% p.a. long term

Full details are available on request.

The longevity assumptions result in the following typical future life expectancies from age 65 (figures for 2016 shown for comparison):

Assumed Life Expectancy	31 March 2016	31 March 2019
Male		
Pensioners	22.1 years	21.6 years
Non-pensioners	23.8 years	22.5 years
Female		
Pensioners	24.4 years	23.9 years
Non-pensioners	26.3 years	25.3 years

Non-pensioners are assumed to be aged 45 at the valuation date

Other demographic assumptions

We are in the unique position of having a very large local authority data set from which to derive our other demographic assumptions. We have analysed the trends and patterns that are present in the membership of local authority funds and tailored our demographic assumptions to reflect LGPS experience. The resulting demographic assumptions are as follows:

Demographic Assumptions	
Retirements in normal health	We have adopted the retirement age pattern assumption as used for the purpose of the 2016 LGPS cost cap valuation. Further details are available on request.
Death in Service	See sample rates below
Retirements in ill health	See sample rates below
Withdrawals	See sample rates below
Promotional salary increases	See sample increases below
Family details	A varying proportion of members are assumed to have a dependant at retirement or on earlier death. For example, at age 60 this is assumed to be 90% for males and 85% for females. The dependant of a male member is assumed to be 3 years younger than him and the dependant of a female member is assumed to be 3 years older than her.
Commutation	50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2008 (equivalent 75% for service from 1 April 2008).
50:50 option	1.0% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option.

Sample rates for demographic assumptions

Males

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.21	252.69	439.47	0.00	0.00	0.00	0.00
25	117	0.21	166.91	290.28	0.00	0.00	0.00	0.00
30	131	0.26	118.43	205.93	0.00	0.00	0.00	0.00
35	144	0.30	92.53	160.88	0.10	0.07	0.02	0.01
40	150	0.51	74.50	129.48	0.16	0.12	0.03	0.02
45	157	0.85	69.98	121.60	0.35	0.27	0.07	0.05
50	162	1.36	57.68	100.12	0.90	0.68	0.23	0.17
55	162	2.13	45.42	78.88	3.54	2.65	0.51	0.38
60	162	3.83	40.49	70.28	6.23	4.67	0.44	0.33
65	162	6.38	0.00	0.00	11.83	8.87	0.00	0.00

Females

Age	Salary Scale	Incidence per 1000 active members per annum						
		Death Before Retirement	Withdrawals		Ill Health Tier 1		Ill Health Tier 2	
		FT & PT	FT	PT	FT	PT	FT	PT
20	105	0.12	227.37	252.63	0.00	0.00	0.00	0.00
25	117	0.12	152.99	169.97	0.10	0.07	0.02	0.01
30	131	0.18	128.25	142.46	0.13	0.10	0.03	0.02
35	144	0.30	110.69	122.91	0.26	0.19	0.05	0.04
40	150	0.48	92.12	102.26	0.39	0.29	0.08	0.06
45	157	0.77	85.97	95.41	0.52	0.39	0.10	0.08
50	162	1.13	72.48	80.35	0.97	0.73	0.24	0.18
55	162	1.49	54.08	60.02	3.59	2.69	0.52	0.39
60	162	1.90	43.58	48.31	5.71	4.28	0.54	0.40
65	162	2.44	0.00	0.00	10.26	7.69	0.00	0.00

Prudence in assumptions

We are required to include a degree of prudence within the valuation. This has been achieved in both the setting of contributions and assessment of funding position.

Contribution rates

- Employer funding plans have been set such that the likelihood the employer's funding target is met by the end of the funding time horizon is more than 50%. The actual likelihood varies by employer. Further details are in the Funding Strategy Statement.

Funding position

- The Fund's investments have a 75% likelihood of returning at least the assumed return.

All other assumptions represent our "best estimate" of future experience.

The assumptions used in this valuation have been agreed with the Administering Authority and are set out in the Fund's Funding Strategy Statement.

Appendix 3 – Rates and Adjustments certificate

In accordance with regulation 62(4) of the Regulations we have made an assessment of the contributions that should be paid into the Fund by participating employers for the period 1 April 2020 to 31 March 2023 in order to maintain the solvency of the Fund.

The method and assumptions used to calculate the contributions set out in the Rates and Adjustments certificate are detailed in the Funding Strategy Statement and in Appendix 2 of our report on the actuarial valuation report dated TBC. These assumptions underpin our estimate of the number of members who will become entitled to a payment of pensions under the provisions of the LGPS and the amount of liabilities arising in respect of such members.

The table below summarises the whole fund Primary and Secondary Contribution rates for the period 1 April 2020 to 31 March 2023. The Primary rate is the payroll weighted average of the underlying individual employer primary rates and the Secondary rate is the total of the underlying individual employer secondary rates, calculated in accordance with the Regulations and CIPFA guidance.

The required minimum contribution rates for each employer in the Fund are set out below.

TBC once all employer rates are confirmed

Further comments

- Contributions expressed as a percentage of payroll should be paid into East Sussex Pension Fund ("the Fund") at a frequency in accordance with the requirements of the Regulations;
- Further sums should be paid to the Fund to meet the costs of any early retirements and/or augmentations using methods and factors issued by us from time to time or as otherwise agreed.
- Further sums should be paid into the Fund to meet the costs of any non-ill health early retirements. These will be paid either:

  a) by an additional 0.75% of pensionable pay (for those employers who have taken up this option); or

  b) using methods and factors issued to the Fund.
- Payments may be required to be made to the Fund by employers to meet the capital costs of any ill-health retirements that exceed those allowed for within our assumptions. If an employer has ill health liability insurance in place with a suitable insurer and provides satisfactory evidence to the Administering Authority, then their certified contribution rate may be reduced by the value of their insurance premium, for the period the insurance is in place.
- The certified contribution rates represent the **minimum** level of contributions to be paid. Employing authorities may pay further amounts at any time and future periodic contributions may be adjusted on a basis approved by the Fund Actuary.

Signature:	[SIGNATURE]	[SIGNATURE]
Name:	Richard Warden	Robert McInroy
Qualification:	Fellows of the Institute and Faculty of Actuaries	
Firm:	Hymans Robertson LLP 20 Waterloo Street Glasgow G2 6DB	
Date:		

Appendix 4 – Section 13 dashboard

The following information has been provided to assist the Government Actuary's Department in complying with Section 13 of the Public Service Pensions Act.

TBC once all employer rates are confirmed

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HYMANS ROBERTSON

East Sussex Pension Fund

Funding Strategy Statement

March 2020

Contents

Funding Strategy Statement

Appendices

1 Introduction

1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the East Sussex Pension Fund ("the Fund"), which is administered by East Sussex County Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser. It is effective from 1 April 2020.

1.2 What is the East Sussex Pension Fund?

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the East Sussex Fund, in effect the LGPS for the East Sussex area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth; and
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

1.3 Why does the Fund need a Funding Strategy Statement?

Employees' benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees' contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in Appendix A.

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Investment Strategy Statement (see Section 4).

1.4 How does the Fund and this FSS affect me?

This depends on who you are:

- A member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full.
- An employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, in what circumstances you might need to pay more and what happens if you cease to be an employer in the Fund. Note that the FSS applies to all employers participating in the Fund.
- An Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money.
- A Council Tax payer: your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (**NB** this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

1.6 How do I find my way around this document?

In Section 2 there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In Section 3 we outline how the Fund calculates the contributions payable by different employers in different situations.

In Section 4 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail if you are interested:

A. The regulatory background, including how and when the FSS is reviewed,

B. Who is responsible for what,

C. What issues the Fund needs to monitor, and how it manages its risks,

D. Some more details about the actuarial calculations required,

E. The assumptions which the Fund actuary currently makes about the future,

F. A glossary explaining the technical terms occasionally used here.

If you have any other queries, please contact East Sussex Pension Fund in the first instance.

2 Basic Funding issues

(More detailed and extensive descriptions are given in Appendix D).

2.1 What is each employer's contribution rate?

This is described in more detail in Appendix D. Employer contributions are normally made up of two elements:

a) the estimated cost of benefits being built up each year, after deducting the members' own contributions and including an allowance for administration expenses. This is referred to as the "*Primary rate*", and is expressed as a percentage of members' pensionable pay; plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, payment of the Secondary rate is in respect of benefits already accrued at the valuation date. The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of any higher rate will be taken by the Fund actuary at subsequent valuations, i.e. will be reflected as a credit when next calculating the employer's contributions.

2.2 How does the actuary calculate the required contribution rate?

In essence this is a three-step process:

1. Calculate the funding target for that employer, i.e. the estimated amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;

2. Determine the time horizon over which the employer should aim to achieve that funding target. See the table in 3.3 and Note (c) for more details;

3. Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon, allowing for various possible economic outcomes over that time horizon. See 2.3 below, and the table in 3.3 Note (e) for more details.

2.3 What different types of employer participate in the Fund?

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

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

The LGPS Regulations define various types of employer as follows:

Scheduled bodies - councils, and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such **academies (or Multi Academy Trusts)**, as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as "Scheduled Bodies", the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the MHCLG regarding the terms of academies' membership in LGPS Funds.

Designating employers - employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

Other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer – **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer – **transferee admission bodies** ("TAB"). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund's admissions policy are not met. (NB The terminology CAB and TAB has been dropped from recent LGPS Regulations, which instead combine both under the single term 'admission bodies'; however, we have retained the old terminology here as we consider it to be helpful in setting funding strategies for these different employers).

2.4 How does the calculated contribution rate vary for different employers?

All three steps above are considered when setting contributions (more details are given in Section 3 and Appendix D).

1. The **funding target** is based on a set of assumptions about the future, (e.g. investment returns, inflation, pensioners' life expectancies). If an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation.

2. The **time horizon** required is the period over which the funding target is achieved. Employers may be given a lower time horizon if they have an older membership profile, or do not have tax-raising powers to increase contributions if investment returns under-perform.

3. The **likelihood of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker then the required likelihood will be set higher, which in turn will increase the required contributions (and vice versa).

For some employers it may be agreed to pool contributions, see 3.4.

Any costs of non ill-health early retirements must be paid by the employer, see 3.6.

Costs of ill-health early retirements are covered in 3.7 and 3.8.

2.5 How is a funding level calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see Appendix D, section D5, for further details of how this is calculated), to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's "deficit"; if it is more than 100% then the employer is said to be in "surplus". The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

It is important to note that the funding level and deficit/surplus are only measurements at a particular point in time, on a particular set of assumptions about the future. Whilst we recognise that various parties will take an interest in these measures, for most employers the key issue is how likely it is that their contributions will be sufficient to pay for their members' benefits (when added to their existing asset share and anticipated investment returns).

In short, funding levels and deficits are short term, high level risk measures, whereas contribution setting is a longer term issue.

2.6 How does the Fund recognise that employer contribution rates can affect council and employer service provision, and council tax?

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

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

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death.
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees.
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund.

- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible. However, a recent shift in regulatory focus means that solvency within each generation is considered by the Government to be a higher priority than stability of contribution rates.
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result.
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see 3.1). In deciding which of these techniques to apply to any given employer, the Fund will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc. This helps the Fund establish a picture of the financial standing of the employer, i.e. its ability to meet its long term Fund commitments.

For instance, where an employer is considered relatively low risk then the Fund will permit options such as stabilisation (see 3.3 Note (b)), a longer time horizon relative to other employers, and/or a lower likelihood of achieving their funding target. Such options will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, where there is doubt that an employer will be able to meet its funding commitments or withstand a significant change in its commitments, then a higher funding target, and/or a shorter time horizon relative to other employers, and/or a higher likelihood of achieving the target may be required.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see Appendix A.

2.7 What approach has the Fund taken to dealing with uncertainty arising from the McCloud court case and its potential impact on the LGPS benefit structure?

The LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The courts have ruled that the 'transitional protections' awarded to some members of public service pension schemes when the schemes were reformed (on 1 April 2014 in the case of the LGPS) were unlawful on the grounds of age discrimination. At the time of writing, the Ministry of Housing, Communities and Local Government (MHCLG) has not provided any details of changes as a result of the case. However it is expected that benefits changes will be required and they will likely increase the value of liabilities. At present, the scale and nature of any increase in liabilities are unknown, which limits the ability of the Fund to make an accurate allowance.

