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NOTICE OF MEETING

Meeting	Hampshire Pension Fund Panel and Board
Date and Time	Friday, 28th September, 2018 at 10.00 am
Place	Mitchell Room, EII Podium, Winchester
Enquiries to	members.services@hants.gov.uk

John Coughlan CBE
Chief Executive
The Castle, Winchester SO23 8UJ

FILMING AND BROADCAST NOTIFICATION
This meeting may be recorded and broadcast live on the County Council's website. The meeting may also be recorded and broadcast by the press and members of the public – please see the Filming Protocol available on the County Council's website.

AGENDA

1. **APOLOGIES FOR ABSENCE**

   To receive any apologies for absence.

2. **DECLARATIONS OF INTEREST**

   All Members who believe they have a Disclosable Pecuniary Interest in any matter to be considered at the meeting must declare that interest and, having regard to Part 3 Paragraph 1.5 of the County Council's Members' Code of Conduct, leave the meeting while the matter is discussed, save for exercising any right to speak in accordance with Paragraph 1.6 of the Code. Furthermore all Members with a Personal Interest in a matter being considered at the meeting should consider, having regard to Part 5, Paragraph 4 of the Code, whether such interest should be declared, and having regard to Part 5, Paragraph 5 of the Code, consider whether it is appropriate to leave the meeting while the matter is discussed, save for exercising any right to speak in accordance with the Code.

3. **CONFIRMATION OF MINUTES (NON-EXEMPT)** (Pages 5 - 8)

   To confirm the Minutes of the meeting held on 27 July 2018.

4. **CHAIRMAN'S ANNOUNCEMENTS**

To receive any announcements the Chairman may wish to make

5. GOVERNANCE - FUNDING STRATEGY STATEMENT - AMENDMENT (Pages 9 - 52)

To consider a report from the Director of Corporate Resources-Corporate Services seeking the approval of the Panel and Board for changes to the Funding Strategy Statement and Employer Policy in relation to the payment of exit credits.

6. GOVERNANCE - PENSION FUND MANAGEMENT COSTS (Pages 53 - 58)

To receive a report from the Director of Corporate Resources-Corporate Services providing an overview of the costs of managing the Pension Fund in 2017/18.

7. EXCLUSION OF THE PRESS AND PUBLIC

That in relation to the following items the press and public be excluded from the meeting, as it is likely, in view of the nature of the business to be transacted or the nature of proceedings, that if a member of the public were present during the items there would be disclosure to them of exempt information within Paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972, and further that in all circumstances of the case, the public interest in maintaining the exempt information outweighs the public interest in disclosing the information, for the reasons set out in the report.

8. CONFIRMATION OF THE MINUTES OF THE PREVIOUS MEETING (Pages 59 - 64)

To confirm the exempt minutes of the meeting held on 27 July 2018.

9. GOVERNANCE - PENSION FUND MANAGEMENT COSTS - EXEMPT (Pages 65 - 68)

To receive an exempt appendix from the Director of Corporate Resources-Corporate Services on the costs of managing the Pension Fund in 2017/18.

10. INVESTMENT - INVESTMENT UPDATE (Pages 69 - 120)

To consider the exempt report of the Director of Corporate Resources - Corporate Services updating the Panel and Board on the Pension Fund's investments since the last meeting of the Pension Fund Panel and Board on 27 July 2018.

11. **INVESTMENTS - ALTERNATIVE INVESTMENTS UPDATE** (Pages 121 - 194)

To consider the exempt report of the Director of Corporate Resources - Corporate Services updating the Pension Fund Panel and Board on the progress of the alternative investments portfolio.

ABOUT THIS AGENDA:

On request, this agenda can be provided in alternative versions (such as large print, Braille or audio) and in alternative languages.

ABOUT THIS MEETING:

The press and public are welcome to attend the public sessions of the meeting. If you have any particular requirements, for example if you require wheelchair access, please contact members.services@hants.gov.uk for assistance.

County Councillors attending as appointed members of this Committee or by virtue of Standing Order 18.5; or with the concurrence of the Chairman in connection with their duties as members of the Council or as a local County Councillor qualify for travelling expenses.

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AT A MEETING of the PENSION FUND PANEL AND BOARD of the County Council held at The Castle, Winchester on Friday 27 July 2018.

Chairman:
p Councillor M. Kemp-Gee

Elected members of the Administering Authority (Councillors):

p C. Carter	p A. Joy
p A. Dowden	p P. Latham
p A. Gibson	p B. Tennent
p J. Glen	p T. Thacker

Employer Representatives (Co-opted members):
a Councillor M. Chaloner (Southampton City Council)
p Mr D. Robbins (Churchers College)

Scheme Member Representatives (Co-opted members):
p Dr C. Allen (pensioners' representative)
p Mr N. Wood (scheme members representative)
p Mrs V. Arrowsmith (deferred members' representative)

Independent Adviser:
p C. Dobson

BROADCASTING ANNOUNCEMENT

The Chairman announced that the press and members of the public were permitted to film and broadcast the meeting. Those remaining at the meeting were consenting to being filmed and recorded, and to the possible use of those images and recording for broadcasting purposes.

96. **APOLOGIES FOR ABSENCE**

Cllr Chaloner sent his apologies.

97. **DECLARATIONS OF INTEREST**

Members were mindful that where they believed they had a Disclosable Pecuniary Interest in any matter considered at the meeting they must declare that interest at the time of the relevant debate and, having regard to the circumstances described in Part 3, Paragraph 1.5 of the County Council's Members' Code of Conduct, leave the meeting while the matter was discussed, save for exercising any right to speak in accordance with Paragraph 1.6 of the Code. Furthermore Members were mindful that where they believed they had a Non-Pecuniary interest in a matter being considered at the meeting they considered whether such interest should be declared, and having regard to Part 5, Paragraph 2 of the Code, considered whether it was appropriate to leave the meeting whilst the matter was discussed, save for exercising

any right to speak in accordance with the Code.

