

ES East Sussex PF Pension Fund

Funding Strategy Statement 2023



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Introduction

This is the Funding Strategy Statement for the East Sussex Pension Fund (the Fund). It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 as amended (the Regulations) and describes East Sussex County Council’s strategy, in its capacity as administering authority, for the funding of the East Sussex Pension Fund.

The Fund’s employers and the Fund Actuary, Barnett Waddingham LLP, have been consulted on the contents of this statement.

This statement should be read in conjunction with the Fund’s Investment Strategy Statement (ISS) and has been prepared with regard to the guidance (*Preparing and Maintaining a funding strategy statement in the LGPS 2016 edition*) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

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Purpose of the Funding Strategy Statement

The purpose of this Funding Strategy Statement (FSS) is to:

- Establish a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;
- Support the desirability of maintaining as nearly constant a primary contribution rate as possible, as defined in Regulation 62(6) of the Regulations;
- Ensure that the regulatory requirements to set contributions to meet the future liability to provide Scheme member benefits in a way that ensures the solvency and long-term cost efficiency of the Fund are met; and
- Take a prudent longer-term view of funding those liabilities.



Aims and purpose of the Fund

The aims of the Fund are to:

- Manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due;
- Enable primary contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to all relevant parties (such as the taxpayers, scheduled, resolution and admitted bodies), while achieving and maintaining Fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the Fund and employers, and the risk appetite of the administering authority and employers alike; and
- Seek returns on investment within reasonable risk parameters.

The purpose of the Fund is to:

- Pay pensions, lump sums and other benefits to Scheme members as provided for under the Regulations;
- Meet the costs associated in administering the Fund; and
- Receive and invest contributions, transfer values and investment income.

Funding objectives

Contributions are paid to the Fund by Scheme members and the employing bodies to provide for the benefits which will become payable to Scheme members when they fall due.

The funding objectives are to:

- Ensure that pension benefits can be met as and when they fall due over the lifetime of the Fund;
- Ensure the solvency of the Fund;
- Set levels of employer contribution rates to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions, while taking into account the different characteristics of participating employers;
- Build up the required assets in such a way that employer contribution rates are kept as stable as possible, with consideration of the long-term cost efficiency objective; and
- Adopt appropriate measures and approaches to reduce the risk, as far as possible, to the Fund, other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.
- In developing the funding strategy, the administering authority should also have regard to the likely outcomes of the review carried out under Section 13(4)(c) of the Public Service Pensions Act 2013. Section 13(4)(c) requires an independent review of the actuarial valuations of the LGPS funds; this involves reporting on whether the rate of employer contributions set as part of the actuarial valuations are set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scheme so far as relating to the pension Fund. The review also looks at compliance and consistency of the actuarial valuations.



Key parties

The key parties involved in the funding process and their responsibilities are set out below.

The administering authority

The administering authority for the Fund is East Sussex County Council. The main responsibilities of the administering authority are to:

- Operate the Fund in accordance with the LGPS Regulations;
- Collect employee and employer contributions, investment income and other amounts due to the Fund as stipulated in the Regulations;
- Invest the Fund's assets in accordance with the Fund's Investment Strategy Statement;
- Pay the benefits due to Scheme members as stipulated in the Regulations;
- Ensure that cash is available to meet liabilities as and when they fall due;
- Take measures as set out in the Regulations to safeguard the Fund against the consequences of employer default;
- Manage the actuarial valuation process in conjunction with the Fund Actuary;
- Prepare and maintain this FSS and also the ISS after consultation with other interested parties;
- Monitor all aspects of the Fund's performance;
- Effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme employer; and
- Enable the Local Pension Board to review the valuation process as they see fit.

Scheme employers

In addition to the administering authority, a number of other Scheme employers participate in the Fund.

The responsibilities of each employer that participates in the Fund, including the administering authority, are to:

- Collect employee contributions and pay these together with their own employer contributions, as certified by the Fund Actuary, to the administering authority within the statutory timescales;
- Notify the administering authority of any new Scheme members and any other membership changes promptly;
- Develop a policy on certain discretions and exercise those discretions as permitted under the Regulations;
- Meet the costs of any augmentations or other additional costs in accordance with agreed policies and procedures; and
- Pay any exit payments due on ceasing participation in the Fund.

Scheme members

Active Scheme members are required to make contributions into the Fund as set by the Department for Levelling Up, Housing and Communities (DLUHC).

Fund Actuary

The Fund Actuary for the Fund is Barnett Waddingham LLP.

The main responsibilities of the Fund Actuary are to:

- Prepare valuations including the setting of employers' contribution rates at a level to ensure Fund solvency and long-term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and the Regulations;
- Prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters such as pension strain costs, ill-health retirement costs, compensatory added years costs, etc;
- Provide advice and valuations on the exiting of employers from the Fund;
- Provide advice and valuations relating to new employers, including recommending the level of bonds or other forms of security required to protect the Fund against the financial effect of employer default;
- Assist the administering authority in assessing whether employer contributions need to be revised between valuations as permitted or required by the Regulations;
- Ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to their role in advising the Fund; and
- Advise on other actuarial matters affecting the financial position of the Fund.

Funding strategy

The factors affecting the Fund's finances are constantly changing, so it is necessary for its financial position and the contributions payable to be reviewed from time to time by means of an actuarial valuation to check that the funding objectives are being met.

The most recent actuarial valuation of the Fund was carried out as at 31 March 2022. The results of the 2022 valuation are set out in the table below:

2022 valuation results	Amounts (£)
Surplus (Deficit)	£858m
Funding level	123%

On a whole Fund level, the primary rate required to cover the employer cost of future benefit accrual is 20.2% of payroll p.a.