The LGPS Scheme Advisory Board (SAB) issued advice to LGPS funds in May 2019. As there was no finalised outcome of the McCloud case by 31 August 2019, the Fund Actuary has acted in line with SAB's advice and valued all member benefits in line with the current LGPS Regulations.

The Fund, in line with the advice in the SAB's note, has considered how to allow for this risk in the setting of employer contribution rates. As a result, the Fund has decided to increase the respective likelihoods of reaching the funding target across employer funding strategies by 5%.

Once the outcome of the McCloud case is known, the Fund may revisit the contribution rates set to ensure they remain appropriate.

The Fund has also considered the McCloud judgement in its approach to cessation valuations. Please see note (j) to table 3.3 for further information.

2.8 When will the next actuarial valuation be?

On 8 May 2019 MHCLG issued a consultation seeking views on (among other things) proposals to amend the LGPS valuation cycle in England and Wales from a three year (triennial) valuation cycle to a four year (quadrennial) valuation cycle.

On 7 October 2019 MHCLG confirmed the next LGPS valuation cycle in England and Wales will be 31 March 2022, regardless of the ongoing consultation. The Fund therefore instructed the Fund Actuary to certify contribution rates for employers for the period 1 April 2020 to 31 March 2023 as part of the 2019 valuation of the Fund.

3 Calculating contributions for individual Employers

3.1 General comments

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, the Fund's three-step process identifies the key issues:

1. What is a suitably (but not overly) prudent funding target?
2. How long should the employer be permitted to reach that target? This should be realistic but not so long that the funding target is in danger of never actually being achieved.
3. What likelihood is required to reach that funding target? This will always be less than 100% as we cannot be certain of the future. Higher likelihood "bars" can be used for employers where the Fund wishes to reduce the risk that the employer ceases leaving a deficit to be picked up by other employers.

These and associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority reserves the right to direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

3.2 The effect of paying lower contributions

In limited circumstances the Administering Authority may permit employers to pay contributions at a lower level than is assessed for the employer using the three step process above. At their absolute discretion the Administering Authority may:

- extend the time horizon for targeting full funding;
- adjust the required likelihood of meeting the funding target;
- permit an employer to participate in the Fund's stabilisation mechanisms;
- permit extended phasing in of contribution rises or reductions;
- pool contributions amongst employers with similar characteristics; and/or
- accept some form of security or guarantee in return for a lower contribution rate that would otherwise be the case.

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than required to meet their funding target, over the appropriate time horizon with the required likelihood of success. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the pace of paying contributions;
- lower contributions in the short term will result in a lower level of future investment returns on the employer's asset share. Thus, deferring a certain amount of contribution may lead to higher contributions in the long-term; and
- it may take longer to reach their funding target, all other things being equal.

Overleaf (3.3) is a summary of how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

Section 3.4 onwards deals with various other funding issues which apply to all employers.

3.3 The different approaches used for different employers

Type of employer	Scheduled Bodies			Community Admission Bodies		Transferee Admission Bodies *
Sub-type	**Major authorities (incl. Town and Parish Councils)**	**Colleges**	**Academies**	**Open to new entrants**	**Closed to new entrants**	**(all)**
Funding Target Basis used	Ongoing participation basis, assumes long-term Fund participation (see Appendix E)			Ongoing participation basis	"Gilts basis" - see Note (a)	Contractor exit basis, assumes fixed contract term in the Fund (see Appendix E)
Maximum time horizon – Note (c)	20 years	20 years	20 years	Future Working Lifetime		Shorter of: Future Working Lifetime of employees, and outstanding contract term
Probability of achieving target – Note (e)	71%	80%	71%	80% or 85% depending on employer risk	80%	See **Note (e)**
Primary rate approach	(see Appendix D – D.2)					
Secondary rate – Note (d)	Monetary amount or % of payroll			Monetary amount or % of payroll		
Phasing of contribution changes	Eligible for stabilisation arrangement See Note (b)	3 years	Eligible for stabilisation arrangement See Note (b)	3 years		none
Review of rates – Note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations					Particularly reviewed in last 3 years of contract
Treatment of surplus	Covered by stabilisation arrangement	Reduce contributions by spreading the surplus over the maximum time horizon	Covered by stabilisation arrangement	Reduce contributions by spreading the surplus over the maximum time horizon		Reduce contributions by spreading the surplus over the remaining contract term.
New employer	n/a	n/a	Note (g)	Note (h)		Notes (h) & (i)
Cessation of participation: cessation debt or surplus payable	Cessation is generally assumed not to be possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (e.g. in the case of Town & Parish Councils), the cessation debt or surplus principles applied would be as per Note (j).			Can be ceased subject to terms of admission agreement. Cessation debt or surplus will be calculated on a basis appropriate to the circumstances of cessation – see Note (j).		Participation is assumed to expire at the end of the contract. Cessation debt or surplus (if any) calculated on ongoing basis. Awarding Authority will be liable for any future deficits and contributions arising.

* Where the Administering Authority recognises a fixed contribution rate agreement between a letting authority and a contractor, the certified employer contribution rate will be derived in line with the methodology specified in the risk sharing agreement. Additionally, in these cases, upon cessation the contractor's assets and liabilities will transfer back to the letting employer with no crystallisation of any deficit or surplus. Further detail on fixed contribution rate agreements is set out in note (i).

Note (a) (Gilts exit basis for CABs closed to new entrants)

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, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority has set a higher funding target (i.e. based on the return from long-term gilt yields and extending the allowance for future improvements in longevity), in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

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

Note (b) (Stabilisation)

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The Administering Authority, on the advice of the Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority (see table below) and;
- there are no material events which cause the employer to become ineligible, e.g. significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring) or changes in the security of an employer.

On the basis of extensive modelling carried out for the 2019 valuation exercise (see Section 4), the contribution rates for all stabilised employers will reduce by 0.5% of pay in each of the next three years. The stabilised details thereafter are:

Type of employer	Major authorities (incl Town and Parish Councils)	Academies
Max contribution increase in each future year	0.5% of pay	0.5% of pay
Max contribution decrease in each future year	0.5% of pay	0.5% of pay

The stabilisation criteria and limits will be reviewed at the 31 March 2022 valuation, to take effect from 1 April 2023.

Note (c) (Maximum time horizon)

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2020 for the 2019 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 time horizons, for example where there were no new entrants.

Note (d) (Secondary rate)

For most employers, at the Administering Authority's discretion and currently excluding closed Community Admission Bodies, secondary rates will be set as a percentage of salaries. However, the Administering Authority reserves the right to amend these rates between valuations and/or to require these payments in monetary terms instead, for instance where:

- the employer is relatively mature, i.e. has a large deficit recovery contribution rate (e.g. above 15% of payroll), in other words its payroll is a smaller proportion of its deficit than is the case for most other employers, or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed the Fund to new entrants.

Note (e) (Likelihood of achieving funding target)

Each employer has its funding target calculated, and a relevant time horizon over which to reach that target. Contributions are set such that, combined with the employer's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum likelihood. A higher required likelihood bar will give rise to higher required contributions, and vice versa.

The way in which contributions are set using these three steps, and relevant economic projections, is described in further detail in Appendix D.

Different likelihoods are set for different employers depending on their nature and circumstances: in broad terms, a higher likelihood will apply due to one or more of the following:

- the Fund believes the employer poses a greater funding risk than other employers,
- the employer does not have tax-raising powers;

- the employer does not have a guarantor or other sufficient security backing its funding position; and/or
- the employer is likely to cease participation in the Fund in the short or medium term.

Note (f) (Regular Reviews)

Such reviews may be triggered by significant events including but not limited to: an employer approaching exit from the Fund, significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

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

Note (g) (New Academy conversions)

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

i. The new academy will be regarded as a separate employer in its own right and will not be pooled with other employers in the Fund. The only exception is where the academy is part of a Multi Academy Trust (MAT) in which case the academy's figures will be calculated as below but can be combined with, for the purpose of setting contribution rates, those of the other academies in the MAT.

ii. The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status.

iii. The new academy will be allocated an initial asset share from the ceding council's assets in the Fund. This asset share will be calculated using the estimated funding position of the ceding council at the date of academy conversion. The assets allocated to the academy will be limited if necessary so that its initial funding level is subject to a maximum of 100%. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion.

iv. The new academy's initial contribution rate will be calculated using market conditions, the council funding position and, membership data, all as at the day prior to conversion.

v. As an alternative to (iv), the academy will have the option to elect to pay contributions at the ceding LEA rate plus 1% p.a. instead. However, this election will not alter its asset or liability allocation as per (ii) and (iii) above. Ultimately, all academies remain responsible for their own allocated assets and liabilities.

vi. It is possible for an academy to leave one MAT and join another. If this occurs, all active, deferred and pensioner members of the academy transfer to the new MAT

The Fund's policies on academies are subject to change in the light of any amendments to MHCLG and/or DfE guidance (or removal of the formal guarantee currently provided to academies by the DfE). Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS. In particular, policy (iv) and (v) above will be reconsidered at each valuation.

Note (h) (New Admission Bodies)

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

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a greater than expected rise in liabilities;
- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit.

Transferee Admission Bodies: For all TABs, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis. See also Note (i) below.

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

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

Note (i) (New Transferee Admission Bodies)

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

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

From 1 April 2019, the Fund’s policy is that new outsourcings are set up under a “pass through” arrangement (although exceptions will be considered on a case-by-case basis at the Fund’s discretion). Pass through arrangements allow for the pension risks to be shared between the letting employer and new contractor. Typically the majority of the pension risk is borne by the letting employer and thus the liability is retained on their balance sheet – as such the contractor would not be required to pay any deficit or receive any surplus at the end of the contract (subject to any agreed exceptions).

However, there is some flexibility within a pass through arrangement. In particular there are two different routes that the letting employer may wish to adopt. The Fund’s default approach will be to set up pass through arrangements using “Option 1 - Fixed primary rate at outset” for all new contractors. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

Option 1 - Fixed primary rate at outset (default approach)

Under this approach, the contractor pays a fixed contribution rate throughout the contract. The contribution rate is calculated by the Fund actuary at the outset and is based on a 71% likelihood of the rate being sufficient, based on the membership profile of the transferring staff, to ensure full funding by the end of the contract (i.e. no surplus or deficit). For the avoidance of doubt, the rate would not change at future valuations.

Option 2 – Pooled approach

Under this approach, the contractor's contribution rate is pooled with the letting authority and therefore the contribution rate is always equal to that which the letting authority is paying. In other words, the contractor will pay the same rate as the letting authority throughout the lifetime of the contract and it will move in line with any changes to the letting authority's rate at future valuations.

The pooled rate is the **total** contribution rate (made up of both the primary and secondary rate). Many letting authorities will currently be paying their primary rate as a percentage of payroll and their secondary rate as a monetary amount. For the purposes of the pooled rate, the secondary rate will be converted to a percentage of payroll and added to the primary rate.

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

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

Note (j) (Admission Bodies Ceasing)

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

- Last active member ceasing participation in the Fund (NB recent LGPS Regulation changes mean that the Administering Authority has the discretion to defer taking action for up to three years, so that if the employer acquires one or more active Fund members during that period then cessation is not triggered. The Fund will consider these on a case by case basis);
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus an exit credit may, at the discretion of the

Administering Authority, be paid to the Admission Body within six months of the cessation date (or another date agreed between the Administering Authority and the Admission Body). If a risk-sharing agreement has been put in place (please see note (i) above) the Administering Authority will exercise its discretion within the amended LGPS Regulations, to determine if an cessation debt or exit credit may be payable..

As discussed in Section 2.7, the LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The Fund has considered how it will reflect the current uncertainty regarding the outcome of this judgement in its approach to cessation valuations. For cessation valuations that are carried out before any changes to the LGPS benefit structure (from 1 April 2014) are confirmed, the Fund's policy is that the actuary will apply an adjustment to the ceasing employer's post 2014 benefit accrual value, as an estimate of the possible impact of resulting benefit changes.

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

a) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit (or surplus) will normally be calculated using a "gilts exit basis", which is more prudent than the ongoing participation basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required and makes it unlikely that any surplus would be paid to the employer.

b) Where there is a guarantor for future deficits and contributions, the details of the guarantee will be considered prior to the cessation valuation being carried out. In some cases the guarantor is simply guarantor of last resort and therefore the cessation valuation will be carried out consistently with the approach taken had there been no guarantor in place. Alternatively, where the guarantor is not simply guarantor of last resort, the cessation may be calculated using the ongoing participation basis as described in Appendix E;

c) Again, depending on the nature of the guarantee, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit or surplus. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee.