98. **CONFIRMATION OF MINUTES**

The minutes of the Pension Fund Panel and Board held on 22 June 2018 were confirmed.

99. **CHAIRMAN'S ANNOUNCEMENTS**

The Chairman welcomed Sarah Manchester who had been appointed as the Substitute Scheme Member Representative and invited her to attend the meeting.

The Chairman announced Cllrs Cartwright and Smith would be joining the Panel and Board. Cllr Cartwright was appointed by the Hampshire and Isle of Wight Local Authorities (HIOWLA) as the employer representative for District Councils. Cllr Smith was nominated by Portsmouth City Council as the employer representative for Unitary Councils, and representation on the Panel and Board switched from Southampton to Portsmouth for the 2018/19 municipal year. All three new representative will be proposed to the County Council for their approval as co-opted members in September 2018.

The Chairman reminded members that there will be an internal training session on 2 August 2018.

The Chairman confirm that Cllr Dowden and Mr Wood would be joining him at the LCG summit in September 2018.

Mrs Arrowsmith gave an update to the committee having attended the SPS on Investment Strategies and Cashflow Management.

100. **ACCESS JOINT GOVERNANCE COMMITTEE MINUTES 26 APRIL 2018**

The Panel and Board received the minutes of the ACCESS Joint Governance Committee held on 26 April 2018.

101. **GOVERNANCE - INTERNAL AUDIT REPORT & OPINION 2017/18**

The Panel considered a report of the Director of Corporate Resources (item 6 in the Minute Book) providing the Pension Fund Panel and Board with the Chief Internal Auditor's opinion on the adequacy and effectiveness of internal control of the Pension Fund. The Chief Internal Auditor's opinion was that the Pension Fund's governance, risk management and framework of control is 'Substantial'.

RESOLVED:

(a) That the Chief Internal Auditor's annual report and opinion statement for 2017/18 was accepted.

102. **GOVERNANCE - PENSION FUND DRAFT ANNUAL REPORT 2017/18**

The Panel and Board considered and noted a report of the Director of Corporate Resources (item 7 in the Minute Book) containing the Pension Fund's Draft Annual Report, including the Pension Fund's Accounts for the year ending 31 March 2018. The accounts were produced by the new statutory deadline of 31 May 2018 and the external audit has been completed in advance of the new deadline of 31 July 2018.

RESOLVED:

(a) That the Annual Report for 2017/18 be approved for publication, and that the Director of Corporate Resources be authorised to make any necessary minor amendments prior to publication.

103. **EXCLUSION OF PRESS AND PUBLIC**

RESOLVED:

That the public be excluded from the meeting during the following items of business, as it is likely, in view of the nature of the business to be transacted or the nature of the proceedings, that if members of the public were present during these items there would be disclosure to them of exempt information within Paragraphs 3 and 5 of Part 1 of Schedule 12A to the Local Government Act 1972, and further that in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information, for the reasons set out in the reports.

104. **MINUTES OF PREVIOUS MEETING HELD ON 22 JUNE 2018 (EXEMPT APPENDIX)**

The exempt minutes of the Pension Fund Panel and Board held on 22 June 2018 were confirmed.

105. **INVESTMENTS – INVESTMENT UPDATE**

The Panel and Board received an exempt report from the Director of Corporate Resources (Item 10 in the Minute Book) updating the Panel and Board on the Fund's investments [SUMMARY OF A MINUTE WHICH CONTAINS EXEMPT INFORMATION]

106. **INVESTMENTS – PROPERTY PORTFOLIOS UPDATE**

The Panel and Board received an exempt report from the Director of Corporate Resources (Item 11 in the Minute Book) updating the Panel and Board on the Fund's property portfolios. [SUMMARY OF A MINUTE WHICH CONTAINS EXEMPT INFORMATION]

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Panel and Board
Date:	28 September 2018
Title:	Governance: Funding Strategy Statement and Employer Policy
Report From:	Director of Corporate Resources

Contact name: Lois Downer

Tel: 01962 847600 **Email:** lois.downer@hants.gov.uk

1. Recommendation(s)

1.1. It is recommended that the Panel and Board approve for consultation, the changes to the Funding Strategy Statement and Employer Policy.

2. Executive Summary

2.1. The purpose of this paper is to seek approval from the Panel and Board for changes to the Funding Strategy Statement (FSS) and Employer Policy in relation to the payment of exit credits.

2.2. Employers will be consulted on the proposed changes following this meeting and a final version of the FSS and Employer Policy will be brought back to the Panel and Board at the next meeting in November 2018.

2.3. Whilst there may be further changes required to these policies in 2018/19 as part of the pre triennial valuation work, the current changes are required for the Fund to be compliant with recently amended LGPS regulations.

2. Contextual information

2.1. The Funding Strategy Statement (FSS) describes the Fund's processes by which employers' pension liabilities are met and contributions are set. The Fund must keep this statement under review and, after consultation with appropriate people, make revisions to reflect any material changes in policy.

2.2. The purpose of the Employer Policy is to set out the Fund's policies and procedures in the treatment of employers including the admission and exit of employers, and is designed to be read in conjunction with the FSS.

2.3. Both of these documents needed updating so that they comply with the new requirement to repay any surplus to an employer who exits the Fund (i.e. if they no longer have any active members paying contributions).

3. Exit credits

3.1. The LGPS (Amendment) Regulations 2018 were laid before parliament on 19 April 2018 and came into force on 14 May 2018. One of the changes was to permit the payment of an exit credit to an exiting employer if the exit valuation showed a surplus of assets over liabilities.

3.2. Historically the LGPS regulations prevented administering authorities from paying a surplus, and would only allow the recovery of any deficit at the point of exit. Any surpluses were retained in the Fund for the benefit of all employers. Consequently the Funding Strategy Statement and Employer Policy need to be updated to allow for the payment of exit credits.