The individual employer contribution rates are set out in the Rates and Adjustments Certificate which forms part of the Fund's 2022 valuation report.

The actuarial valuation involves a projection of future cashflows to and from the Fund. The main purpose of the valuation is to determine the level of employers' contributions that should be paid to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund. A summary of the methods and assumptions adopted is set out in the sections below.

Funding method

The key objective in determining employers' contribution rates is to establish a funding target and then set levels of employer contribution rates to meet that target over an agreed period.

The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund.

For all employers, the method adopted is to consider separately the benefits accrued before the valuation date (past service) and benefits expected to be accrued after the valuation date (future service). These are evaluated as follows:

- The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service. It makes allowance for future increases to members' pay and pensions. A funding level in excess of 100% indicates a surplus of assets over liabilities; while a funding level of less than 100% indicates a deficit; and
- The future service funding rate (also referred to as the primary rate as defined in Regulation 62(5) of the Regulations) is the level of contributions required from the individual employers which, in combination with employee contributions is expected to cover the cost of benefits accruing in future.
- The adjustment required to the primary rate to calculate an employer's total contribution rate is referred to as the secondary rate, as defined in Regulation 62(7). Further details of how the secondary rate is calculated for employers is given below in the Deficit recovery/surplus amortisation periods section.

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The approach to the primary rate will depend on specific employer circumstances and in particular may depend on whether an employer is an “open” employer – one which allows new staff access to the Fund, or a “closed” employer – one which no longer permits new staff access to the Fund. The expected period of participation by an employer in the Fund may also affect the total contribution rate.

For open employers, the actuarial funding method that is adopted is known as the Projected Unit Method. The key feature of this method is that, in assessing the future service cost, the primary rate represents the cost of one year’s benefit accrual only.

For closed employers, the actuarial funding method adopted is known as the Attained Age Method. The key difference between this method and the Projected Unit Method is that the Attained Age Method assesses the average cost of the benefits that will accrue over an appropriate specific period, such as the length of a contract or the remaining expected working lifetime of active members.

The approach by employer may vary to reflect an employer’s specific circumstance, however, in general the closed employers in the Fund are admission bodies who have joined the Fund as part of an outsourcing contract and therefore the Attained Age Method is used in setting their contributions. All other employers (for example councils, higher education bodies and academies) are generally open employers and therefore the Projected Unit Method is used. The administering authority holds details of the open or closed status of each employer.

Valuation assumptions and funding model

In completing the actuarial valuation, it is necessary to formulate assumptions about the factors affecting the Fund's future finances such as price inflation, pay increases, investment returns, rates of mortality, early retirement and staff turnover etc.

The assumptions adopted at the valuation can therefore be considered as:

- The demographic (or statistical) assumptions which are essentially estimates of the likelihood or timing of benefits and contributions being paid, and
- The financial assumptions which will determine the estimates of the amount of benefits and contributions payable and their current (or present) value.

Future price inflation

The base assumption in any valuation is the future level of price inflation over a period commensurate with the duration of the liabilities, as measured by the Retail Price Index inflation (RPI). This is derived using the 20 year point on the Bank of England implied Retail Price Index (RPI) inflation curve, with consideration of the market conditions over the six months straddling the valuation date. The 20 year point on the curve is taken as 20 years is consistent with the average duration of an LGPS Fund. A deduction of 0.3% p.a. is applied to the yield at the 20 year point to reflect the shape of the yield curve. A further deduction of 0.4% p.a. is applied to reflect the view that investors are willing to pay a premium for inflation-linked products in return for protection against unexpected inflation.

Future pension increases

Pension increases are linked to changes in the level of the Consumer Price Index inflation (CPI). Inflation as measured by the CPI has historically been less than RPI principally due to different calculation methods. However, RPI is due to be aligned with CPIH (CPI but with allowance for housing costs) from 2030.

Therefore, reflecting the anticipated amendment to RPI from 2030 and therefore the relative difference between RPI and CPI, a deduction of 0.35% p.a. is made to the RPI assumption to derive the CPI assumption.

Future pay increases

As some of the benefits are linked to pay levels at retirement, it is necessary to make an assumption as to future levels of pay increases. Historically, there has been a close link between price inflation and pay increases with pay increases exceeding price inflation in the longer term. The long-term pay increase assumption adopted as at 31 March 2022 was CPI plus 1.0% p.a. which includes allowance for promotional increases.

Future investment returns/discount rate

To determine the value of accrued liabilities and derive future contribution requirements it is necessary to discount future payments to and from the Fund to present day values.

The discount rate that is applied to all projected liabilities reflects a prudent estimate of the rate of investment return that is expected to be earned from the Fund's long-term investment strategy by considering average market yields in the six months straddling the valuation date. The discount rate so determined may be referred to as the "ongoing" discount rate.

It may be appropriate for an alternative discount rate approach to be taken to reflect an individual employer's situation. This may be, for example, to reflect an employer targeting a cessation event or to reflect the administering authority's views on the level of risk that an employer poses to the Fund. The Fund Actuary will incorporate any such adjustments after consultation with the administering authority.

A summary of the financial assumptions adopted for the 2022 valuation is set out in the table below:

Financial assumptions as at 31 March 2022	Amounts
RPI inflation	3.2% p.a.
CPI inflation	2.9% p.a.
Pension/deferred pension increases and CARE revaluation	In line with CPI inflation
Pay increases	CPI inflation + 1.0% p.a.
Discount rate	4.6% p.a.