Under (a) and (b), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund may spread the payment subject to there being some security in place for the employer such as an indemnity or guarantee.

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

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit on the gilts exit basis, and would carry out the cessation valuation on the ongoing participation basis: secondary contributions would be derived from this cessation debt. This approach would be monitored as part of each formal valuation and secondary contributions would be reassessed as required. The Admission Body may

terminate the agreement only via payment of the outstanding debt assessed on the gilts exit basis. Furthermore, the Fund reserves the right to revert to the "gilts exit basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Admission Body would have no contributing members.

Further details of the Fund's arrangement for a ceasing employer are set out in the Cessation Policy, which is set out in Appendix G.

3.4 Pooled contributions

From time to time, with the advice of the Actuary, the Administering Authority may set up pools for employers with similar or complementary characteristics. This will always be in line with its broader funding strategy.

The intention of the pool is to minimise contribution rate volatility which would otherwise occur when members join, leave, take early retirement, receive pay rises markedly different from expectations, etc. Such events can cause large changes in contribution rates for very small employers in particular, unless these are smoothed out for instance by pooling across a number of employers.

On the other hand it should be noted that the employers in the pool will still have their own individual funding positions tracked by the Actuary, so that some employers will be much better funded, and others much more poorly funded, than the pool average. This therefore means that if any given employer was funding on a stand-alone basis, as opposed to being in the pool, then its contribution rate could be much higher or lower than the pool contribution rate.

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

3.5 Non ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). (**NB** the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014). Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

Certain employers, all of which are subject to the stabilisation mechanism, pay an additional 0.75% of pay per annum to meet expected non-ill health early retirement strain costs. Non stabilised employers (and stabilised employers choosing not to pay the additional 0.75% p.a. of pay) are required to pay additional contributions ('strain') whenever an employee retires before attaining retirement age.

3.6 Ill health early retirement costs

In the event of a member's early retirement on the grounds of ill-health, a funding strain will usually arise, which can be very large. Such strains are currently met by each employer, although individual employers may elect to take external insurance (see 3.7 below).

3.7 External Ill health insurance

If an employer provides satisfactory evidence to the Administering Authority of a current external insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged, and
- there is no need for monitoring of allowances.

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 Fund intends to offer ill health insurance to a subset of employers in the Fund. This is likely to be for smaller employers (e.g. CABs and academies) who are typically less able to cope with large and unexpected strain costs. The Fund will be contacting these employers in due course.

3.8 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt or receive an exit credit on an appropriate basis (see 3.3, Note (j)) and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:

a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;

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

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

3.9 Policies on bulk transfers

This section covers bulk transfer payments into, out of and within the Fund. Each case will be treated on its own merits, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities; and
- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.

4 Funding strategy and links to investment strategy

4.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Investment Strategy Statement, which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out as part of each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

4.2 What is the link between funding strategy and investment strategy?

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

Therefore, the funding and investment strategies are inextricably linked.

4.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The actuary's assumptions for future investment returns (described further in Appendix E) are based on the current benchmark investment strategy of the Fund. The future investment return assumptions underlying each of the fund's three funding bases include a margin for prudence, and are therefore considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government (see Appendix A1).

In the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility in asset values. However, the actuary takes a long term view when assessing employer contribution rates and the contribution rate setting methodology takes into account this potential variability.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.4 Does the Fund monitor its overall funding position?

The Administering Authority monitors the relative funding position, i.e. changes in the relationship between asset values and the liabilities value, on a regular basis and reports this to the regular Pensions Committee meetings.

5 Statutory reporting and comparison to other LGPS Funds

5.1 Purpose

Under Section 13(4)(c) of the Public Service Pensions Act 2013 ("Section 13"), the Government Actuary's Department must, following each triennial actuarial valuation, report to MHCLG on each of the LGPS Funds in England & Wales. This report will cover whether, for each Fund, the rate of employer contributions are set at an appropriate level to ensure both the solvency and the long term cost efficiency of the Fund.

This additional MHCLG oversight may have an impact on the strategy for setting contribution rates at future valuations.

5.2 Solvency

For the purposes of Section 13, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

(a) the rate of employer contributions is set to target a funding level for the Fund of 100%, over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds); and either

(b) employers collectively have the financial capacity to increase employer contributions, and/or the Fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or

(c) there is an appropriate plan in place should there be, or if there is expected in future to be, a material reduction in the capacity of fund employers to increase contributions as might be needed.

5.3 Long Term Cost Efficiency

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long term cost efficiency if:

i. the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual,

ii. with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, MHCLG may have regard to various absolute and relative considerations. A relative consideration is primarily concerned with comparing LGPS pension funds with other LGPS pension funds. An absolute consideration is primarily concerned with comparing Funds with a given objective benchmark.

Relative considerations include:

1. the implied deficit recovery period; and
2. the investment return required to achieve full funding after 20 years.

Absolute considerations include:

1. the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;
2. how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy;
3. the extent to which contributions actually paid have been in line with the expected contributions based on the extant rates and adjustment certificate; and
4. the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual Fund experience.

MHCLG may assess and compare these metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

Appendix A – Regulatory framework

A1 Why does the Fund need an FSS?

The Ministry of Housing, Communities and Local Government (MHCLG) has stated that the purpose of the FSS is:

*"to establish a **clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;*

*to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*

*to take a **prudent longer-term view** of funding those liabilities."*

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

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2016) and to its Statement of Investment Principles / Investment Strategy Statement.

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

A2 Does the Administering Authority consult anyone on the FSS?

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

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

a) A draft version of the FSS was issued to all participating employers in November/December 2019 for comment by 17th January 2020;

b) There was also an Employers Forum on 29 November 2019 at which questions regarding the funding strategy could be raised and answered;

c) Following the end of the consultation period the FSS was updated where required and then published, on 1 April 2020.

A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website, at https://www.eastsussex.gov.uk/yourcouncil/pension-fund-policies/
- A copy sent by e-mail to each participating employer in the Fund;
- Copies made available on request.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation (which may move to every four years in future – see Section 2.8). This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation.

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

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

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

A5 How does the FSS fit into other Fund documents?

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

These documents can be found on the web at https://www.eastsussex.gov.uk/yourcouncil/pension-fund-policies/

Appendix B – Responsibilities of key parties

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

B1 The Administering Authority should:-

1. operate the Fund as per the LGPS Regulations;
2. effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
3. collect employer and employee contributions, and investment income and other amounts due to the Fund;
4. ensure that cash is available to meet benefit payments as and when they fall due;
5. pay from the Fund the relevant benefits and entitlements that are due;
6. invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Investment Strategy Statement (ISS) and LGPS Regulations;
7. communicate appropriately with employers so that they fully understand their obligations to the Fund;
8. take appropriate measures to safeguard the Fund against the consequences of employer default;
9. manage the valuation process in consultation with the Fund's actuary;
10. provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
11. prepare and maintain a FSS and an ISS, after consultation;
12. notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
13. monitor all aspects of the fund's performance and funding and amend the FSS and ISS as necessary and appropriate.

B2 The Individual Employer should:-

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

B3 The Fund Actuary should:-

1. prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
2. provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
3. provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);

4. prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
5. assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
6. advise on the termination of employers' participation in the Fund; and
7. fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties:-

1. investment advisers (either internal or external) should ensure the Fund's ISS remains appropriate, and consistent with this FSS;
2. investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the ISS;
3. auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
4. governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
5. legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures;
6. MHCLG (assisted by the Government Actuary's Department) and the Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

Appendix C – Key risks and controls

C1 Types of risk

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

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

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities and contribution rates over the long-term.	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc. Analyse progress at three yearly valuations for all employers. Inter-valuation roll-forward of liabilities between valuations at whole Fund level.
Inappropriate long-term investment strategy.	Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes. Chosen option considered to provide the best balance.
Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.
Pay and price inflation significantly more than anticipated.	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 bonds also helps to mitigate this risk. 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.

Risk	Summary of Control Mechanisms
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions.
Orphaned employers give rise to added costs for the Fund	The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future. If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 3.9).
Effect of possible asset underperformance as a result of climate change	The Fund invests its assets in line with Responsible Investment beliefs and guidelines. The impact of different climate change scenarios on future funding positions was modelled at the 2019 valuation, with the risk reflected via the use of prudent likelihood 'bars' (see section 3.1).

C3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, monetary amounts rather than % of pay sought for closed employers and consider alternative investment strategies.
Deteriorating patterns of early retirements	Employers are charged the extra cost of non ill-health retirements following each individual decision. Employer ill health retirement experience is monitored, and insurance is an option.
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:

Risk	Summary of Control Mechanisms
	Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (b) to 3.3). For other employers, review of contributions is permitted in general between valuations (see Note (f) to 3.3) and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.

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.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. The Administering Authority is monitoring the progress on the McCloud court case and will consider an interim valuation or other appropriate action once more information is known. The government's long term preferred solution to GMP indexation and equalisation - conversion of GMPs to scheme benefits - was built into the 2019 valuation.
Time, cost and/or reputational risks associated with any MHCLG intervention triggered by the Section 13 analysis (see Section 5).	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.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.

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.	The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data. The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions between triennial valuations Deficit contributions may be expressed as monetary amounts.
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way	The Administering Authority maintains close contact with its specialist advisers. Advice is delivered via formal meetings involving Elected Members, and recorded appropriately. Actuarial advice is subject to professional requirements such as peer review.
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.	The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes. Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see Notes (h) and (j) to 3.3). Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. Vetting prospective employers before admission. Where permitted under the regulations requiring a bond to protect the Fund from various risks. Requiring new Community Admission Bodies to have a guarantor.

Risk	Summary of Control Mechanisms
	Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to 3.3). Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to 3.3).
An employer ceasing to exist resulting in an exit credit being payable	The Administering Authority regularly monitors admission bodies coming up to cessation The Administering Authority invests in liquid assets to ensure that exit credits can be paid when required.

Appendix D – The calculation of Employer contributions

In Section 2 there was a broad description of the way in which contribution rates are calculated. This Appendix considers these calculations in much more detail.

As discussed in Section 2, the actuary calculates the required contribution rate for each employer using a three-step process:

1. Calculate the funding target for that employer, i.e. the estimated amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;

2. Determine the time horizon over which the employer should aim to achieve that funding target. See the table in 3.3 and Note (c) for more details;

3. Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon, allowing for various possible economic outcomes over that time horizon. See the table in 3.3 Note (e) for more details.

The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

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

Employer contributions are normally made up of two elements:

a) the estimated cost of ongoing benefits being accrued, referred to as the "Primary contribution rate" (see D2 below); plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "Secondary contribution rate" (see D3 below).

The contribution rate for each employer is measured as above, appropriate for each employer's a assets, liabilities and membership. The whole Fund position, including that used in reporting to MHCLG (see section 5), is calculated in effect as the sum of all the individual employer rates. MHCLG currently only regulates at whole Fund level, without monitoring individual employer positions.

D2 How is the Primary contribution rate calculated?

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

The Primary rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The Primary rate is calculated such that it is projected to:

1. meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets,

2. within the determined time horizon (see note 3.3 Note (c) for further details),

3. with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

* The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund's actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. Further information about this model is included in Appendix E. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

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

D3 How is the Secondary contribution rate calculated?

The Fund aims for the employer to have assets sufficient to meet 100% of its accrued liabilities at the end of its funding time horizon based on the employer's funding target assumptions (see Appendix E).

The Secondary rate is calculated as the balance over and above the Primary rate, such that the total contribution rate is projected to:

1. meet the required funding target relating to combined past and future service benefit accrual, including accrued asset share (see D5 below)
2. at the end of the determined time horizon (see 3.3 Note (c) for further details)
3. with a sufficiently high likelihood, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

The projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund Actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. Further information about this model is included in Appendix E. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

1. past contributions relative to the cost of accruals of benefits;
2. different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
3. the effect of any differences in the funding target, i.e. the valuation basis used to value the employer's liabilities at the end of the time horizon;
4. any different time horizons;
5. the difference between actual and assumed rises in pensionable pay;
6. the difference between actual and assumed increases to pensions in payment and deferred pensions;
7. the difference between actual and assumed retirements on grounds of ill-health from active status;
8. the difference between actual and assumed amounts of pension ceasing on death;
9. the additional costs of any non ill-health retirements relative to any extra payments made; and/or

10. differences in the required likelihood of achieving the funding target.