3.3. The regulations specify that the exit credit must be paid within three months of the employer exit or such longer term as is agreed. For practicality it is proposed that the policy states the exit credit will be paid within three months of the Fund receiving all the necessary information to make the payment. This will allow for circumstances where the employer exit is not made known to the Fund well in advance (i.e. on early termination of a contract or a sudden change in circumstances such as an ill health retirement for an employer with only one active employee).

3.4. The Fund will pay the exit credit to the exiting employer in most circumstances, regardless of any side agreement which may be in place between the exiting employer and its guarantor. (Some employers may have side agreements with contractors which allow the deficit to be recharged by the contractor back to the letting authority). Employers will have to ensure that existing and future contracts allow for the possibility of surpluses on exit or else they may find an unintended situation whereby they would pay for a deficit but would not receive a refund from the contractor for a surplus. Pension Services have highlighted this issue to employers in the May newsletter and will make sure the information is included in any employer information regarding the pension implications of outsourcing.

3.5. The proposed policy changes allow for a surplus on exit to be retained in the Fund where this is an explicit part of a subsumption agreement from a continuing employer. The particular circumstance that this allows for is the recent commitment from employers in the scheduled body group to subsume liabilities of community admission bodies in the admitted body group. The retention of any surplus will mitigate the risk of any future deficits that do arise.

3.6. When the regulations were laid, there was a question as to the tax implications of paying an exit credit. However HMRC have confirmed that there is no tax due and payments do not need to be reported on the quarterly tax return.

3.7. The draft FSS is attached as Appendix 1 with the proposed changes highlighted on pages 3, 4 and 6. The draft Employer Policy is attached as Appendix 2 with the proposed changes highlighted on page 14.

4. Next steps

4.1. If the Panel and Board approve the proposed changes to the FSS and Employer Policy for consultation, it is proposed that employers will be consulted on the changes in October, allowing a sufficient period for employers to understand the impact of the proposals.

4.2. A report will be provided to the next meeting of the Panel and Board, making final recommendations based on the feedback from the consultation process.

4.3. Pension Services are continuing to work with the Fund actuary to review the treatment of different employers in the Fund in the lead up to the triennial valuation in 2019. This work will result in further changes to the FSS and Employer Policy which will be brought to the Panel and Board for consideration later this year.

CORPORATE OR LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	no
People in Hampshire live safe, healthy and independent lives:	no
People in Hampshire enjoy a rich and diverse environment:	no
People in Hampshire enjoy being part of strong, inclusive communities:	no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because an action is required by the Pension Fund Panel and Board as the Administering Authority for the Hampshire Pension Fund.	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document	Location
None	

IMPACT ASSESSMENTS:

1. Equality Duty

1.1. The County Council has a duty under Section 149 of the Equality Act 2010 (‘the Act’) to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited under the Act;
- Advance equality of opportunity between persons who share a relevant protected characteristic (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

Due regard in this context involves having due regard in particular to:

a) The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;

b) Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;

c) Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionally low.

1.2. **Equalities Impact Assessment:**

1.3. Equality objectives are not considered to be adversely affected by the proposals in this report.

2. Impact on Crime and Disorder:

2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime.

3. Climate Change:

3.1. How does what is being proposed impact on our carbon footprint / energy consumption?

No specific impact.

3.2. How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact.

3.3. How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact

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Funding Strategy Statement

Introduction

The Local Government Pension Scheme Regulations 2013 require the Fund to prepare and publish a Funding Strategy Statement (FSS). The Fund's Actuary must have regard to this statement when setting employers' contribution rates.

As required by 2013 Regulation 58, the Statement has been reviewed (and where appropriate revised) having regard to guidance published by CIPFA in September 2016.

This FSS should be read in the context of the Fund's Investment Strategy Statement (ISS) which sets out in detail the Fund's investment arrangements and strategy. The current version of this is attached for information. The administering authority has had regard to the ISS in preparing this FSS.

Consultation

In accordance with Regulation 58, all Fund employers have been consulted on the contents of this FSS and their views have been considered in formulating it. However, the FSS describes a single strategy for the Fund as a whole.

The Fund's Actuary, Aon Hewitt Limited, has also been consulted on the content of this FSS.

Purpose of the Funding Strategy Statement

The purposes of this FSS are to set out the processes by which the administering authority:

- Establishes a clear and transparent funding strategy, that will identify how employers' pension liabilities are best met going forward.
- Supports the desirability of maintaining as nearly constant a primary contribution rate as possible, as defined in Regulation 62(5) of the LGPS Regulations 2013.
- Ensures that the regulatory requirements to set contributions so as to ensure the solvency and long-term cost efficiency of the Fund are met.
- Takes a prudent longer-term view of funding those liabilities.

Aims of the Fund

The Fund has three main aims:

- To manage the employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due
- To enable primary contribution rates to be kept nearly constant as possible (subject to the administering authority not taking undue risk) at reasonable cost to 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.

- Seek returns on investment within reasonable risk parameters.

The main aims of the Fund are explained in more detail below.

To manage the employers' liabilities effectively

Hampshire County Council as administering authority makes sure that the Fund's liabilities are managed effectively. This is achieved by commissioning actuarial valuations every three years as required by law. These determine the employers' contribution rates required to make sure liabilities can be managed effectively. The administering authority also commissions additional work in relation to the specific issues described below.

The Fund's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term.

The Fund is deemed to be solvent when the assets held are equal to 100% of the Solvency Target.

The administering authority will make sure that the Fund always has enough cash available to pay pensions, transfer values to other pension funds, and other costs and expenses. Such expenditure will normally be met from incoming contributions from employees and employers and investment income, to avoid the cost of selling any of the Fund's investments. The position is reviewed every three months to make sure enough cash is available to meet the Fund's obligations.

The administering authority operates a group funding framework. Many employers are grouped for the purpose of determining employers' contributions in respect of the liabilities and more details are given later in this statement.

The administering authority publishes an Employer Policy which explains in more detail the funding policies for certain categories of employer on admission and exit.