Asset valuation

For the purpose of the valuation, the asset value used is the market value of the accumulated fund at the valuation date, adjusted to reflect average market conditions during the six months straddling the valuation date. This is referred to as the smoothed asset value and is calculated as a consistent approach to the valuation of the liabilities.

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The Fund's assets are notionally allocated to employers at an individual level by allowing for actual Fund returns achieved on the assets and cashflows paid into and out of the Fund in respect of each employer (e.g. contributions received and benefits paid).

Demographic assumptions

The demographic assumptions incorporated into the valuation are based on Fund-specific experience and national statistics, adjusted as appropriate to reflect the individual circumstances of the Fund and/or individual employers.

Further details of the assumptions adopted are included in the Fund's 2022 valuation report.

McCloud/Sargeant judgements

When the Government reformed public service pension schemes in 2014 and 2015 they introduced protections for older members. In December 2018, the Court of Appeal ruled that younger members of the Judges' and Firefighters' Pension schemes have been discriminated against because the protections do not apply to them. The Government has confirmed that there will be changes to all main public sector schemes, including the LGPS, to remove this age discrimination. A consultation has been run in relation to the changes proposed for the LGPS and legislation is now being drafted to bring forward these changes. We understand the updated Regulations are to be consulted on over the course of 2022 with revised Regulations effective from October 2023.

For the 2022 valuation, as required by the Department for Levelling Up, Housing & Communities, in calculating the value of members' liabilities it was assumed that:

- The current underpin (which only applies to those members within 10 years of their NPA at 31 March 2012) will be revised and will apply to all members who were active in the Scheme on or before 31 March 2012 and who join the post 1 April 2014 scheme without a disqualifying service gap;
- The period of protection will apply from 1 April 2014 to 31 March 2022 but will cease when a member leaves active service or reaches their final salary scheme normal retirement age (whichever is sooner);
- Where a member remains in active service beyond 31 March 2022 the comparison of their benefits will be based on their final salary when they leave the LGPS or when they reach their final salary scheme normal retirement age (again whichever is sooner);
- Underpin protection will apply to qualifying members who leave active membership of the LGPS with an immediate or deferred entitlement to a pension; and
- The underpin will consider when members take their benefit.

Further details of the McCloud/Sergeant judgement can be found below in the Regulatory risks section.

Based on the member data provided, and the above understanding of the proposed Regulations, the Fund Actuary has assessed the impact of the underpin protection for each active member in the Fund. Both benefits have been calculated for each member and the higher benefit valued to determine the appropriate liability for that member and relevant employer.

Guaranteed Minimum Pension (GMP) indexation and equalization

On 23 March 2021, the Government published the outcome to its Guaranteed Minimum Pension Indexation consultation, concluding that all public service pension schemes, including the LGPS, will be directed to provide full indexation to members with a GMP reaching State Pension Age (SPA) beyond 5 April 2021. This is a permanent extension of the existing ‘interim solution’ that has applied to members with a GMP reaching SPA on or after 6 April 2016. Details of the consultation outcome can be found [here](#).

The 2022 valuation approach for GMP is that the Fund will pay limited increases for members that have reached SPA by 6 April 2016, with the government providing the remainder of the inflationary increase. For members that reach SPA after this date, the Fund will be required to pay the entire inflationary increase.

Stabilisation mechanism

The LGPS Regulations (Regulation 62 (5)(b)) specify that the actuary must have regard to the desirability of maintaining as nearly constant a primary rate as possible. However it is a key objective of the fund to maintain stability of total rates as far as possible. The Fund therefore adopts a stabilisation approach to achieve this aim.

Where an employer is categorised as an employer type in the following table, the employer’s total contribution will be stabilised as shown in the table. Decreases apply if the employer has a funding level greater than 115%. Increases apply if the funding level is less than 115% and the current rate is less than the 2022 primary rate, otherwise the employer continues to pay the current rate.

Type of employer	Maximum total contribution increase over the next 3 years, effective from 1 April 2023	Maximum total contribution decrease over the next 3 years, effective from 1 April 2023
Major authorities (e.g. all councils, Police and Fire services)	1% of pay	1% of pay
Academies (including academies in the Academy Pool)	1% of pay p.a.	1% of pay p.a.

Note: the stabilisation mechanism and limits will be reviewed at the next tri-ennial valuation exercise, expected as at 31 March 2025.

Note: As the Academy Pool has been formed for the 2022 valuation and academies are currently paying different contribution rates, the academy rates will be set, using the above mechanism, and step towards the contribution rate calculated for the Pool.

Deficit recovery/surplus amortisation periods

Whilst one of the funding objectives is to build up sufficient assets to meet the cost of benefits as they accrue, it is recognised that at any particular point in time, the value of the accumulated assets will be different to the value of accrued liabilities, depending on how the actual experience of the Fund differs to the actuarial assumptions. This theory applies at an individual employer level; each employer in the Fund has their own share of deficit or surplus attributable to their section of the Fund.

Where the valuation for an employer discloses a deficit then the level of required employer contributions includes an adjustment to fund the deficit. The deficit recovery period will depend on employer type, employer covenant and other relevant factors, but in any case, will not exceed a period of 20 years. The adjustment may be set either as a percentage of payroll or as a fixed monetary amount.

Where the valuation for an employer discloses a surplus then the level of required employer contribution may include an adjustment to amortise the surplus.

The deficit recovery period or amortisation period that is adopted for any particular employer will depend on:

- The significance of the surplus or deficit relative to that employer's liabilities;
- The covenant of the individual employer (including any security in place) and any limited period of participation in the Fund;
- The remaining contract length of an employer in the Fund (if applicable); and
- The implications in terms of stability of future levels of employers' contribution.
- In 2021, the Fund commissioned an employer covenant analysis from PwC.