D5 How is each employer's asset share calculated?

The Administering Authority does not operate separate bank accounts or investment mandates for each employer. Therefore it cannot account for each employer's assets separately. Instead, the Fund Actuary must apportion the assets of the whole Fund between the individual employers. There are broadly two ways to do this:

1) A technique known as "analysis of surplus" in which the Fund actuary estimates the surplus/deficit of an employer at the current valuation date by analysing movements in the surplus/deficit from the previous actuarial valuation date. The estimated surplus/deficit is compared to the employer's liability value to calculate the employer's asset value. The actuary will quantify the impact of investment, membership and other experience to analyse the movement in the surplus/deficit. This technique makes a number of simplifying assumptions due to the unavailability of certain items of information. This leads to a balancing, or miscellaneous, item in the analysis of surplus, which is split between employers in proportion to their asset shares.

2) A 'cashflow approach' in which an employer's assets are tracked over time allowing for cashflows paid in (contributions, transfers in etc.), cashflows paid out (benefit payments, transfers out etc.) and investment returns on the employer's assets.

Until 31 March 2016 the Administering Authority used the 'analysis of surplus' approach to apportion the Fund's assets between individual employers.

Since then, the Fund has adopted a cashflow approach for tracking individual employer assets.

The Fund Actuary uses the Hymans Robertson's proprietary "HEAT" system to track employer assets on a monthly basis. Starting with each employer's assets from the previous month end, cashflows paid in/out and investment returns achieved on the Fund's assets over the course of the month are added to calculate an asset value at the month end.

The Fund is satisfied that this new approach provides the most accurate asset allocations between employers that is reasonably possible at present.

D6 How does the Fund adjust employer asset shares when an individual member moves from one employer in the Fund to another?

Under the cashflow approach for tracking employer asset shares, the Fund has allowed for any individual members transferring from one employer in the Fund to another, via the transfer of a sum from the ceding employer's asset share to the receiving employer's asset share. This sum is equal to the member's Cash Equivalent Transfer Value (CETV) as advised by the Fund's administrators.

Appendix E – Actuarial assumptions

E1 What are the actuarial assumptions used to calculate employer contribution rates?

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

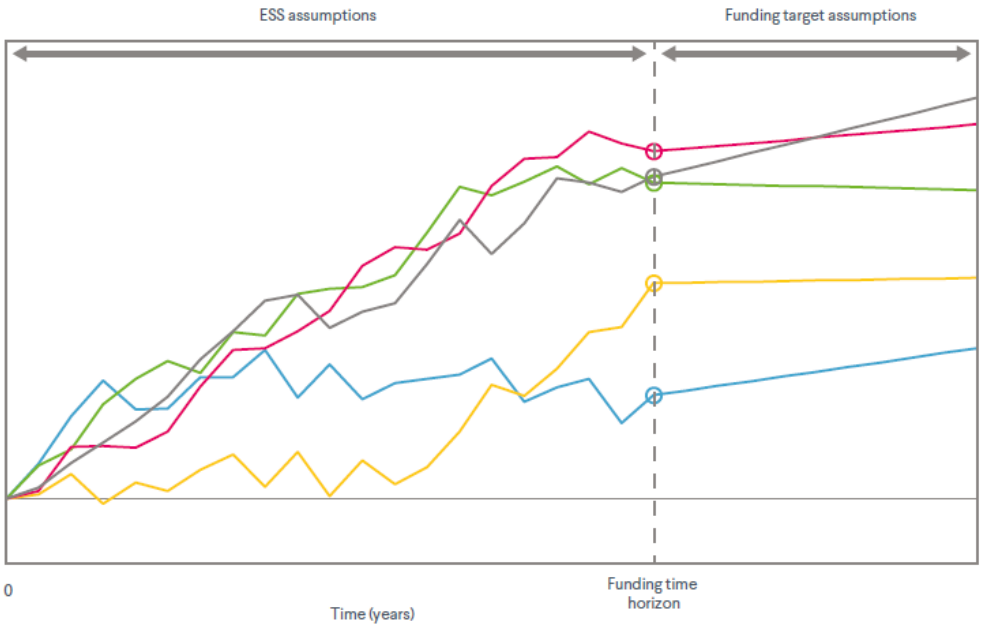
Changes in assumptions will affect the funding target and required contribution rate. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The actuary's approach to calculating employer contribution rates involves the projection of each employer's future benefit payments, contributions and investment returns into the future under 5,000 possible economic scenarios. Future inflation (and therefore benefit payments) and investment returns for each asset class (and therefore employer asset values) are variables in the projections. By projecting the evolution of an employer's assets and benefit payments 5,000 times, a contribution rate can be set that results in a sufficient number of these future projections (determined by the employer's required likelihood) being successful at the end of the employer's time horizon. In this context, a successful contribution rate is one which results in the employer having met its funding target at the end of the time horizon.

Setting employer contribution rates therefore requires two types of assumptions to be made about the future:

1. Assumptions to project the employer's assets, benefits and cashflows to the end of the funding time horizon. For this purpose the actuary uses Hymans Robertson's proprietary stochastic economic model - the Economic Scenario Service ("ESS").

2. Assumptions to assess whether, for a given projection, the funding target is satisfied at the end of the time horizon. For this purpose, the Fund has three different funding bases.



Details on the ESS assumptions and funding target assumptions are included below (in E2 and E3 respectively).

E2 What assumptions are used in the ESS?

The actuary uses Hymans Robertson's ESS model to project a range of possible outcomes for the future behaviour of asset returns and economic variables. With this type of modelling, there is no single figure for an assumption about future inflation or investment returns. Instead, there is a range of what future inflation or returns will be which leads to likelihoods of the assumption being higher or lower than a certain value.

The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2019. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the simulated yields at that time horizon.

		Annualised total returns									
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Overseas Equity	Property	A rated corporate bonds (medium)	RPI inflation expectation	17 year real govt bond yield	17 year govt bond yield
5 years	16th %'ile	-0.4%	-2.3%	-2.9%	-4.1%	-4.1%	-3.5%	-2.7%	1.9%	-2.5%	0.8%
	50th %'ile	0.7%	0.5%	0.3%	4.0%	4.1%	2.4%	0.8%	3.3%	-1.7%	2.1%
	84th %'ile	2.0%	3.3%	3.4%	12.7%	12.5%	8.8%	4.0%	4.9%	-0.8%	3.6%
10 years	16th %'ile	-0.2%	-1.8%	-1.3%	-1.5%	-1.4%	-1.5%	-0.9%	1.9%	-2.0%	1.2%
	50th %'ile	1.3%	0.0%	0.2%	4.6%	4.7%	3.1%	0.8%	3.3%	-0.8%	2.8%
	84th %'ile	2.9%	1.9%	1.7%	10.9%	10.8%	7.8%	2.5%	4.9%	0.4%	4.8%
20 years	16th %'ile	0.7%	-1.1%	0.1%	1.2%	1.3%	0.6%	0.7%	2.0%	-0.7%	2.2%
	50th %'ile	2.4%	0.3%	1.0%	5.7%	5.8%	4.3%	1.9%	3.2%	0.8%	4.0%
	84th %'ile	4.5%	2.0%	2.0%	10.3%	10.4%	8.1%	3.0%	4.7%	2.2%	6.3%
	Volatility (Disp) (1 yr)	1%	7%	10%	17%	17%	14%	11%	1%		

E3 What assumptions are used in the funding target?

At the end of an employer's funding time horizon, an assessment will be made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). Valuing the cost of future benefits requires the actuary to make assumptions about the following financial factors:

- Benefit increases and CARE revaluation
- Salary growth
- Investment returns (the "discount rate")

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is unlikely to be appropriate for every projection. For example, a high assumed future investment return (discount rate) would not be prudent in projections with a weak outlook for economic growth. Therefore, instead of using a fixed value for each assumption, the actuary references economic indicators to ensure the assumptions remain appropriate for the prevailing economic environment in each projection. The economic indicators the actuary uses are: future inflation expectations and the prevailing risk free rate of return (the yield on long term UK government bonds is used as a proxy for this rate).

The Fund has three funding bases which will apply to different employers depending on their type. Each funding basis has a different assumption for future investment returns when determining the employer's funding target.

Funding basis	Ongoing participation basis	Contractor exit basis	Low risk exit basis
Employer type	All employers except Transferee Admission Bodies and closed Community Admission Bodies	Transferee Admission Bodies	Community Admission Bodies that are closed to new entrants
Investment return assumption underlying the employer's funding target (at the end of its time horizon)	Long term government bond yields plus an asset outperformance assumption (AOA) of 1.9% p.a.	Long term government bond yields plus an AOA equal to the AOA used to allocate assets to the employer on joining the Fund	Long term government bond yields with no allowance for outperformance on the Fund's assets

E4 What other assumptions apply?

The following assumptions are those of the most significance used in both the projection of the assets, benefits and cashflows and in the funding target.

a) Salary growth

After discussion with Fund officers, the salary increase assumption at the 2019 valuation has been set equal to Consumer Price Inflation (CPI).

This is a change from the previous valuation, where the assumption was CPI plus 0.4% per annum. The change has led to a reduction in the funding target (all other things being equal).

b) Pension increases

Since 2011 CPI, rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

At this valuation, we have continued to assume that CPI is 1.0% per annum lower than RPI (Note that the reduction is applied in a geometric, not arithmetic, basis).

c) Life expectancy

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

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

Allowance has been made in the ongoing valuation basis for future improvements in line with the 2018 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.25% per annum

minimum underpin to future reductions in mortality rates. This updated allowance for future improvements will generally result in lower life expectancy assumptions and hence a reduced funding target (all other things being equal).

The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members' benefits.

d) General

The same financial assumptions are adopted for most employers (on the ongoing participation basis identified above), in deriving the funding target underpinning the Primary and Secondary rates: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

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

Appendix F – Glossary

Funding basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of the funding target at the end of the employer's time horizon. The main assumptions will relate to the level of future investment returns, salary growth, pension increases and longevity. More prudent assumptions will give a higher funding target, whereas more optimistic assumptions will give a lower funding target.
Administering Authority	The council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
Admission Bodies	Employers where there is an Admission Agreement setting out the employer's obligations. These can be Community Admission Bodies or Transferee Admission Bodies. For more details (see 2.3).
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Designating Employer	Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund.
Employer	An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **funding target** values for each employer are individually tracked, together with its **Primary rate** at each **valuation**.
Gilt	A UK Government bond, ie a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but are also used in funding as an objective measure of a risk-free rate of return.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's.
Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority, but can sometimes be another type of employer such as an Academy.

LGPS	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 100 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Maturity	A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.
Members	The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).
Primary contribution rate	The employer contribution rate required to pay for ongoing accrual of active members' benefits (including an allowance for administrative expenses). See Appendix D for further details.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's **members**, ie current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also.
Rates and Adjustments Certificate	A formal document required by the LGPS Regulations, which must be updated at the conclusion of the formal **valuation**. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the period until the next valuation is completed.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employees must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).
Secondary contribution rate	The difference between the employer's actual and **Primary contribution rates**. See Appendix D for further details.
Stabilisation	Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund.
Valuation	A risk management exercise to review the **Primary and Secondary contribution rates**, and other statutory information for a Fund, and usually individual employers too.

Appendix G – Cessation Policy

Policy for Employers Leaving the Fund

EAST SUSSEX PENSION FUND

Effective: 1 April 2020

1. INTRODUCTION

This is the policy of the East Sussex Pension Fund ("the Fund") as regards the treatment of employers leaving the Fund.

It has been prepared by the Administering Authority to the Fund, East Sussex County Council, in collaboration with the Fund's actuary, Hymans Robertson LLP. This policy replaces all previous policies on employer termination and is effective from 1st April 2020.

These procedures and policies apply to employers participating in the Fund.