Exiting the fund

Where an employer exits the fund, an exit valuation will be carried out in accordance with Regulation 64. The exit valuation will take account of

- any bulk transfer payments due or other activity as a consequence of exiting the Fund; and
- the future funding arrangements for any liabilities that will remain in the Fund.

In particular, the exit valuation will distinguish between residual liabilities which will become orphan liabilities, and liabilities which will be subsumed by other employers or otherwise continue to be funded to the satisfaction of the Administering Authority.

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"orphan liabilities" arise where an employer is leaving the Fund, the Administering Authority will have no further access for funding from that employer once any exit valuation has been completed and any sums due have been paid to the Fund, and no particular employer or group of employers will be responsible for the future funding of those liabilities.

For orphan liabilities the funding target in the exit valuation will anticipate investment in low risk investments, currently assumed to be Government fixed-interest and index-linked bonds. This is to minimise the risk to other employers in the Fund of having to make good any deficiency arising on the orphan liabilities. The Administering Authority currently operates a single investment strategy and so the remaining employers in the Fund assume the risk of the Fund's assets delivering returns less than the assumed rate in the exit valuation in respect of orphan liabilities.

"subsumed liabilities" refer to the situation where another employer, or group of employers, in the Fund agrees to provide future funding in respect of any emerging deficiencies in relation to the liabilities of a former (exited) employer. The subsuming employer will also normally benefit from any emerging surplus on those liabilities.

On exit the non-active liabilities of admission bodies in paragraph 1(d)(i) of Schedule 2 Part 3 which commenced in the Fund on or after 1 April 2018 will be attributed to (i.e. assumed to be subsumed by) the relevant Scheme employer as defined in the regulations.

For subsumed liabilities the exit valuation will be calculated using a funding target (and hence assumptions) consistent with that used to set ongoing contributions for the exiting employer. This will be the ongoing orphan funding target for employers admitted under paragraph 1(d)(i) of Schedule 2 where the relevant Scheme Employer is an academy. For all other employers the administering authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of the liabilities of the accepting employer or group. Generally this will mean assuming continued investment in more risky investments than Government bonds.

For subsumed liabilities the exit valuation will take account of a number of other factors such as the funding target used to calculate the initial asset transfer where the exiting employer is a short term admission body under paragraph 1(d)(i) of Schedule 2; the funding target used to calculate the ongoing contributions for the employer; whether the exiting employer is a going concern or is ceasing to exist, and whether there is a Guarantor.

Regardless of whether the residual liabilities are orphan liabilities or subsumed liabilities, the departing employer (or Guarantor if the employer is unable to pay) will generally be expected to make good the funding obligation revealed in the exit valuation. In other words, the fact that liabilities may become subsumed liabilities does not necessarily remove the possibility of an exit payment being required nor of a surplus credit being repaid.

Exiting the fund – surpluses

Where an employer exits on or after 14 May 2018 and the exit valuation determines that the departing employer is in surplus, the Administering Authority's

general policy is that the exit credit will be paid to the departing employer within three months of the Fund receiving all the necessary information to make the payment.

An exit payment will usually be paid to the departing employer and Employers who are letting contracts need to ensure these cover any arrangements regarding exit credits. However the Administering Authority may deem that in some circumstances it is not appropriate to make an exit payment to the exiting employer, for example if it is a stated condition of an employer subsuming the liabilities that no surplus will be repaid to the exiting employer as is the case for those organisations in the Admission Body Group which have a commitment from employers within the Scheduled Body Group to subsume the liabilities on exit.

Potential exits

Where the Administering Authority considers that it is possible that an employer may leave the Fund at some point in the future and the employer would leave orphan liabilities on its exit from the Fund, an ongoing funding target (the "ongoing orphan funding target") will, unless the circumstances dictate otherwise, be used to determine the employer's ongoing contributions at the triennial valuation. The ongoing orphan funding target anticipates the approach which will be taken to valuing the employer's liabilities on exit. It will generally be calculated using a discount rate or rates set by reference to the yield on long-dated government bonds on the valuation date. Allowance may be made, at the Administering Authority's discretion and on the advice of the Fund's Actuary, for some out-performance of the Fund's assets relative to gilts in determining the discount rate which applies to the period during which the employees are assumed to remain active members and for future expected increases in gilt yields in determining the discount rate which applies to pensioner and deferred liabilities and for active members in the period after they are assumed to have left service.

Interim reviews for employers

Regulation 64(4) provides the administering authority with the power to carry out valuations in respect of admission bodies and other employers which are expected to cease at some point in the future, and for the Fund's Actuary to certify revised contribution rates, between triennial valuation dates.

The administering authority's overriding objective at all times is that, where possible, the funding target for that body is clear, and that contribution rates payable are appropriate for that funding target. However, this is not always possible as any date of exit may be unknown (for example, participation may be assumed at present to be indefinite), and because market conditions change daily.

The administering authority's general approach in this area is as follows:

- Where the date of exit is known, and is more than three years away, or is unknown and assumed to be indefinite, interim valuations will generally not be required by the administering authority.
- For paragraph 1(d)(i) bodies (2013 Regulations – Schedule 2 Part 3) falling into the above category, the administering authority sees it as the responsibility of the Relevant Scheme Employer to instruct it if an interim

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valuation is required. Such an exercise would be at the expense of the Relevant Scheme Employer unless otherwise agreed.

- A material change in circumstances, for example the date of exit becoming known, material membership movements or material financial information coming to light may cause the administering authority to review the situation informally and subsequently request a formal interim valuation.
- Where an employer is due to leave the Fund within the next three years, the administering authority will monitor developments and may see fit to request an interim valuation at any time in order to try to effect a smoother transition to exit.

In addition, the administering authority reserves the right to request an interim valuation of any employer at any time in accordance with Regulation 64(4).