For employers not covered by the Stabilisation Mechanism above, the following approach will be applied. The Administering Authority have discretion to adopt a different approach where this is more appropriate to reflect the situation specific to the employer.

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Type of employer	Approach to amortise surplus/deficit	Maximum recovery period
Colleges	Where the funding level is greater than 115% on the employer’s funding assumptions, the surplus in excess of 115% is amortised over the maximum recovery period. Deficit is amortised over an appropriate period up to the maximum recovery period	15 years
Community Admission Bodies	Where the funding level is greater than 115% on the employer’s funding assumptions, the surplus in excess of 115% is amortised over the maximum recovery period. Deficit is amortised over an appropriate period up to the maximum recovery period	Average future working lifetime of active members
Transferee Admission Bodies	Surplus/deficit is amortised over an appropriate period up to the maximum recovery period	Remaining contract term

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Pooling of individual employers

The policy of the Fund is that each individual employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly, contribution rates are set for individual employers to reflect their own particular circumstances.

However, certain groups of individual employers are pooled for the purposes of determining contribution rates to recognise common characteristics or where the number of Scheme members is small.

Forming/disbanding a funding pool

Where the Fund identifies a group of employers with similar characteristics and potential merits for pooling, it is possible to form a pool for these employers. Advice should be sought from the Fund Actuary to consider the appropriateness and practicalities of forming the funding pool.

Conversely, the Fund may consider it no longer appropriate to pool a group of employers. This could be due to divergence of previously similar characteristics or an employer becoming a dominant party in the pool (such that the results of the pool are largely driven by that dominant employer). Where this scenario arises, advice should be sought from the Fund Actuary.

Funding pools should be monitored on a regular basis, at least at each actuarial valuation, in order to ensure the pooling arrangement remains appropriate.

The funding pools adopted for the Fund at the 2022 valuation are summarised in the table below:

Pool	Type of pooling	Notes
Town and Parish Councils	For contribution rate purposes only	Individual funding level is tracked separately at each tri-ennial valuation and a contribution rate determined at pool level
Academies including Free Schools	For funding level and contribution rate purposes	Funding level is determined for the pool at each tri-ennial valuation

The main purpose of pooling is to produce more stable employer contribution levels, although recognising that ultimately there will be some level of cross-subsidy of pension cost amongst pooled employers.

Town and Parish Councils Pool

All Town and Parish Councils (T&PCs) will pay the same contribution rate, although their individual funding position will be tracked at employer level individually.

A T&PC may defer a cessation valuation if the last member leaves the scheme, but the T&PC is intending to offer the scheme to a new employee. This will be agreed with the Fund and any deficit payments, as calculated by the Actuary, due by the T&PC must continue to be paid during the suspension period. Any suspension period will be time-limited to a maximum of three years and at the discretion of the Fund. Once the T&PC has an active member, the pooled contribution rate will be paid.

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If there are no active members at the end of the suspension period or a T&PC Pool Member chooses to close scheme participation to new employees, then a cessation valuation will be carried out to determine an exit payment/credit and that employer would no longer be a Member of the T&PC Pool. This will protect the remaining Pool Members from the change of employer characteristics which apply after closure. If a T&PC becomes insolvent and is unable to meet their pension liabilities, then the Fund will, in the first instance, secure any payments required to meet these liabilities from any guarantor. If there is no guarantor, then these liabilities will fall to the T&PC pool.

The cessation valuation will be carried out in line with the Fund's policy as set out in the "Cessation valuations" section below.

The Academy Pool

Eligibility

Academies, multi-academy trusts (MAT) and free schools are all eligible to join the Academy Pool and participate in the pooling arrangement.

Joining and leaving the Academy Pool

New academies

When a school converts to academy status, the new academy (or the sponsoring multi-academy trust) becomes a Scheme employer in its own right.

Funding at start

On conversion to academy status, the new academy will be allocated assets based on the active cover of the relevant local authority at the conversion date. The assets allocated to the academy will be capped at 100% of the value of the liabilities. The active cover approach is based on the funding level of the local authority's active liabilities, after fully funding the local authority's deferred and pensioner liabilities. On conversion to academy status, the new academy will become part of the Academy Pool, unless they opt-out, and will be allocated assets based on the funding level of the Pool at the conversion date.

An existing academy or MAT can only join or leave the Pool at each tri-ennial valuation. If an academy or MAT decline to join the Pool or leave the Pool for any reason then they will not be allowed to join or re-join the Pool at future dates, unless there are exceptional circumstances and at the sole discretion of the Administering Authority. If an academy or MAT want to leave the Academy Pool they may only do so at the next tri-ennial valuation.

Contribution rate

The pooled contribution rate for the Academy Pool Members will be calculated allowing for the stabilisation mechanism set out above. The contribution rates for the period 1 April 2023 to 31 March 2026, for each Pool Member will be stepped towards the calculated pooled rate.

The contribution rate payable when a new academy or free school joins the Academy Pool will be in line with the contribution rate certified for the Academy Pool at the 2022 valuation.

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If the new academy or free school elects not to join the Academy Pool, the contribution rate will be calculated based on the funding position at the start as calculated above and membership data at the date prior to conversion.

In addition, Academy Pool Members are required to make additional contributions of 0.75% p.a. of pay to meet the costs of non-ill health (redundancy, efficiency, flexible retirement etc) early retirements.