1.1 Regulatory Framework

The Local Government Pension Scheme Regulations 2013 outline the general framework for employees and employers participating in the Local Government Pension Scheme in England and Wales. The regulations that are relevant to employers leaving the scheme are as follows:

- **Regulation 64 (1) & (2) – these regulations state that, where an employing authority ceases to be a scheme employer, the Administering Authority is required to obtain an actuarial valuation of the liabilities of current and former employees as at the termination date.**
    - **Where a deficit exists, it requires the rates and adjustments certificate to be amended to show the revised contributions due from the ceasing employer.**
    - **Where a surplus exists, at its discretion the Fund will pay an exit credit to the ceasing employer within six months of the cessation date.**

  In exercising its discretion the Administering Authority will take account of:
    - **the extent to which the ceasing employer's assets are in excess of its liabilities;**
    - **the proportion of the excess of assets which has arisen because of the value of the ceasing employer's contributions;**
    - **any representations made by the ceasing employer and (if applicable) the letting authority/guarantor; and**
    - **any other relevant factors.**

- **64 (2a), (2B & 2C) – these regulations state that, where in the reasonable opinion of the administering authority an exiting employer might be expected to have one or more active members contributing in the near future, a "suspension notice" can be issued by the administering authority to that employer. Any such notice can suspend the exiting employer's liability to pay any exit payment for a period of up to 3 years. During the period of any such notice the exiting employer is still required to make such contributions in respect of its liabilities as the administering authority reasonably requires.**
- **Regulation 64 (3) – this regulation states that in instances where it is not possible to obtain additional contributions from the employer leaving the Fund or from the bond/indemnity or guarantor, the contribution rate(s) for the appropriate Scheme employer (in the case of ("Transferee") Admission Bodies) or remaining Fund employers may be amended.**
- **Regulation 64 (4) – this regulation states that where it is believed a scheme employer may cease at some point in the future the Administering Authority may obtain a certificate from the Fund actuary revising the contributions for that employer, with a view to ensuring that the assets and liabilities of the employer are broadly expected to be in balance when the admission agreement ends.**

These regulations relate to all employers in the Fund.

1.2 Reviews of Policy

This policy will be reviewed at least every three years following triennial valuations or following changes in the Regulations pertaining to employers leaving the Fund.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate. Any queries should be directed to Wendy Neller, Pensions Strategy and Governance Manager, in the first instance at Wendy.Neller@eastsussex.gov.uk or on 01273 481 904.

2. PRINCIPLES

2.1 Overriding Principles

The purpose of a cessation valuation is to determine the level of any surplus or deficit in an employer's share of the Fund as at the date the employer leaves the Fund. Where a deficit exists and unless the cost of doing so is deemed to outweigh the likely recovery to the Fund, the Fund will pursue an outgoing body (including the liquidator, receiver, administrator or successor body if appropriate) for any deficit. The Fund will also pursue any bond or indemnity provider and guarantor, for payment where appropriate. Where a surplus exists, the Fund will exercise its discretion and where appropriate, pay an exit credit to the outgoing body within six months of the cessation date (or another date agreed between the Fund and the body).

It is the Fund's policy that the determination of any surplus or deficit on termination should aim to minimise, as far as is practicable, the risk that the remaining, unconnected employers in the Fund have to make contributions in future towards meeting the past service liabilities of current and former employees of employers leaving the Fund.

Section 4 of this document sets out the bases currently in use for cessation valuations. These bases may be updated or withdrawn at the discretion of the Administering Authority on the advice of the Fund Actuary and will expire no later than 31 March 2023.

2.2 Interaction with Funding Policy

It is the Fund's policy that each employer is responsible for the funding of all Fund benefits of its own members, including current and previous employees. The Funding Strategy Statement sets this out in more detail and addresses the issue of cross-subsidies between employers. Whilst employer contributions may be pooled in the interests of stability and administrative ease for the purpose of triennial funding valuations under Regulation 62, the individual funding position for each employer is tracked by the Actuary at each triennial valuation. Any cessation valuation will be carried out using assets and liabilities allocated to the employer at the last triennial valuation as a starting point. This position will be updated to allow for membership movements and market conditions as at the cessation date.

Note j of section 3 of the Funding Strategy Statement sets out funding policy for admission bodies leaving the Fund.

2.3 Principles for Determining Payment

The Administering Authority will determine the deficit / surplus attributable to the employer on cessation having taken actuarial advice.

If the employer is in surplus, where appropriate, an exit credit will be paid to the employer within six months of the cessation date (or another date agreed between the Administering Authority and the employer). However, if an employer is aware that it will be leaving the Fund in future, it should alert the Administering Authority and request a valuation under Regulation 64 (4). If this valuation indicates that a surplus position is likely, then the Actuary will be able to advise the Administering Authority whether a contribution reduction (before the employer ceases) is appropriate.

If it is determined that there is a deficit and the employer is required to make a payment to the Fund, the Administering Authority will advise the employer of the amount required.

The Administering Authority will consider issuing a "suspension notice" where in its reasonable opinion the employer is likely to have one or more active members during the period of that notice. Where this is the case the Administering Authority will liaise with the employer, confirming any ongoing employer contributions required during the period that any "suspension notice" is in force.

The Fund's policy is for any deficit on cessation to be recovered through a single lump sum payment to the Fund, where possible. The Fund may consider permitting an employer to spread the payment over an agreed period where it considers that this does not pose a material risk to the solvency of the Fund.

If the payment is to be spread, the Administering Authority will consult with the Actuary to determine the appropriate payments to be made.

In the normal course of events (i.e. where the process below has been adhered to), the outgoing body will not be exposed to interest rate, investment or other funding risks after the cessation date. However, the final deficit payment may be adjusted, at the Administering Authority's discretion, by the addition of interest at the level of the base rate between the cessation date and the final payment date(s).

Please note from 1 April 2019 the Fund's policy is that new outsourcings are set up under a "pass through" arrangement (see Section 3.3 note (i) in the Funding Strategy Statement). On cessation of this type of employer participation, the underlying assets and liabilities return to the letting employer and no exit credit or debt will be due.

2.4 Post cessation funding agreement

The Administering Authority may, at its discretion, agree to set up a funding agreement with the ceasing employer which would allow it to continue to pay contributions towards its cessation deficit after the date of cessation. Depending on circumstances, the Administering Authority may allow the ceasing employer to be exposed to interest rate, investment or other funding risks during the course of the agreement.

Any such agreement would be tailored to the ceasing employer's specific circumstances and be subject to the following principles:

- **Demonstrable evidence e.g. such as financial accounts and forecasts and other business planning information, which shows that the employer is unable to meet the deficit payment as a single lump sum and allows the Administering Authority to form a view on the employer's financial covenant.**
- **Contingent security being lodged by the employer in a form that is satisfactory to the Administering Authority to cover the amount of the deficit in the event of the employer becoming insolvent or otherwise ceasing trading.**
- **An appropriate time period set by the Administering Authority based on its assessment of the risk of the cessation debt not being met in full. It is very unlikely that the time period would exceed the longest period (currently 20 years) given to Fund employers to recover deficit, as set out in the Funding Strategy Statement.**
- **A legally binding document outlining the terms of the agreement, signed by the Administering Authority and the ceasing employer (and any guarantor, if relevant).**
- **All costs (e.g. legal, actuarial, administrative) associated with setting up and running the agreement to be met by the ceasing employer.**

3. PROCESS

3.1 Responsibilities of ceasing employers

An employer which is aware that its participation in the Fund is likely to come to an end must:

- **advise the Fund, in writing, of the likely ending of its participation (either within the terms of the admission agreement in respect of an admission body (typically a 3 month notice period is required) or otherwise as required by the Regulations for all other scheme employers). It should be noted that this includes closed employers where the last employee member is leaving (whether due to retirement, death or otherwise leaving employment);**
- **provide any relevant information on the reason for leaving the Fund and, where appropriate, contact information in the case of a take-over, merger or insolvency;provide information, where appropriate, on the likelihood that it will have one or more active members contributing to the Fund within the next three years;**
- **provide all other information and data requirements as requested by the Administering Authority which is relevant, including in particular any changes to the membership which could affect the liabilities (e.g. salary increases and early retirements) and an indication of what will happen to current employee members on cessation (e.g. will they transfer to another Fund employer, will they cease to accrue benefits within the Fund, etc.); and**
- **where an exit credit exists, provide information to explain why the arrangements made by them make payment of an exit credit more or less appropriate.**

3.2 Responsibilities of Administering Authority

The Administering Authority will:

- **gather information as required, including, but not limited to, the following:**
    - **details of the cessation - the reason the employer is leaving the Fund (i.e. end of contract, insolvency, merger, machinery of government changes, etc.) and any supporting documentation that may have an effect on the cessation;**
    - **complete membership data for the outgoing employer and identify changes since the previous formal valuation; and**
    - **the likely outcome for any remaining employee members (e.g. will they be transferred to a new employer, or will they cease to accrue liabilities in the Fund).**
- **identify the party that will be responsible for the employer's deficit on cessation (i.e. the employer itself, an insurance company, a receiver, another Fund employer, guarantor, etc.);**
- **commission the Fund actuary to carry out a cessation valuation under the appropriate regulation;**
- **where applicable, discuss with the employer the possibility of paying adjusted contribution rates that target a 100% funding level by the date of cessation through increased contributions in the case of a deficit on the cessation basis or reduced contributions in respect of a surplus;**

- **where applicable, liaise with the original ceding employer or guarantor and ensure it is aware of its responsibilities, in particular for any residual liabilities or risk associated with the outgoing employer's membership, and, where an exit credit exists, provide information to explain why the arrangements made by them make payment of an exit credit to the ceasing employer more or less appropriate;**
- **where applicable liaise with the employer regarding the issue of a "suspension notice" under regulation 64 (2A), confirming any ongoing contributions to be made by the employer during the period that the "suspension notice" remains in force; and**
- **having taken actuarial advice, notify the employer and other relevant parties in writing of the payment required in respect of any deficit on cessation and pursue payment.**

3.3 Responsibilities of the Actuary

Following commission of a cessation valuation by the Administering Authority, the Fund Actuary will:

- **calculate the surplus or deficit attributable to the outgoing employer on an appropriate basis, taking into account the principles set out in this policy;**
- **provide actuarial advice to the Administering Authority on how any cessation deficit should be recovered or where applicable "suspension notice" be applied, giving consideration to the circumstances of the employer and any information collected to date in respect to the cessation; and**
- **where appropriate, advise on the implications of the employer leaving on the remaining Fund employers, including any residual effects to be considered as part of triennial valuations.**

4. CESSATION VALUATION BASIS

The following bases will apply from 1 April 2020 to 31 March 2023, the date by which the next valuation is signed off, unless otherwise withdrawn or updated by the Administering Authority on the advice of the Fund Actuary.

4.1 Gilts Discount Rate

The annualised gross redemption yield on the FTSE Actuaries Over 15 Years UK Gilts Index as at the date of cessation, rounded to the nearest 0.1% per annum.

4.2 Ongoing Discount Rate

The annualised gross redemption yield on the FTSE Actuaries Over 15 Years UK Gilts Index plus 1.9% per annum (calculated geometrically) at the date of cessation, rounded to the nearest 0.1% per annum (or if different the margin above the FTSE Actuaries Over 15 Years UK Gilts Index used to allocate assets to the employer on joining the Fund).

4.3 Pension Increases

The pension increase assumption is determined in line with the Consumer Prices Index (CPI). The CPI assumption is based on the assumption for the Retail Prices Index (RPI) less 1.0% per annum.

RPI is calculated as the geometric difference between the annualised gross redemption yield on the FTSE Actuaries Over 15 Years UK Gilts Index and the annualised gross redemption yield on the FTSE Actuaries Over 15 Years Index-Linked Gilts (3% Inflation) Index as at the cessation date, rounded to the nearest 0.1% per annum.

4.4 Salary Increases (Where Applicable)

As determined in the most recent valuation of the Fund, assumed salary increases will be CPI per annum.

4.5 Post-Retirement Mortality

Post-retirement mortality for all members is determined in line with Club Vita analysis which is carried out on behalf of the Fund at the triennial formal valuation. These are a bespoke set of Vita Curves that are specifically tailored to the individual membership profile of the Fund. Future improvements are in line with CMI Projections assuming the current rate of improvements has reached a 'peak' and that a long term rate of 1.25% per annum will apply.

Further details are set out in the most recent formal valuation report of the Fund.

Under the gilts cessation basis, an allowance is made for further improvements to life expectancies by adjusting the value of liabilities upwards by 5%.

4.6 Other Demographic Assumptions

As set and outlined in the report on the most recent formal valuation of the Fund.