Inter-valuation funding valuations

In order to monitor developments, the administering authority may from time to time request informal valuations or other calculations. Generally, in such cases the calculations will be based on an approximate update of the asset and liability values, and liabilities calculated using assumptions consistent with the latest valuation. It is unlikely that the liabilities would be calculated using individual membership data, or that the demographic assumptions would be reviewed.

Guarantors

Some employers may participate in the Fund by virtue of the existence of a Guarantor. The administering authority maintains a list of employers and their Guarantors. For any new admission body wishing to join the Fund, the administering authority will require a Guarantor. The administering authority, unless notified otherwise, sees the role of a Guarantor to include the following:

- If an employer leaves the Fund and defaults on any of its financial obligations to the Fund, the Guarantor is expected to provide the Fund with the amount certified by the Fund's Actuary as due, including any interest payable.
- If the Guarantor is also an employer in the Fund and is judged by the administering authority to have suitable financial security, the Guarantor may clear some of the financial liability by subsuming the residual liabilities into its own pool of Fund liabilities. In other words, it agrees to be a source of future funding in respect of those liabilities should future deficiencies emerge.

During the period of participation of the employer a Guarantor may at any time agree to the future subsumption of any residual liabilities of that employer. That action may reduce the funding target for the employer, which may, in turn, lead to reduced contribution requirements.

The Guarantor will be permitted to subsume all assets and liabilities of an employer including the inheritance of any deficiency or surplus. However, where the Guarantor is a grouped employer, the administering authority will insist upon the Guarantor meeting the contributions required to clear the deficiency inherited by the Guarantor (whether immediately or over an appropriate period), to protect the other employers in the Guarantor's group from this element of the group's

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deficiency. Conversely a Guarantor may receive a reduction to its contributions to ensure that the benefit of a surplus is provided to the Guarantor rather than spread across the Guarantor's group.

Bonds and other securitisation

Paragraph 7 of Part 3 of Schedule 2 of the 2013 Regulations creates a requirement for a new admission body to carry out to the satisfaction of the administering authority (and the Relevant Scheme Employer in the case of paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations), an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.

Where the level of risk identified by the assessment is such as to require it the admission body shall enter into an indemnity or bond with an appropriate party. Where it is not desirable for an admission body to enter into an indemnity or bond, the body is required to secure a guarantee in a form satisfactory to the administering authority from an organisation who either funds, owns or controls the functions of the admission body.

The administering authority's approach in this area is as follows:

- In the case of paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations, and other admission bodies with a Guarantor, so long as the administering authority judges the Relevant Scheme Employer or Guarantor to have suitable financial security, any bond exists purely to protect the Relevant Scheme Employer against default of the admission body. It is entirely the responsibility of the Relevant Scheme Employer or Guarantor to arrange any risk assessments and decide the level of required bond. The administering authority can supply some standard calculations provided by the Fund's actuary to aid the Relevant Scheme Employer or Guarantor, but this should in no way be taken as advice on this matter. Levels of required bond cover can fluctuate and the administering authority recommends that Relevant Scheme Employers review required cover regularly, at least once a year.
- In the case of paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations, where the administering authority does not judge the Relevant Scheme Employer to have suitable financial security, the administering authority must be involved in assessing the required level of bond to protect the Fund. Admission can only proceed once the administering authority has agreed the level of bond cover. Levels of required bond cover can fluctuate and the administering authority will require the Relevant Scheme Employer to review required cover jointly with it regularly, at least once a year.
- In the case of bodies other than paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations, the administering authority must be involved in assessing the required level of bond to protect the Fund. Admission can only proceed once the administering authority has agreed the level of bond cover. Levels of required bond cover can fluctuate and the administering authority will review required cover

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regularly, at least once a year.

To enable primary contribution rates to be kept as nearly constant as possible

Achieving nearly constant primary contribution rates requires stability of employers' active membership profile and use of assumptions which are relatively constant over time. The administering authority has no control over employers' active membership although the methodology used to calculate the future service rate does vary according to whether or not the employer admits new members to the Fund. In relation to the assumptions, the administering authority believes that the same assumptions should be used to determine the past service liabilities (and hence the solvency target) as are used to determine employers' primary contribution rates.

The demographic assumptions are reviewed by the Actuary on a triennial basis and updated as required to allow for recent Fund experience and other national factors as required. It is not expected that material changes would be made to these assumptions from one valuation to the next.

In relation to the financial assumptions, these can vary quite materially from one valuation to the next as market conditions alter. A substantial proportion of the Fund's investments are held in asset classes such as shares and property, with the aim of increasing investment returns and keeping costs to employers reasonable. However, the expected returns on these asset classes can be quite volatile and so the real discount rate can change materially from one triennial valuation to the next, leading to a material change in employers' primary contribution rates.

Where justified, and as long as it doesn't run counter to the main aims of ensuring solvency and long-term cost efficiency, the administering authority will permit a stepping in of changes to employers' primary contribution rates over a period of up to four years. Care needs to be taken in relation to admission bodies and other employers which participate in the Fund for a fixed period (for example, non-local authority employers awarded contracts to provide local authority services), where use of stepping to smooth primary contribution rate changes is less appropriate.

The administering authority recognises that a balance needs to be struck regarding the financial demands made of admission bodies. On the one hand, the administering authority requires all admission bodies to be fully self funding (either on a grouped or an individual basis), such that other employers in the Fund are not subject to expense as a consequence of the participation of those admission bodies. On the other hand, requiring contributions to target full funding at all times, without further smoothing, may cause failure of the body in question in periods of extreme economic conditions, leading to significant costs for other participating employers.

Employers within the Admission Body Group where there is no commitment from a long-term secure employer such as one of the Councils, or the Scheduled Body Group as a whole, to subsume the liabilities from the exit date should in theory pay contributions to target solvency on the ongoing orphan funding target.