Funding

The assets and liabilities will be reassessed and updated at each tri-ennial valuation. Each Academy Pool Member will have the same funding level based on the total assets and liabilities of the Academy Pool. Assets allocated to each Academy Pool Member is therefore the product of their individual liabilities and the funding level of the Academy Pool.

Cessation of an academy

If an academy participating in the Academy Pool ceases participation in the Fund, a cessation valuation is carried out by the Fund's actuary. The valuation approach is as follows:

- The funding level of the Academy Pool is calculated at the cessation date using the Fund's ongoing assumptions updated to reflect market conditions at the cessation date.
- The value of the liabilities attributable to the ceasing academy are calculated at the cessation date using the Fund's ongoing assumptions updated to reflect market conditions at the cessation date. The assets allocated to the academy is the product of the funding level of the Academy Pool and the value of the academy's ongoing liabilities calculated at the cessation date
- The academy's liabilities are recalculated using a minimum risk basis (minimum risk liabilities) and the debt, if any, is the difference between the minimum risk liabilities and the allocated assets

Risk-sharing

There are employers that participate in the Fund with a risk-sharing arrangement in place with another employer in the Fund.

For example, there are employers participating in the Fund with pass-through provisions: under this arrangement the pass-through employer does not take on the risk of underfunding as this risk remains with the letting authority or relevant guaranteeing employer. When the pass-through employer ceases participation in the Fund, it is not responsible for making any exit payment, nor receiving any exit credit, as any deficit or surplus ultimately falls to the letting authority or relevant guaranteeing employer.

At the 2022 valuation, risk-sharing arrangements were allowed for by allocating any deficit/liabilities covered by the risk-sharing arrangement to the relevant responsible employer.

Contribution payments

Employers pay contributions on a monthly basis. Primary contributions are certified as a percentage of payroll and therefore amounts paid by employers each month will fluctuate in line with payroll each month. Secondary contributions can be certified as a percentage of payroll or as a monetary amount. Monetary amounts are typically payable in 12 equal monthly instalments throughout the relevant year.

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Employers must pay contributions in line with the Rates and Adjustments Certificate, but they may be able to alter the timing of contributions payable and/or pay in additional contributions with agreement from the administering authority.

No discount will be offered in exchange for early payment of either primary or secondary contributions.

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New employers joining the Fund

When a new employer joins the Fund, the Fund Actuary is required to set the contribution rates payable by the new employer and allocate a share of Fund assets to the new employer as appropriate. The most common types of new employers joining the Fund are admission bodies and new academies. These are considered in more detail below for admission bodies, with academies covered above.

Admission bodies

New admission bodies in the Fund are commonly a result of a transfer of staff from an existing employer in the Fund to another body (for example as part of a transfer of services from a council or academy to an external provider under Schedule 2 Part 3 of the Regulations). Typically these transfers will be for a limited period (the contract length), over which the new admission body employer is required to pay contributions into the Fund in respect of the transferred members.

From 1 April 2019, the default approach has been for admission bodies to join the Fund 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 as set out under the 'Contribution rate' section below.

The Administering Authority is willing to administer either of the two options as long as the approach is documented in the Admission Agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to the contractor's decisions and where 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

Funding at start of contract

For pass-through and full transfer of risk arrangements, it may be appropriate for the new admission body to be allocated a share of Fund assets equal to the value of the benefits transferred, i.e. the new admission body starts off on a fully funded basis. This is calculated on the relevant funding basis and the opening position may be different when calculated on an alternative basis (e.g. on an accounting basis).

There may be special arrangements made as part of the contract such that pass-through or a full risk transfer approach is not adopted. In these cases, the initial assets allocated to the new admission body will reflect the level of risk transferred and may therefore not be on a fully funded basis or may not reflect the full value of the benefits attributable to the transferring members.

Contribution rate

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 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 and there is no exit payment or exit credit payable on termination of the admission agreement.

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.

Accounting

Under the Option 1 pass-through arrangement, for accounting purposes, the contractor's obligation is simply to pay the agreed contribution rate. The contractor would not be expected to include any liability in respect of their LGPS pension participation on their balance sheet. Instead, the letting authority would include it in their disclosures. The contractor may report its participation in the LGPS as if it were a defined contribution scheme.

Under the Option 2 pass-through arrangement, it is less clear whether the contractor needs to include a liability on their balance sheet as they are subject to some pensions risk but they never have to meet a past service funding deficit so it could be argued that they have no accounting balance sheet obligation. In these cases, the contractor and letting authority should check with their auditors what their requirements are.

Security

To mitigate the risk to the Fund that a new admission body will not be able to meet its obligations to the Fund in the future, the new admission body may be required to put in place a bond in accordance with Schedule 2 Part 3 of the Regulations, if required by the letting authority and administering authority.

If, for any reason, it is not desirable for a new admission body to enter into a bond, the new admission body may provide an alternative form of security which is satisfactory to the administering authority.

Risk-sharing

Although pass-through is the default approach, new admission bodies and the relevant letting authority may make a commercial agreement to deal with the pensions risk differently. For example, it may be agreed that the pensions risk is shared between the letting authority and the new admission body.

The administering authority may consider risk-sharing arrangements on a case-by-case basis at the Fund's discretion. Any such arrangement should not lead to any undue risk to the other employers in the Fund.

Legal and actuarial advice in relation to risk-sharing arrangements should be sought where required.

Contribution reviews between actuarial valuations

It is anticipated for most Scheme employers that the contribution rates certified at the formal actuarial valuation will remain payable for the period of the rates and adjustments certificate. However, there may be circumstances where a review of the contribution rates payable by an employer (or a group of employers) under Regulation 64A is deemed appropriate by the administering authority.