4.7 LGPS benefit changes

The LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the "McCloud" case and other similar court cases. The Fund has considered how it will reflect the current uncertainty regarding the outcome of this judgement in its approach to cessation valuations. For cessation valuations that are carried out before any changes to the LGPS benefit structure (from 1 April 2014) are confirmed, the Fund's policy is that the actuary will apply an adjustment to the ceasing employer's post 2014 benefit accrual value, as an estimate of the possible cost of resulting benefit changes.

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East Sussex Pension Fund

Investment Strategy Statement

March 2020

Introduction and background

This is the Investment Strategy Statement ("ISS") of the East Sussex Pension Fund ("the Fund"), which is administered by East Sussex County Council, ("the Administering Authority"). The ISS is made in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ("the Regulations").

The ISS has been prepared by the Pension Committee ("the Committee") having taken advice from the Fund's investment adviser, Hymans Robertson LLP. The Committee acts on the delegated authority of the Administering Authority. The ISS, which was approved by the Committee on 16 March 2020, is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Committee has consulted on the contents of the Fund's investment strategy with such persons it considers appropriate.

The Committee seeks to invest in accordance with the ISS, any Fund money that is not needed immediately to make payments from the Fund. The ISS should be read in conjunction with the Fund's Funding Strategy Statement.

The suitability of particular investments and types of investments

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependents, on a defined benefits basis. This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary and/or inflation increases.

The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund. This benchmark is consistent with the Committee's views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities. The Committee discuss the appropriateness of the Fund's strategic asset allocation at least once a year.

The Fund carries out an asset liability modelling exercise in conjunction with each actuarial valuation. A number of different contribution and investment strategies are modelled and the future evolution of the Fund considered under a wide range of different scenarios. The Committee considers the chances of achieving their long term funding target and also considers the level of downside risk in the various strategies by identifying the low funding levels which might emerge in the event of poor outcomes.

This approach helps to ensure that the investment strategy takes due account of the maturity profile of the Fund (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the funding bases used).

In addition, the Committee monitors investment strategy on an ongoing basis, focusing on factors including, but not limited to:

- Suitability given the Fund's level of funding and liability profile
- The level of expected risk
- Outlook for asset returns

The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation and has implemented a rebalancing policy Appendix A.

To help clearly define the strategic approach adopted by the Committee it has set out its investment beliefs Appendix B.

Investment of money in a wide variety of investments

Asset classes

The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities, fixed interest and index linked bonds, cash, property and commodities, either directly or through pooled funds. The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products for the purpose of efficient portfolio management or to hedge specific risks.

The Committee reviews the nature of Fund investments on a regular basis, with particular reference to suitability and diversification. The Committee seeks and considers written advice from a suitably qualified person in undertaking such a review. If, at any time, investment in a security or product not previously known to the Committee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

The Fund's target investment strategy is set out below. The table also includes the maximum percentage of total Fund value that it will invest in these asset classes. In line with the Regulations, the authority's investment strategy does not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007.

Table 1: Fund allocation

Asset class	Target allocation %	Maximum invested* %	Role within the Strategy
Global Equity	33.0	44.0	Growth Assets
UK Equity	7.0		Growth Assets
Absolute Return	21.0	24.0**	Growth Assets
Private Equity	5.5	7.5	Growth Assets
Property	10.0	13.0	Income Assets
Infrastructure	4.0	6.0	Income Assets
Private Debt	3.0	5.0	Income Assets
Absolute Return Bonds	8.0	9.0	Income Assets
Index-Linked Gilts	5.0	6.0	Protection Assets
Fixed Interest Bonds	3.5	4.5	Protection Assets
Cash	0.0	2.0	Protection Assets
Total	100.0		

*The maximum invested figures are based on the rebalancing ranges agreed by the East Sussex Pension Committee within its rebalancing policy.

** Additional allowance of 1% to rebalancing figures whilst allocations to infrastructure and private debt take place.

Restrictions on investment

The Regulations have removed the previous restrictions that applied under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009. The Committee's approach to setting its investment strategy and assessing the suitability of different types of investment takes account of the various

risks involved and a rebalancing policy is applied to maintain the asset split close to the agreed asset allocation target. Therefore it is not felt necessary to set additional restrictions on investments.

Managers

The Committee has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate, they are consistent with the overall asset allocation for the Fund. The Fund's investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles. The manager of the passive funds in which the Fund invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices.

When the Committee decide to invest in a new fund, a shortlist of options is recommended by the Investment Advisor and discussed by the Committee.

The approach to risk, including the ways in which risks are to be measured and managed

The Committee is aware that the Fund has a need to take risk (e.g. investing in growth and income assets) to help it achieve its funding objectives. It has an active risk management programme in place that aims to help it identify the risks being taken and put in place processes to manage, measure, monitor and (where possible) mitigate the risks being taken. The investment section of the Risk Register is reviewed at least every six months by the Committee.

The principal risks affecting the Fund are set out below. We also discuss the Fund's approach to managing these risks and the contingency plans that are in place:

Funding risks

- Financial mismatch – The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.
- Changing demographics –The risk that longevity improves and other demographic factors change, increasing the cost of Fund benefits.
- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Fund's liabilities.

The Committee measures and manages financial mismatch in two ways. As indicated above, the Committee has set a strategic asset allocation benchmark for the Fund, which is reviewed on at least an annual basis. This benchmark was set taking into account asset liability modelling which focused on probability of success and level of downside risk.

The results from the 2016 analysis highlighted that the Fund - utilising its current stabilisation parameters for contributions – has a good chance of being fully funded in future at the end of the projection period used without adopting an over prudent approach towards its investment strategy. The Committee assesses risk relative to the strategic benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. The Committee also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The Committee also seeks to understand the assumptions used in any analysis and modelling so they can be compared to their own views and the level of risks associated with these assumptions to be assessed.

The Committee reviews the demographic assumptions of the Fund every three years as part of its triennial valuation to mitigate the risk that any changes to longevity and other factors would have on the Fund.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

Asset risks

- Concentration - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Fund's assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Environmental, social and governance ("ESG") – The risk that ESG related factors reduce the Fund's ability to generate the long-term returns. The Fund believes that climate change poses material risks to the Fund but that it also presents positive investment opportunities.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

The Committee measure and manage asset risks as follows.

The Fund's strategic asset allocation benchmark invests in a diversified range of asset classes. The Committee has put in place rebalancing arrangements to ensure the Fund's "actual allocation" does not deviate substantially from its target. The Fund invests in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, help reduce the Fund's asset concentration risk. By investing across a range of assets, including liquid quoted equities and bonds, as well as property, the Committee has recognised the need for access to liquidity in the short term.

The Fund invests in a range of overseas markets which provides a diversified approach to currency markets; the Committee also assesses the Fund's currency risk during their risk analysis. Details of the Fund's approach to managing ESG risks are set out later in this document.

The Committee has considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by appointing more than one manager and having a large proportion of the Fund's assets managed on a passive basis. The Committee assess the Fund's managers' performance on a regular basis, and will take steps, including potentially replacing one or more of their managers, if underperformance persists.

Other provider risk

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee seeks suitable professional advice.

- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.
- Stock Lending- The Fund will participate in any stock-lending arrangements in the future as part of the LGPS ACCESS pool. The Committee will ensure that robust controls are in place to protect the security of the Fund's assets before entering into any stock lending arrangements. The manager(s) of pooled funds may undertake a certain amount of stock lending on behalf of unit-holders. Where a pooled fund engages in this activity the extent is fully disclosed by the manager (unless the assets are invested in LGPS pooled arrangements in which case this will be delegated to the Pool Operator).

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Fund, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). The Committee has the power to replace a provider should serious concerns exist.

A separate schedule of risks that the Fund monitors is set out in the Fund's Funding Strategy Statement.

The approach to pooling investments, including the use of collective investment vehicles and shared services

The Fund is a participating scheme in the ACCESS Pool. The proposed structure and basis on which the ACCESS Pool will operate was set out in the July 2016 submission to Government.

Assets to be invested in the Pool

The Fund's intention is to invest its assets through the ACCESS Pool as and when suitable Pool investment solutions become available. The ACCESS Pool has launched several sub-funds in which the East Sussex Pension Fund now participates and there are further launches planned for later in 2020 which East Sussex plan to be involved with.

The Fund's investment mandates with Longview, Ruffer and Newton have been transferred into ACCESS to date.

An indicative timetable for investing through the Pool was set out in the July 2016 submission to Government. They key criteria for assessment of Pool solutions will be as follows:

1. That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund
2. That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

At the time of preparing this statement the Fund has elected not to invest the following assets via the ACCESS Pool:

Table 2 – Assets held outside the pool

Asset class	Manager	Target % of Fund assets	Benchmark	Reason for not investing via the ACCESS Pool
Private Equity	Harbourvest Partners / Adam Street Partners	5.5%	MSCI All Countries World	Existing illiquid asset programmes will run off at normal lifecycle to avoid crystallising exit costs and loss of illiquidity premium earned.
Infrastructure	M & G Infracapital / UBS Infrastructure / Pantheon	4.0%	GBP 3 Month LIBOR	Existing illiquid asset programmes will run off at normal lifecycle to avoid crystallising exit costs and loss of illiquidity premium earned.
Private Debt	M & G	3.0%	GBP 3 Month LIBOR	Existing illiquid asset programmes will run off at normal lifecycle to avoid crystallising exit costs and loss of illiquidity premium earned.
Operational cash	East Sussex County Council	0.0%	N/A	East Sussex Pension Fund needs to manage its cash flow to meet statutory liabilities, including monthly pension payroll payments, therefore, a reasonable level of operational cash will be required to maintain efficient administration of schemes and would be held outside the Pool.

Any assets not currently invested in the Pool will be reviewed at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money. The next such review will take place no later than 2022.

Structure and governance of the ACCESS Pool

East Sussex is a member of the ACCESS pool along with the following 10 other pension funds:

Cambridgeshire	Kent
Essex	Norfolk
Hampshire	Northamptonshire
Hertfordshire	Suffolk
Isle of Wight	West Sussex

All eleven funds are committed to collaboratively working together to meet the criteria for pooling and have signed a Memorandum of Understanding to underpin their partnership. ACCESS is working to a project plan in order to create the appropriate means to pool investments.

The ACCESS Funds have set out how they meet the pooling criteria, the pool's structure, governance arrangements and services to be shared in the submission made to the Government in July 2016, which is available on ACCESS's website http://www.accesspool.org/

The "ACCESS Pool" is not a legal entity. However a Joint Committee (JC), comprising elected Pension Committee Chairmen from each Administering Authority and supported by the Officer Working Group has been established via an Inter Authority Agreement. Papers from previous and future ACCESS JC meetings papers can be found using the following link: https://democracy.kent.gov.uk/mgOutsideBodyDetails.aspx?ID=898

ACCESS has taken advice on its sub-fund design and is implementing the consolidation of a significant portion of participating Authorities' liquid assets in the initial set of sub-funds. This sub-fund proposal will allow the Operator to make rapid progress in preparing and submitting an application for authorisation of the ACCESS ACS and a set of "pilot and pipeline" sub-funds.

Investments under Pool Governance (Passive) - The value of assets to be held within the Pool includes passively managed assets which will be held in Life Policies. The Life Policies themselves will necessarily remain an agreement between the participating Authority and the appointed external investment manager. This was acknowledged as an acceptable outcome by Government. All passive assets will therefore be held out-side the Authorised Contractual Scheme (ACS) and will not be managed or administered by the Pool Operator.

How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments

To clearly define the approach adopted by the Committee to these issues it has approved a Responsible Investment (RI) Policy which is included as Appendix C. Within this it is recognised that environmental social and corporate governance factors can influence long term investment performance and the ability to achieve long term sustainable returns. The Committee considers the Fund's approach to responsible investment with four core principles:

a. We will apply **long-term thinking** to deliver **long-term sustainable returns**.
b. We will seek **sustainable returns** from **well-governed assets**.
c. We will use an **evidence-based** long term investment appraisal to inform **decision-making** in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.
d. We will evaluate and manage **carbon exposure in order to mitigate risks to the Fund from climate change**.

More detail on the way in which these principles are incorporated into the Fund's investments is contained in Appendix C. The Committee takes RI matters very seriously and conducts a regular review of its policies in this area and its investment managers' approach to RI.