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However, to enable contributions to remain affordable for them in the short term, the funding target adopted for the Admission Body Group has been relaxed and is the same as that adopted for the Scheduled Body Group. This is a temporary measure to enable contributions to remain affordable in the short-term than would otherwise be permitted. However should a body in the Admission Body Group leave the Fund during the relaxation period, that body would be required to make good its funding deficiency including any underpayment on account of contributions having been relaxed. Only if that body is unable to meet any exit deficiency and there is no Guarantor would other solutions to the ongoing funding of the body's liabilities be sought (such as the Scheduled Body funding group providing future funding for any deficiency which cannot be met by the outgoing community admission body).

The Admission Body Group will be re-assessed in advance of the 2019 valuation with a view to moving admission bodies with no commitment from a long term secure employer to subsume the liabilities at the exit date onto the ongoing orphan funding target.

Seek returns on investment within reasonable risk parameters

Returns should be higher over the long term than those from index-linked stocks by investing in other asset classes such as shares, property and alternative investments.

Risk parameters are controlled by restricting investment to asset classes generally recognised as appropriate for UK pension funds. From time to time the administering authority reviews the potential risks of investing in the various asset classes, with help from the Fund's Actuary and its investment managers.

The Fund's funding strategy requires the assets to deliver a long-term return of above the discount rate of 4.5%, the fund actuary's best estimate for the Fund's average return is 5.7% as at March 2016. An investment management structure has been developed and managers appointed to deliver a long-term return in excess of returns on cash and gilt investments within an acceptable level of risk. Details of the structure and managers are in the Investment Strategy Statement.

Purpose of the Fund

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income.
- pay out monies in respect of scheme benefits, transfer values costs, charges and expenses, as defined in the Local Government Pension Scheme Regulations 2013 and as required in the Local Government Scheme (Management and Investment of Funds) Regulations 2016.

Responsibilities of the key parties

The three main parties with obligations to the Fund are the County Council as administering authority, the other employers in the Fund, and the Fund's Actuary. The administering authority delegates responsibility for fulfilling its obligations to

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the Panel and Board.

The County Council as administering authority is required to:

- Operate a pension fund
- Collect employer and employee contributions, investment income and other amounts due to the Pension Fund as stipulated in LGPS Regulations.
- Pay from the Fund the relevant entitlements as stipulated in LGPS Regulations.
- Invest surplus monies in accordance with LGPS Regulations
- Ensure that cash is available to meet liabilities as and when they fall due.
- Take measurers as set out in the regulations to safeguard the Fund against the consequences of employer default.
- Manage the valuation process in consultation with the Fund's Actuary.
- Prepare and maintain a Funding Strategy Statement and an Investment Strategy Statement, both after proper consultation with interested parties.
- Monitor all aspects of the Fund's performance and funding, and amend the FSS/ISS accordingly.
- Effectively manage any potential conflicts of interest arising from its dual role as both administering authority and as a Scheme Employer.
- Enable the Pension Fund Panel and Board to review the valuation process.

The individual employer is required to:

- Deduct contributions from employees' pay correctly.
- Pay all ongoing contributions, including employer contributions determined by the actuary, promptly by the due date.
- Develop a policy on certain discretions and exercise discretions as permitted within the regulatory framework.
- Make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits and early retirement strain.
- Notify the administering authority promptly of all changes to active membership that affect future funding.
- Pay any exit payments on ceasing participation in the Fund.

The Fund actuary should:

- 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 LGPS Regulations.
- Prepare advice and calculations in connection with bulk transfers and the

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funding aspects of individual benefit-related matters such as pension strain costs, ill health retirement costs, compensatory added years cots, etc.

- Provide advice and valuations on the exiting of employers from the Fund.
- Provide advice to the administering authority on bonds or other forms of security against the financial effect on the Fund 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 that may be of relevance to his or her role in advising the fund.

Funding Strategy

Risk based approach

The Fund utilises a risk based approach to funding strategy.

A risk based approach entails carrying out the actuarial valuation on the basis of the assessed likelihood of meeting the funding objectives, rather than relying on a 'deterministic' approach which gives little idea of the associated risk. In practice, three key decisions are required for the risk based approach:

- what the Solvency Target should be (the funding objective - where the administering authority wants the Fund to get to),
- the Trajectory Period (how quickly the administering authority wants the Fund to get there), and
- the Probability of Funding Success (how likely the administering authority wants it to be now that the Fund will actually achieve the Solvency Target by the end of the Trajectory Period).

These three choices, supported by risk modelling carried out by the Fund's actuary, define the discount rate (investment return assumption) to be adopted and, by extension, the appropriate employer contributions payable. Together they measure the riskiness (and hence also the degree of prudence) of the funding strategy.

These three terms are considered in more detail below.

Solvency Target and Funding Target

Solvency and 'funding success'

The administering authority's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term. The Solvency Target is the amount of assets which the Fund wishes to hold at the end of the Trajectory Period (see later) to meet this aim, and is the value of the Fund's liabilities evaluated using appropriate actuarial methods and assumptions.

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The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target. The Administering Authority believes that its funding strategy will ensure the solvency of the Fund because employers collectively have the financial capacity to increase employer contributions should future circumstances require, in order to continue to target a funding level of 100%. For Scheduled Bodies, and certain other bodies of sound covenant whose participation is indefinite in nature, appropriate actuarial methods and assumptions are taken to be measurement by use of the Projected Unit method of valuation, and using assumptions such that, if the Fund's financial position continued to be assessed by use of such methods and assumptions, and contributions were paid in accordance with those methods and assumptions, there would be a better than evens chance that the Fund would continue to be 100% funded after a period of 25 years. The level of funding implied by this is the Solvency Target. For the purpose of this Statement, the required level of chance is defined as the Probability of Maintaining Solvency. The administering authority will generally assume indefinite investment in a broad range of assets of higher risk than risk-free assets for scheduled bodies and certain other bodies.

For certain Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund could potentially be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit, the required Probability of Maintaining Solvency will be set at a more prudent level dependent on circumstances.