A contribution review may be requested by an employer or be required by the administering authority. 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 review may only take place if one of the following conditions are met:

- (i) it appears likely to the administering authority that the amount of the liabilities arising or likely to arise has changed significantly since the last valuation;
- (ii) it appears likely to the administering authority that there has been a significant change in the ability of the Scheme employer or employers to meet the obligations of employers in the Scheme; or
- (iii) a Scheme employer or employers have requested a review of Scheme employer contributions and have undertaken to meet the costs of that review. A request under this condition can only be made if there has been a significant change in the liabilities arising or likely to arise and/or there has been a significant change in the ability of the Scheme employer to meet its obligations to the Fund.

Guidance on the administering authority's approach considering the appropriateness of a review and the process in which a review will be conducted is set out in the Fund's separate Contribution review policy. This includes details of the process that should be followed where an employer would like to request a review.

Once a review of contribution rates has been agreed, unless the impact of amending the contribution rates is deemed immaterial by the Fund Actuary, then the results of the review will be applied with effect from the agreed review date, regardless of the direction of change in the contribution rates.

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Note that where a Scheme employer seems likely to exit the Fund before the next actuarial valuation then the administering authority can exercise its powers under Regulation 64(4) to carry out a review of contributions with a view to providing that assets attributable to the Scheme employer are equivalent to the exit payment that will be due from the Scheme employer. These cases do not fall under the separate contribution review policy.

With the exception of any cases falling under Regulation 64(4), the administering authority will not accept a request for a review of contributions where the effective date is within 12 months of the next Rates and Adjustments Certificate.

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.

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Cessation valuations

When a Scheme employer exits the Fund and becomes an exiting employer, as required under the Regulations the Fund Actuary will be asked to carry out an actuarial valuation in order to determine the liabilities in respect of the benefits held by the exiting employer's current and former employees. The Fund Actuary is also required to determine the exit payment due from the exiting employer to the Fund or the exit credit payable from the Fund to the exiting employer.

Any deficit in the Fund in respect of the exiting employer will be due to the Fund as a single lump sum payment, unless it is agreed by the administering authority and the other parties involved that an alternative approach is permissible. For example:

- It may be agreed with the administering authority that the exit payment can be spread over some agreed period;
- the assets and liabilities relating to the employer may transfer within the Fund to another participating employer; or
- the employer's exit may be deferred subject to agreement with the administering authority, for example if it intends to offer Scheme membership to a new employee within the following three years or where a deferred debt arrangement is agreed.
- Similarly, any surplus in the Fund in respect of the exiting employer may be treated differently to a payment of an exit credit, subject to the agreement between the relevant parties and any legal documentation.

In assessing the value of the liabilities attributable to the exiting employer, the Fund Actuary may adopt differing approaches depending on the employer and the specific details surrounding the employer's cessation scenario. However, in general the following approaches will apply.

If there is no guarantor in the Fund willing to accept responsibility for the residual liabilities of the exiting employer, then those liabilities are likely to be assessed on a "minimum risk" basis leading to a higher exit payment being required from (or lower exit credit being paid to) the employer, in order to extinguish their liabilities to the Fund and to reduce the risk of these liabilities needing to be met by other participating employers in future. A minimum risk basis means the discount rate is linked to gilt yields.

If it is agreed that another employer in the Fund will accept responsibility for the residual liabilities, then the assumptions adopted will be consistent with the current ongoing funding position, but additional prudence may be included in order to take into account potential uncertainties and risk e.g. due to adverse market changes, additional liabilities arising from regulatory or legislative change and political/economic uncertainties.

Exit credit policy

The Local Government Pension Scheme (LGPS) (Amendment) Regulations 2018 were introduced in May 2018 which allow administering authorities to make an exit credit payment to exiting employers. A copy of the Fund's Exit Credit Policy is available on the Funds website.

Managing exit payments

Where a cessation valuation reveals a deficit and an exit payment is due, the expectation is that the employer settles this debt immediately through a single cash payment. However, should it not be possible for the employer to settle this amount immediately, or where it is beneficial for both the Administering Authority and employer, providing the employer puts forward sufficient supporting evidence to the administering authority, the administering authority may agree a deferred debt agreement (DDA) with the employer under Regulation 64(7A) or a debt spreading agreement (DSA) under Regulation 64B.

Under a DDA, the exiting employer becomes a deferred employer in the Fund (i.e. they remain as a Scheme employer but with no active members) and remains responsible for paying the secondary rate of contributions to fund their deficit. The secondary rate of contributions will be reviewed at each actuarial valuation until the termination of the agreement.

Under a DSA, the cessation debt is crystallised and spread over a period deemed reasonable by the administering authority having regard to the views of the Fund Actuary.

Whilst a DSA involves crystallising the cessation debt and the employer's only obligation is to settle this set amount, in a DDA the employer remains in the Fund as a Scheme employer and is exposed to the same risks (unless agreed otherwise with the administering authority) as active employers in the Fund (e.g. investment, interest rate, inflation, longevity and regulatory risks) meaning that the deficit will change over time.

Guidance on the administering authority's policy for entering into, monitoring and terminating a DDA or DSA is set out in the Fund's separate DSA and DDA policies. This includes details of when a DDA or a DSA may be permitted and the information required from the employer when putting forward a request for a DDA or DSA.

Regulatory factors

At the date of drafting this FSS, the government is currently consulting on potential changes to the Regulations, some which may affect the timing of future actuarial valuations. This is set out in the *Local government pension scheme: changes to the local valuation cycle and the management of employer risk* consultation document.

Further details of this can be found in the Regulatory risks section below.