At the present time the Committee does not take into account non-financial factors when selecting, retaining, or realising its investments.

To date, the Fund's approach to Social investments has largely been to delegate this to their underlying investment managers as part of their overall RI duties.

The Fund does not hold any assets which it deems to be social investments.

The exercise of rights (including voting rights) attaching to investments

Voting rights

The Committee has delegated the exercise of voting rights to the investment manager(s) on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the Fund's managers have produced written guidelines of their process and practice in this regard, which is considered as part of the appointment of an investment manager process. The managers are strongly encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f). The Committee will publish an annual report of voting activity as part of the Fund's annual report.

Stewardship

The Committee understands that stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. The Committee has formally agreed to adhere to the Stewardship Code as published by the Financial Reporting Council. A copy of the Fund's statement of compliance with the Stewardship code can be found on the Fund's website https://www.eastsussex.gov.uk/yourcouncil/pension-fund-policies/.

The Committee expects its investment managers to be signatories or comply with the Stewardship Code as published by the Financial Reporting Council. Asset manager signatories have been categorised in three tiers.

- **Tier 1** – Signatories provide a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary.
- **Tier 2** – Signatories meet many of the reporting expectations but report less transparently on their approach to stewardship or do not provide explanations where they depart from provisions of the Code.
- **Tier 3** – Significant reporting improvements need to be made to ensure the approach is more transparent. Signatories have not engaged with the process of improving their statements and their statements continue to be generic and provide no, or poor, explanations where they depart from provisions of the Code.

Investment Managers Stewardship Rating

Tier 1

- UBS Asset Management
- Newton Investment Managment
- Ruffer LLP
- Schroder Investment Manangment Limited
- M & G Investment Managment
- Longview Partners
- Northern Trust Global Investments

Tier 2

- None

Tier 3

- None

The Committee expects both the ACCESS Pool and any directly appointed fund managers to also comply with the Stewardship Code. In addition to the Fund's views on the Stewardship Code, the Fund believes in collective

engagement and is a member of the Local Authority Pension Fund Forum (LAPFF), through which it collectively exercises a voice across a range of corporate governance issues.

Appendices

Appendix A – Rebalancing Policy

Appendix B – Investment Beliefs

Appendix C – Responsible Investment Policy

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East Sussex Pension Fund

Rebalancing Policy

September 2018

Appendix A

Rebalancing Ranges

The following ranges have been agreed by the Committee to set as points at which rebalancing should take place.

Asset class	Strategic target (%)	Range (%)
Global Equities	33.0	36.0 – 44.0
UK Equities	7.0	
Private Equity	5.5	3.5 – 7.5
Absolute Return	21.0	19.0 – 23.0
Total Growth	**66.5**	**60.0 – 73.0**
Property	10.0	8.0 – 12.0
Infrastructure	4.0	2.0 – 6.0
Private Debt	3.0	1.0 – 5.0
Total Income	**17.0**	**15.0 – 19.0**
Absolute Return Bonds	8.0	7.0 – 9.0
Fixed Interest Bonds	3.5	2.5 – 4.5
Index-Linked Gilts	5.0	4.0 – 6.0
Cash	0.0	0.0 – 2.0
Total Protection	**16.5**	**15.0 – 18.0**
Total	**100.0**	

Rebalancing for the Fund – General Rules

The following general rules will determine how a rebalancing process for the Fund will operate.

- **Rebalancing would apply only to equities, absolute return funds and bonds** - Due to the transaction costs and illiquidity associated with the other investments such as property, rebalancing for those asset classes will be considered on an annual/ad hoc basis;
- **Rebalancing would be monitored on a quarterly basis**
- **Each benchmark allocation would have a weighted tolerance range –** A tolerance range will be defined for growth and matching assets and each underlying mandate; these tolerance ranges will be used in determining when rebalancing will occur;

Appendix A

- **Cash holdings to be used for rebalancing**. Where possible any net investments or disinvestments should be used to manage allocations, for example, by investing any surplus cash into the most underweight asset class.
- **Rebalancing will occur at two levels; at the growth vs matching level, and at the mandate level –** The rebalancing process will determine if rebalancing is required between growth and matching assets, and separately if rebalancing is required between asset classes. However, it is more important to be willing to incur transaction costs if necessary to rebalance between bonds and equities, for example, than switching between managers with similar mandates (e.g. Longview and L&G global equities).
- **Rebalancing transactions will aim to rebalance allocations out with their tolerance ranges to the midpoint (at least) of the tolerance range –** The mid-point of the tolerance range is the mid-point between a benchmark allocation and its upper or lower tolerance limit. Assuming an asset class with a 60% allocation and a 54%-66% tolerance range, the upper mid-point would be the halfway point between 60-66% (i.e. 63%). The lower mid-point would be the halfway point between 54% and 60% (i.e. 57%). Analysis suggests that this is the best way of balancing the impact of transaction costs against returns.

The allocations to private equity and infrastructure (and to a lesser extent property) will vary with general market movements and are not easily altered, due to the illiquid nature of the asset classes. Therefore we do not anticipate any rebalancing being carried out in relation to the Fund's private equity or infrastructure investments.

Appendix B

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East Sussex Pension Fund

Investment Beliefs

Appendix B

March 2020

Fund specific investment beliefs

The Pension Committee has prepared a set of investment beliefs based on their experience of the workings of the Fund and the nature of the underlying investments held. These are set out below:

Belief: Clear and well defined objectives are essential to achieve future success

The Committee is aware that there is a need to generate a sufficient level of return from the Fund's assets, while at the same time having a clear understanding of the potential risks and ensuring there is sufficient liquidity available to pay members' benefits as they fall due.

Evidence of Belief in Practice: The objectives of the Fund are considered every three years as part of the actuarial valuation process and the accompanying review of the long term investment strategy.

Belief: Strategic asset allocation is a key determinant of risk and return, and thus is typically more important than manager or stock selection

The Committee understands that having the appropriate strategy in place is a key driver of the Fund's future success. As a result, priority is given to more strategic investment matters.

Evidence of Belief in Practice: The appropriateness of the strategic asset allocation is currently considered by the Committee on at least an annual basis. The intention is to also establish a Working Group tasked with conducting a more detailed review of investment strategy on a more frequent basis.

Belief: Funding and investment strategy are linked

The Committee understands that a number of funding related aspects feed into investment strategy decisions, including maturity, financial risk of the employer and level of required return. Given this, actuarial and investment matters, most notably setting investment strategy, are looked at in tandem by the Committee.

Evidence of Belief in Practice: The Scheme Actuary and Investment Adviser are both invited to attend meetings where investment strategy and funding are discussed in detail. Regular asset liability modelling exercises incorporate long term projections for the nature of the Fund's liabilities alongside the expected returns and risks arising from the Fund's invested assets.

Belief: Long term investing provides opportunities for enhancing returns

The Committee believes that investors with long term time horizons are typically less constrained by liquidity requirements and able to better withstand periods of price volatility. As a long term investor, the Fund may choose to gain additional compensation by investing in assets that are illiquid (e.g. property, infrastructure and private equity) or may be subject to higher levels of volatility (a premium return is required for any such investments). Having this long-term focus also helps the Fund tolerate periods of active manager underperformance when the manager's investment style is out of favour with the market.

Evidence of Belief in Practice: The Committee invests in illiquid asset classes comprising private equity, infrastructure, private debt and property. These investments are expected to benefit from an additional illiquidity return premium over time.

Belief: Equities are expected to generate superior long term returns

Appendix B

The Committee believes that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. The Committee is therefore comfortable that the Fund maintains a significant allocation to equities in order to support the affordability of contributions.

Evidence of Belief in Practice: Almost half of the Fund's assets are invested in either listed or unlisted equities (45.5% in aggregate).

Belief: Alternative asset class investments provide diversification

The Committee believes that diversification across asset classes can help reduce the volatility of the Fund's overall asset value and improve its risk-return characteristics. The Committee believes that investing across a range of asset classes (including, but not restricted to, equities, bonds, absolute return funds, infrastructure and property) will provide the Fund with diversification benefits.

Evidence of Belief in Practice: The Fund invests in nine different asset classes, two of which are diversified growth and absolute return credit, which themselves provide exposure to a wider range of asset classes.

Belief: Government bonds provide liquidity and a degree of liability matching

Government bonds have characteristics that are similar to the assumptions used in valuing pension liabilities e.g. sensitive to changes in interest rates and (for index-linked) to changes in market-implied inflation. This makes them a suitable asset for reducing the Fund's funding risks. In addition, this asset class has proven to be highly liquid at times of market stress, enabling it to be used for rebalancing and to help meet any outflows that may fall due. Given this, the Committee hold a proportion of the Fund's assets in this asset class.

Evidence of Belief in Practice: The Fund has a target allocation of 3.5% to corporate bonds and 5% to index linked gilts. The Committee consider this to be an appropriate allocation for providing liquidity at times of stress, whilst taking into account the long-term nature of the Fund's investment strategy and the lower expected return these asset classes have relative to other asset classes.

Belief: Fees and costs matter

The Committee recognises that fees and costs reduce the Fund's investment returns. The Committee considers the fees and costs of its investment arrangements to ensure the Fund is getting value for money and to minimise, as far as possible, any cost leakages from its investment process.

Evidence of Belief in Practice: The Fund employs a combination of active and passive management for its equity and bond assets. Of the Fund's equity allocation, a large proportion is currently invested passively. The Fund also participates in the ACCESS Pool which, in part, seeks to achieve lower annual management charges by benefitting from pooling assets into a more attractive proposition for fund managers.

Beliefs: Rebalancing can add value

Academic studies show that regular rebalancing can help add value over the long-term. As a result, the Fund has put in place agreed tolerance ranges for their liquid assets, with the intention that assets will be rebalanced, at least towards target, should these ranges be breached.

Evidence of Belief in Practice: The Fund has a rebalancing policy and, when individual mandates or asset categories are in breach of a limit, this is discussed at Committee meetings with a view to agreeing upon the most appropriate course of action.

Belief: Active management can add value but is not guaranteed

Appendix B

The Committee recognises that certain asset classes can only be accessed via active management. The Committee also recognises that active managers may be able to generate higher returns for the Fund (net of fees), or similar returns but at lower volatility, than equivalent passive exposure. The Committee will aim to minimise excessive turnover in its active managers. By carefully selecting and monitoring active managers and recognising that periods of underperformance will arise, the Committee seeks to minimise the additional risk from active management, and continue to monitor active managers to ensure their mandates remain appropriate for the Fund.

Evidence of Belief in Practice: The Fund employs active managers to manage 62% of the Fund's assets. Performance of these managers is reviewed on quarterly basis. For many asset classes, there is no passive management option. However, active managers are employed for bond and equity mandates where a passive equivalent is available.

Belief: Passive management has a role to play in the Fund's structure

The Committee recognises that passive management allows the Fund to access certain asset classes (e.g. equities) on a low cost basis and when combined with active management can help reduce the relative volatility of the Fund's performance.

Evidence of Belief in Practice: The Fund employs a passive manager to manage 38% of the Fund's assets, across equity (33%) and index-linked gilts (5%).

Belief: Choice of benchmark index matters

The Committee recognises that, for each asset class, there is a range of benchmark indices that they could use. As a result, the Committee focus on the benchmark's underlying characteristics and consider how they may be appropriate for the Fund. Choice of benchmark is particularly relevant for passive mandates where the manager's job is to track the index as closely as possible.

Evidence of Belief in Practice: There is a benchmark regional equity allocation in place with the Fund's passive equity manager, which means that a broad allocation to different equity regions is maintained over time. The Fund also invests in a passive fund that replicates an index that is constructed based on a set of factor-based rules (RAFI) and a passive fund that replicates an index that is constructed in such a way as to benefit from a long-term transition to a low carbon economy (Climate Aware Fund).

Belief: Environmental, social and corporate governance ('ESG') issues can have a material impact on the long term performance of its investments

The Committee recognises that ESG issues can impact the Fund's returns and reputation. Given this, the Committee aims to be aware of, and monitor, financially material ESG-related risks and issues through the Fund's investment managers. The Committee commits to an ongoing development of its ESG policy to ensure it reflects latest industry developments and regulations.

Evidence of Belief in Practice: The Committee maintain a responsible investment policy included as an appendix in the ISS and an ESG statement published on the Fund's website.