For such bodies the administering authority will normally adopt a funding target which:

- in the case of admission bodies, particularly those which do not admit new members, anticipates the approach to valuing the liabilities on exit – the "ongoing orphan funding target" as defined earlier in this statement;
- in the case of scheduled bodies without a government guarantee which are deemed to be of weaker covenant than the local authorities, produces a higher chance of achieving solvency/funding success through adoption of a lower discount rate than adopted for the local authorities.

Probability of Funding Success

The administering authority deems funding success to have been achieved if the Fund, at the end of the Trajectory Period, has achieved the Solvency Target. The Probability of Funding Success is the assessed chance of this happening based on the level of contributions payable by members and employers.

Consistent with the aim of enabling employers' primary contribution rates to be kept as nearly constant as possible, the required chance of achieving the Solvency Target at the end of the relevant Trajectory Period for each employer or employer group can be altered at successive valuations within an overall envelope of acceptable risk.

The administering authority will not permit contributions to be set following a valuation that have an unacceptably low chance of achieving the Solvency Target at the end of the relevant Trajectory Period.

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Funding Target

The Funding Target is the amount of assets which the Fund needs to hold at the valuation date to pay the liabilities at that date as indicated by the chosen valuation method and assumptions. The valuation calculations, including the future service contributions and any adjustment for surplus or deficiency, set the level of contributions payable and dictate the chance of achieving the Solvency Target at the end of the Trajectory Period (defined below).

Consistent with the aim of enabling employers' primary contribution rates to be kept as nearly constant as possible:

- Contribution rates are set by use of the Projected Unit valuation method for most employers. The Projected Unit method is used in the actuarial valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the future service contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period.
- For employers who no longer admit new members, the Attained Age valuation method is normally used. This means that the future service contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.
- For bodies closed to new entrants and other bodies whose participation in the Fund could potentially be of limited duration through known constraints or reduced covenant, the administering authority will take into account the potential for participation to cease, the potential timing of such exit, and any likely change in investment strategy regarding the assets held in respect of the admission body's liabilities at the date of exit.

Recovery and Trajectory periods

The Trajectory Period in relation to an employer is the period between the valuation date and the date which solvency is targeted to be achieved. A Trajectory Period of 25 years has been adopted at the 2016 valuation.

When an actuarial valuation shows that the Fund is in deficiency, employers' contribution rates will be adjusted to achieve a 100% funding ratio over a period of years (the Recovery Period), while ensuring that the probability of achieving solvency over the Trajectory Period remains acceptable. In consultation with the Fund's actuary, the administering authority has set a common maximum recovery period of 19 years for all employers in the Fund. The actual recovery period within this maximum of 19 years is determined at each actuarial valuation by balancing the Fund's solvency requirements against the financial strength of the Fund's main scheduled employers.

The Fund's liabilities mostly take the form of benefit payments over long periods of time. The main scheduled employers in the Fund are financed through central and local taxation and can be viewed as very financially secure. As these employers ultimately underwrite the Fund's finances, the administering authority has agreed a recovery period of 19 years for scheduled bodies in the 2016 actuarial valuation.

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Grouping of Employers

In some circumstances it is desirable to group employers within the Fund together for funding purposes (i.e. to calculate employer contribution rates). Reasons might include reducing the volatility of contribution rates for employers, facilitating situations where employers have a common source of funding or accommodating employers who wish to share the risks related to their participation in the Fund.

Employers may be grouped entirely, such that all of the risks of participation are shared, or only partially grouped such that only specified risks are shared.

All employers in the Fund are grouped together regarding the risks associated with payment of ill health pensions and partner's pensions and lump sum benefits on death in service. The cost of such benefits is shared across the employers in the Fund. This is because the administering authority, in view of the size of the Fund, does not see it as cost effective or necessary to insure these benefits externally.

Group Funding Framework

Within the Fund there are two groups of employers for funding purposes; the Scheduled Body Group and the Admission Body Group. Employers within a group share all risks of participation, with the exception of liability for ill health pensions, partner's pensions and lump sum benefits payable on death in service, with other employers in the group. A small, but increasing, number of employers sit outside of the groups.

Scheduled Body Group

The Scheduled Body Group includes:

- Scheduled bodies listed in Part 1 of Schedule 2 of the Regulations, excepting those employers (or category of employers) who in the view of the Administering Authority:
    - Are deemed by central government to be private sector organisations, or
    - Receive a significant proportion of their income from either non-government sources or otherwise are not considered to have a central or local government guarantee, or
    - Are otherwise considered by the Administering Authority to be less financially secure than the principal councils to the extent that there is a perceived (or potential) covenant risk to the Fund.
- Town and Parish Council employers under Part 2 (paragraph 2) of Schedule 2 of the Regulations who, due to their unique size and transience as active participating bodies, would benefit significantly from being able to share risks with a wider pool (and where the risk to that wider pool is deemed negligible)
- Paragraph 1(d)(i) bodies admitted under Schedule 2 Part 3 of the 2013 Regulations where
    - the employer was admitted to the Group before 4 March 2016

- there is a pass through arrangement with an employer which is itself a grouped scheduled body, and
- that body and letting authority (as appropriate) adheres to any mechanisms as required by the Administering Authority to protect other grouped employers from the additional and unique risks which that body contributes to the Group.

With effect from 31 March 2016, the following category of employers have ceased to participate in the Scheduled Body Group to become ungrouped employers in the Fund:

- Bodies in the Higher Education and Further Education sector (including post-92 Colleges and Universities)

The Administering Authority will keep under review the funding arrangements of all employers and may remove additional employers from the grouping arrangements should their situations change.

Admission Body Group

The Administering Authority views the purpose of the Admission Body Group to be primarily to smooth contributions for charities and other not-for-profit organisations which would otherwise be exposed to the potential of volatile contributions. For historic reasons other admission bodies have participated in the Group. With effect from 31 March 2016, the following category of employers have ceased to participate in the Admission Body Group to become ungrouped employers in the Fund:

- Bodies in the Higher Education and Further Education sector (including pre-92 Universities and independent schools). These bodies will become ungrouped employers, consistent with the treatment of other post-92 Universities and colleges.
- Housing Associations. These are closed employers with no subsumption commitment.