Bulk transfers

Bulk transfers of staff into or out of the Fund can take place from other LGPS Funds or non-LGPS Funds. In either case, the Fund Actuary for both Funds will be required to negotiate the terms for the bulk transfer – specifically the terms by which the value of assets to be paid from one Fund to the other is calculated.

The agreement will be specific to the situation surrounding each bulk transfer but in general the Fund will look to receive the bulk transfer on no less than a fully funded transfer (i.e. the assets paid from the ceding Fund are sufficient to cover the value of the liabilities on the agreed basis).

A bulk transfer may be required by an issued Direction Order. This is generally in relation to an employer merger, where all the assets and liabilities attributable to the transferring employer in its original Fund are transferred to the receiving Fund.

Links with the Investment Strategy Statement (ISS)

The main link between the Funding Strategy Statement (FSS) and the ISS relates to the discount rate that underlies the funding strategy as set out in the FSS, and the expected rate of investment return which is expected to be achieved by the long-term investment strategy as set out in the ISS.

As explained above, the ongoing discount rate that is adopted in the actuarial valuation is derived by considering the expected return from the long-term investment strategy. This ensures consistency between the funding strategy and investment strategy.



Investment Strategy Statement

September 2021

Risks and counter measures

Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of employer contributions, it is recognised that there are risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.

The major risks to the funding strategy are financial, although there are other external factors including demographic risks, regulatory risks and governance risks.

Financial risks

The main financial risk is that the actual investment strategy fails to produce the expected rate of investment return (in real terms) that underlies the funding strategy. This could be due to a number of factors, including market returns being less than expected and/or the fund managers who are employed to implement the chosen investment strategy failing to achieve their performance targets.

The valuation results are most sensitive to the real discount rate (i.e. the difference between the discount rate assumption and the price inflation assumption). Broadly speaking an increase/decrease of 0.5% p.a. in the real discount rate will decrease/increase the valuation of the liabilities by 10%, and decrease/increase the required employer contribution by around 2.5% of payroll p.a.

However, the Investment and Pension Fund Committee regularly monitors the investment returns achieved by the fund managers and receives advice from the independent advisers and officers on investment strategy.

The Committee may also seek advice from the Fund Actuary on valuation related matters.

In addition, the Fund Actuary provides funding updates between valuations to check whether the funding strategy continues to meet the funding objectives.

Demographic risks

Longevity

Allowance is made in the funding strategy via the actuarial assumptions for a continuing improvement in life expectancy. However, the main demographic risk to the funding strategy is that it might underestimate the continuing improvement in longevity. For example, an increase of one year to life expectancy of all members in the Fund will increase the liabilities by approximately 3% - 4%.

The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review. The Fund commissions bespoke longevity analysis by Club Vita in order to assess the mortality experience of the Fund and help set an appropriate mortality assumption for funding purposes.

Non ill-health retirement costs

The liabilities of the Fund can also increase by more than anticipated as a result of the additional financial costs of early retirements and ill-health retirements. 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).

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The administering authority monitors the incidence of early retirements and procedures are in place that require individual employers to pay additional amounts into the Fund to meet any additional costs arising from early retirements.

Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding assumptions do not allow for early 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.

Ill health retirement costs

The administering authority monitors ill-health retirements and employers are required to meet any additional costs arising from ill-health retirements. Some employers have an external insurance policy in place to mitigate this risk and so these employers are not required to make any additional payments relating to ill-health retirements.

Climate risk

There are a large number of interlinked systemic long term financial risks related to climate change which could potentially have a material impact on the assets and/or the liabilities of the Fund. The most obvious of these climate change risks will be the financial risks to the value of the Fund's assets, the potential increased volatility of markets and potential changes in life expectancy. It is possible that some of these factors will impact the assets and liabilities of the Fund in the same direction, although not necessarily by the same amount.

The Fund therefore has a fiduciary duty to consider climate change risk when making investment decisions and to ensure any decisions support the effective management of climate change. The Fund therefore expects their appointed investment managers to be informed about climate change risks and take investment opportunities accordingly within their processes.

As part of the 2022 valuation, the Fund Actuary provided the Fund with a climate risk analysis which assessed the potential exposure of the Fund's funding position to climate risk under different climate scenarios and considered the resilience of the Fund's funding strategy. The Fund will continue to assess this risk on a regular basis.

Maturity risk

The maturity of a Fund (or of an employer in the Fund) is an assessment of how close on average the members are to retirement (or already retired). The more mature the Fund or employer, the greater proportion of its membership that is near or in retirement. For a mature Fund or employer, the time available to generate investment returns is shorter and therefore the level of maturity needs to be considered as part of setting funding and investment strategies.

The cashflow profile of the Fund needs to be considered alongside the level of maturity: as a Fund matures, the ratio of active to pensioner members falls, meaning the ratio of contributions being paid into the Fund to the benefits being paid out of the Fund also falls. This therefore increases the risk of the Fund having to sell assets in order to meet its benefit payments.

The government has published a consultation (*Local government pension scheme: changes to the local valuation cycle and management of employer risk*) which may affect the Fund's exposure to maturity risk. More information on this can be found in the Regulatory risks section below.

Regulatory risks

The benefits provided by the Scheme and employee contribution levels are set out in Regulations determined by central government. The tax status of the invested assets is also determined by the government.

The funding strategy is therefore exposed to the risks of changes in the Regulations governing the Scheme and changes to the tax regime which may affect the cost to individual employers participating in the Scheme.

However, the administering authority participates in any consultation process of any proposed changes in Regulations and seeks advice from the Fund Actuary on the financial implications of any proposed changes.