Belief: Climate change presents a financial risk to the future investment returns from the Fund.

The Committee recognises that climate change issues can impact the Fund's returns and reputation. The impacts of climate change on the returns of the Fund in the future are unknown at this point but the Committee recognises that they need to allocate sufficient time and resource to monitor the possible risks and also identify any investment opportunities which may become available as a result. The committee is aware that not all companies and sectors are affected in the same way by climate change.

Appendix B

Evidence of Belief in Practice: The Fund's fossil fuel exposure is monitored on a quarterly basis and discussed at Committee meetings. The Fund invests in the UBS Climate Aware Fund which aims to benefit (relative to a market-cap index) from a long-term transition to a low carbon economy.

Belief: Close engagement with - and challenge to - the investment managers will improve understanding of these risks.

The Committee believes that investors with long term time horizons are more exposed to certain risks and requires that its investment managers are aware of and consider these when making investments. It is acknowledged that investment managers carry out detailed research on the prospects for individual companies and industries and have access to company management. The Committee meets with investment managers at their regular meetings and has the opportunity to discuss relevant developments in detail. To challenge investments to ensure these are being followed and that all relevant risks have been considered.

Evidence of Belief in Practice: At least one of the Fund's managers is invited to present at quarterly Committee meetings and is questioned on approach to responsible investment. Voting and engagement information is collected on a quarterly basis and used to update the ESG statement.

Belief: Individual stock selection decisions will be delegated to active managers but the Fund will retain the right to sell holdings in exceptional circumstances.

The Committee believes that it is the role of its active managers to do the necessary due diligence on each individual stock selection they make. The Committee requires that its active managers provide on request the investment rational for each investment that they have made. Where the Committee has determined through this engagement with the active manager that the risks posed by a stock outweighs the potential gain they will retain the right to instruct its active managers to sell those holdings. As a result, no restrictions are currently placed on the Fund's active investment managers.

Evidence of Belief in Practice: The Fund's active managers provide quarterly reporting that justifies the purchase, and sale, of a particular holding. Further explanation is also provided when managers present at Committee meetings.

Belief: The Fund will aim to collaborate with other investors where this is expected to have a positive impact

The Committee recognises that through active shareholder engagement it can get those companies it is invested in to improve their corporate behavior. Improvements made by these engagements lead to an increase in the long term value of the Fund's investments. The Committee believes that these can be maximized by collaborating with other like-minded investors to increase the pressure for change and encourages improvements to be made.

Evidence of Belief in Practice: The Fund is a member of the LAPFF (Local Authority Pension Fund Forum) which engages widely with companies representing the interest of over 70 LGPS funds. The Fund has also been instrumental in developing the approach of the ACCESS pool in using its influence in this area.

Belief: The nature of the underlying benchmark is an important consideration, most notably for passive mandates.

The Committee understands that the underlying benchmark they set their investment managers will drive the behaviour of the managers and the investment risks they will take. The Committee also recognises that for its passive mandates the manager will only buy the stocks within the benchmark they are tracking. The Committee is aware that to ensure it is investing in the way that meets the needs of the Fund it needs to ensure it provides suitable benchmarks for each investment mandate. Therefore, the

choice of benchmark index by the Committee is very important, will continue to explore the potential for using low carbon indices.

Evidence of Belief in Practice: The Fund has a wide range of equity benchmarks that are replicated by UBS, including a 'fundamental indexation' index (RAFI) and a market-cap index with a discretionary climate change overlay (Climate Aware). The Committee has also recently reviewed the benchmarks and targets in place for the Fund's managers, and amended its reporting accordingly.

Appendix B

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Appendix C

East Sussex Pension Fund

Responsible Investment Policy

November 2018

Appendix C

Responsible Investment Policy

Introduction and background

Regulation 7(2) (e) The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 requires an administering authority to demonstrate that it considers any factors that are financially material to the performance of the Fund's investments, including social, environmental and corporate governance factors, depending on the time horizon over which their liabilities arise.

The East Sussex Pension Fund ("the Fund") is a long term responsible investor aiming to deliver a sustainable Pension Fund for all stakeholders. The Fund complies with and follows the principles of the UK Stewardship Code and working within the spirit of the United Nations Principles of Responsible Investment ("UNIPRI").

East Sussex County Council ("the Council") is the administering authority of the Fund and has a fiduciary duty to act in the best, long-term, interests of the Fund's employers and scheme members. The Fund believes that in order to fulfil this duty, it must have a clear policy on how it invests in a responsible manner.

Responsible Investment is a fundamental part of the Fund's overarching investment strategy as set out in its Investment Strategy Statement. That is, to maximise returns subject to an acceptable level of risk whilst increasing certainty of cost for employers, and minimising the long term cost of the scheme. The Fund believes that consideration of Environmental, Social and Corporate Governance ("ESG") factors are fundamental to this, particularly where they are likely to impact on the overarching investment objective.

The Fund's approach aims to ensure that consideration of ESG factors is embedded in the investment process, utilising the various tools available to manage ESG risks and to harness opportunities presented by ESG factors.

What is our policy on Responsible Investment?

The Fund's core principles of responsible investment are:

a. We will apply **long-term thinking** to deliver **long-term sustainable returns**.

b. We will seek **sustainable returns** from **well-governed assets**.

c. We will use an **evidence-based** long term investment appraisal to inform **decision-making** in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.

d. We will evaluate and manage **carbon exposure in order to mitigate risks to the Fund from climate change**.

Appendix C

What will we do to ensure that these core principles are met?

Core Principle	Associated Actions
We will apply long-term thinking to deliver long-term sustainable returns	• The Fund's long-term investment objectives will be detailed in its Investment Strategy Statement. • The Fund will set longer-term performance objectives for its investment managers. • The Fund will seek to ensure that its long term interests are aligned with that of its investment managers on all issues including on RI considerations. • Policies relating to RI will be considered at the Fund's annual investment strategy day as part of the Fund's long term investment planning process.
We will seek sustainable returns from well-governed assets	• The Fund will apply a robust approach to stewardship, linked to the Fund's belief that engagement can positively and effectively influence behaviours. • The Fund will engage with companies when we believe engagement will add value to the Fund or change corporate behaviour for the better. • The Fund is committed to compliance with the UK Stewardship Code and working within the spirit of the United Nations Principles of Responsible Investment ("UNIPRI"). • We will hold our investment managers to account to ensure compliance with this policy. • The Fund is committed to collective engagement through its membership of the Local Authority Pension Fund Forum (LAPFF), the ACCESS LGPS pool and other opportunities that arise from time to time. • The Fund will exercise its voting rights in all markets where practicable.
We will use an evidence-based long term investment appraisal to inform decision-making in the implementation of RI principles and consider the costs of RI decisions consistent with our fiduciary duties.	• The Fund will consider the potential financial impact of RI related issues on an ongoing basis (e.g. climate change or executive remuneration). • The Fund will consider the potential financial impact of investment opportunities that arise from RI related factors (e.g. investment in renewable energies or housing infrastructure). • The Fund will consider investment opportunities that have positive impacts and recognises that the changing external environment presents new opportunities i.e. Renewable energy and social impact investments.
We will evaluate and manage **carbon exposure in order to mitigate risks to the Fund from climate change**	• The Fund has identified climate change as a potential long-term financial risk. • The Fund will regularly review the tools and solutions available to assess and manage carbon exposure. • The Fund will review its carbon foot print annually both at the Fund and investment manager level. • The Fund will incorporate climate risk assessment as part of the annual investment strategy review (considering the Fund's investment strategy under a range of climate change scenarios, including a 2˚C scenario). • The Fund will review the Fund's passive equity benchmarks and consider increasing the use of indices tilted towards low carbon.

Appendix C

How will we monitor our performance on Responsible Investment?

The Fund will ultimately be transparent and accountable in terms of its performance on Responsible Investment. This will be achieved through the following approach:

- The Fund will publish its Investment Strategy Statement on its website in line with the scheme regulations.
- Decisions relating to the setting of investment policy will be explained.
- The Fund will publish its RI policy on its website. We will review it on an ongoing basis, including consulting the Local Pension Board, at least every three years in line with the fund ISS.
- The Fund will monitor closely its appointed investment managers whom the Fund rely on to implement its RI policy.
- The Fund (through the Pension Board) will undertake an annual review of corporate governance, voting and engagement activity undertaken by the Fund and its underlying managers.
- The Fund will publish an annual summary of voting and engagement activity.
- The Fund will disclose the results of the Fund's equity carbon footprint.
- The Fund will ensure that its decision makers are properly trained and kept abreast of ESG issues in order to make informed decisions, including regular RI/UN Sustainable Development Goals training.
- The Fund will include RI as a standing item on Pensions Committee and the Pension Board agendas (with a view to reporting on manager performance in relation to RI investing and noting any hot topics / issues arising).
- The Fund will undertake a fundamental review of any specific RI issues considered by the Pension Committee to be of potentially material financial impact.
- The Fund actively considers RI capabilities and advice when selecting and monitoring its investment advisors.
- The Fund expects its investment advisors to proactively consider and integrate RI issues when providing investment advice to the Fund.
- The Fund will consider and respond to feedback from stakeholders in relation to issues of concern.

Responsible Investment and ACCESS LGPS

The implementation of the Fund's investment strategy will be undertaken by the ACCESS Pool. These are eleven funds committed to collaboratively working together to meet the criteria for pooling and have signed an Inter Authority Agreement to underpin their partnership. It is expected that the Fund's ability to invest in a responsible way will be enhanced through the ACCESS LGPS Pool due to the inherent benefits of scale and innovation that will result from the collaboration.

Engagement versus Exclusion

East Sussex Pension Fund has never sought to implement a policy that explicitly excludes certain types of investments, companies or sectors except where they are barred by UK law. The Fund believes that its influence as a shareholder is better deployed by engaging with companies, in order to influence behaviour and enhance shareholder value. The Fund believes that this influence would be lost through a divestment or screening approach. Ultimately the Fund will always retain the right to disinvest from certain companies or sectors in the event that all other approaches are unsuccessful and it is determined that the investment is no longer aligned with the interests of the Fund or that the issue poses a material financial risk. Under pooling it is likely that any such decision will need to be made in conjunction with other members of the ACCESS pool.

The Fund's approach to engagement recognises the importance of working in partnership to magnify the voice and maximise the influence of investors as owners. The Fund appreciates that to gain the attention of companies in

Appendix C

addressing governance concerns; it needs to join with other investors sharing similar concerns. It does this primarily through:

- Membership of representative bodies including LAPFF;
- Membership of the Pensions and Lifetime Savings Association (PLSA);
- Giving support to shareholder resolutions where these reflect concerns which are shared and affect the Fund's interests;
- Joining wider lobbying activities when appropriate opportunities arise.

Exercise of Voting Rights

The Fund continues to exercise its ownership rights by adopting a policy of actively voting stock it holds, and delegate's responsibility for voting to its appointed investment managers who are required to vote wherever the Fund has a voting interest. Wherever practicable, votes must be cast in accordance with the voting guidelines for investment managers of ACCESS ACS (Authorised Contractual Scheme).

The ACCESS Pool appointed operator, Link Fund Solutions Limited ("LFS") recognises that as the Manager of the ACCESS ACS, it has a responsibility as a shareholder, and to its investors the ACCESS funds, to promote good corporate governance and management in the companies in the ACS, which the Fund invests and it requires investment managers appointed to manage the Fund to exercise the voting rights attached to investments held in the Fund unless market circumstances make it impossible to do so. The document sets out guidelines to which LFS expects investment managers to have regard in the exercise of voting rights on behalf of the Fund however LFS recognises that in certain cases there may be good reasons not to follow the guidelines set out in this document and in those circumstances LFS expects its investment managers to exercise their discretion having regard to the long-term interests of the shareholders in the Fund and the principles of good corporate governance. LFS requires investment managers to report on voting activity monthly.

Where investment managers do not adopt the positions set out in these guidelines, it is required that they should provide a robust explanation of the position adopted. LFS also expects that investment managers will be signatories to and comply with the Financial Reporting Council's Stewardship Code (the Code) and United Nations Principles of Responsible Investment (UNPRI). If they have not signed up to either the Code or UNPRI they should be prepared to explain the reasons.

The Fund is committed to the UK Stewardship Code and has developed a statement of compliance for assessment by the Financial Reporting Council.