There are a number of general risks to the Fund and the LGPS, including:

- If the LGPS was to be discontinued in its current form it is not known what would happen to members' benefits.
- The potential effects of GMP equalisation between males and females, if implemented, are not yet known.
- More generally, as a statutory scheme the benefits provided by the LGPS or the structure of the scheme could be changed by the government.
- The State Pension Age is due to be reviewed by the government in the next few years.

At the time of preparing this FSS, specific regulatory risks of particular interest to the LGPS are in relation to the McCloud/Sargeant judgements and the timing of future funding valuations consultation. These are discussed in the sections below.

McCloud/Sargeant judgements

The Court of Appeal judgment on the McCloud and Sargeant cases, relate to age discrimination against the age-based transitional provisions put into place when the new judicial pension arrangements were introduced in 2015. The members argued that these transitional provisions were directly discriminatory on grounds of age and indirectly discriminatory on grounds of sex and race, based on the correlation between these two factors reflected in the judicial membership. The Tribunal ruled against the Government, deeming the transitional provisions as not a proportionate means of achieving a legitimate aim.

The Government subsequently applied to the Supreme Court to appeal the judgement but their application was denied on 27 June 2019. On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases. A ministerial statement in response to this was published on 13 May 2021 and revised Regulations are awaited to bring a remedy into play.

At the time of drafting this FSS, Regulations and therefore confirmation of the remedy are not yet finalised and are expected in 2023.

Consultation: Local government pension scheme: changes to the local valuation cycle and management of employer risk

On 8 May 2019, the government published a consultation seeking views on policy proposals to amend the rules of the LGPS in England and Wales. The consultation covered:

- amendments to the local fund valuations from the current three year (triennial) to a four year (quadrennial) cycle;
- a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle;
- proposals for flexibility on exit payments;
- proposals for further policy changes to exit credits; and
- proposals for changes to the employers required to offer LGPS membership.

The proposals for flexibility on exit payments and for further policy changes to exit credits have been finalised, however, are still to be finalised for the remaining three proposals. This FSS will be revisited once the outcome is known and reviewed where appropriate.

Timing of future actuarial valuations

LGPS valuations currently take place on a triennial basis which results in employer contributions being reviewed every three years. In September 2018 it was announced by the Chief Secretary to HMT, Elizabeth Truss, that the national Scheme valuation would take place on a quadrennial basis (i.e. every four years) along with the other public sector pension schemes. These results of the national Scheme valuation are used to test the cost control cap mechanism and HMT believed that all public sector scheme should have the cost cap test happen at the same time.

Changes to employers required to offer LGPS membership

At the time of drafting this FSS, under the current Regulations further education corporations, sixth form college corporations and higher education corporations in England and Wales are required to offer membership of the LGPS to their non-teaching staff.

With consideration of the nature of the LGPS and the changes in nature of the further education and higher education sectors, the government has proposed to remove the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer new employees access to the LGPS. Given the significance of these types of employers in the Fund, this could impact on the level of maturity of the Fund and the cashflow profile. For example, increased risk of contribution income being insufficient to meet benefit outgo, if not in the short term then in the long term as the payroll in respect of these types of employers decreases with fewer and fewer active members participating in the Fund.

This also brings an increased risk to the Fund in relation to these employers becoming exiting employers in the Fund. Should they decide not to admit new members to the Fund, the active membership attributable to the employers will gradually reduce to zero, triggering an exit under the Regulations and a potential significant exit payment. This has the associated risk of the employer not being able to meet the exit payment and thus the exit payment falling to the other employers in the Fund.

Employer risks

Many different employers participate in the Fund. Accordingly, it is recognised that a number of employer-specific events could impact on the funding strategy including:

- Structural changes in an individual employer’s membership;
- An individual employer deciding to close the Scheme to new employees; and
- An employer ceasing to exist without having fully funded their pension liabilities.

However, the administering authority monitors the position of employers participating in the Fund, particularly those which may be susceptible to the events outlined and takes advice from the Fund Actuary when required. In particular, the Fund will commission an employer risk review from an external adviser or the Fund Actuary on a regular basis, every three years as a minimum, to help identify the employers in the Fund that might be considered as high risk. In the case of admitted bodies, the Fund has a policy of requiring some form of security from the employer, in the form of a guarantee or a bond, in case of employer default where the risk falls to the Fund. Where the risk of default falls on the liabilities of an original letting authority, the Fund provides advice to the letting authority to enable them to make a decision on whether a guarantee, some other form of security or a bond should be required.

In addition, the administering authority keeps in close touch with all individual employers participating in the Fund to ensure that, as administering authority, it has the most up to date information available on individual employer situations. It also keeps individual employers briefed on funding and related issues.

Governance risks

Accurate data is necessary to ensure that members ultimately receive their correct benefits. The administering authority is responsible for keeping data up to date and results of the actuarial valuation depend on accurate data. If incorrect data is valued then there is a risk that the contributions paid are not adequate to cover the cost of the benefits accrued.



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Monitoring and review

This FSS is reviewed formally, in consultation with the key parties, at least every three years to tie in with the triennial actuarial valuation process.

The most recent valuation was carried out as at 31 March 2022, certifying the contribution rates payable by each employer in the Fund for the period from 1 April 2023 to 31 March 2026.

The timing of the next funding valuation is due to be confirmed as part of the government's *Local government pension scheme: changes to the local valuation cycle and management of employer risk* consultation which closed on 31 July 2019. At the time of drafting this FSS, it is anticipated that the next funding valuation will be due as at 31 March 2025.

The administering authority also monitors the financial position of the Fund between actuarial valuations and may review the FSS more frequently if necessary.

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