New funding groups would be considered by the Administering Authority, but only with the consent of the employers involved.

Funding principles applying to grouped employers

Common employers' contribution rates are set for each of these groups, instead of individual contribution rates for each employer. The Administering Authority accepts that this can give rise to cross-subsidies between employers. However, employers in the Fund are required to make upfront contributions determined by the Fund's Actuary to cover the costs of unreduced early retirements, which is a major distinction between employers over time. The Administering Authority and the Fund's Actuary periodically review whether separate rates for individual employers or groups of employers are required.

Within each group, employers share risk according to a set of clearly defined principles which are as follows:

- The group exists to produce a common primary contribution rate for employers in the group

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- Only the group funding target is relevant when producing a common primary contribution rate, and
  - An employer's cash contribution depends on its level of payroll when a stream of deficit contributions is being set, and any special arrangements put in place in relation to being a Relevant Scheme Employer for a grouped paragraph 1(d)(i) body admitted under Schedule 2 Part 3 of the 2013 Regulations,
  - While an employer has contributing members in the Fund, the employer will share a responsibility to contribute towards any emerging deficiency within the relevant funding group, or will benefit from an emerging surplus within the relevant funding group through a deduction against previous deficiency obligations.
- Unless it is a paragraph 1(d)(i) body admitted under Schedule 2 Part 3 of the 2013 Regulations, or as otherwise agreed between the administering authority and the employer, the employer is assumed to belong to the group indefinitely
  - As an employer can always be called upon to pay its share of any group deficiency, a flow of new entrants to the employer is required to finance this
  - Funding targets used to assess ongoing contributions at the triennial valuation are set using an ongoing actuarial basis that assumes participation is indefinite
- Employers are liable to fund deficiencies emerging at each valuation in proportion to their own payroll at the time of the valuation. Relevant Scheme Employers in relation to a grouped paragraph 1(d)(i) body admitted under Schedule 2 Part 3 of the 2013 Regulations will also be liable in respect of payroll transferred to the paragraph 1(d)(i) body, to the extent that the contributions are not fully covered by those made by the paragraph 1(d)(i) body.
- Streams of deficiency contributions, once certified at a valuation will normally remain in place for the duration of the relevant recovery period. New streams of such contributions may be certified at subsequent valuations in respect of new surplus or deficiency emerging at the relevant valuation. In certain circumstances, contribution streams set at a previous valuation may be modified at subsequent valuations if the administering authority and the Fund's actuary agree.
- Employers will pay a common future service ("primary") contribution rate. Relevant Scheme Employers in relation to a grouped paragraph 1(d)(i) body will also be liable in respect of any increased rate payable in respect of the paragraph 1(d)(i) body by virtue of the admission agreement being a closed agreement.
- When employers exit the Fund they will be assumed to leave the group. The funding target adopted at that time will be assessed in light of the employer’s circumstances and, in particular whether its liabilities will be subsumed (i.e. another employer or group will be responsible for the future funding of those liabilities) or will become orphan (where the Fund has no access to any future funding for those liabilities).

For most purposes, such as for the purpose of calculating an exit valuation or calculations under FRS102/IAS19, each employer in a group is assumed to have the same funding level as the group as a whole, based on the value of benefits accrued to date for the group as a whole and notional assets held in respect of the group. The funding level of the group is expressed as a percentage and calculated as:

> notional assets held in respect of the group divided by value of benefits accrued to date for the group as a whole.

However, where circumstances dictate otherwise (e.g. to protect the remaining employers in a group), and it is necessary to allocate a notional value of assets to an employer in a group, this may be calculated as the value of the liabilities less the present value of the employer's stream of deficiency contributions.

Further aspects of funding strategy that may be relevant from time to time are described below:

Notional sub-funds

In order to establish contribution rates for individual employers or groups of employers it is convenient to subdivide the Fund notionally between the employers, as if each employer had its own notional sub-fund.

This subdivision is for funding purposes only. It is purely notional and does not imply any formal subdivision of assets, nor ownership of any particular assets or groups of assets by any individual employer or group.

Roll forward of sub-funds

The notional sub-fund allocated to each employer or group will be updated allowing for all cashflows associated with that employer's or group's membership, including contribution income, benefits paid, transfers in and out and investment income allocated as set out below.

In some cases there is insufficient information to complete these calculations. In these circumstances:

- Where, in the opinion of the Fund's Actuary, the unavailable cashflow data is of low materiality, estimated cashflows will be used.
- Where, in the opinion of the Fund's Actuary, the unavailable cashflow data is material, the Fund's Actuary will use an analysis of gains and losses to update the notional sub-fund. This method is less precise than using cashflows, and involves calculating gains and losses to the surplus or deficiency shown at the previous valuation to determine an expected surplus or deficiency at this valuation. This is compared with the liabilities evaluated at this valuation to calculate an implied notional asset holding.

Attribution of investment income

Where the Administering Authority has agreed with a scheme employer that the scheme employer will have a tailored asset portfolio notionally allocated to it, the assets notionally allocated to that employer will be credited with a rate of return appropriate to the agreed allocation.

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Where the employer has not been allocated a tailored notional portfolio of assets, the assets notionally allocated to that employer will be credited with the rate of return earned by the Fund assets as a whole, adjusted for any return credited to those employers for whom a tailored notional asset portfolio exists.

Phasing in of new contribution rates

At each actuarial valuation, the Administering Authority will consider whether changes to employers' contribution rates should be payable immediately, or be phased in. The Administering Authority discusses with the Fund's actuary the risks of adopting such an approach. The current policy is to phase in changes to the primary rate of employers' contributions over a maximum of four steps. However, phasing in of increases to deficit recovery contributions may be permitted if unusual and difficult budgetary constraints make this necessary, or if other changes, such as changes to the funding target, justify this approach. Whenever contribution changes are being phased in, this can only be achieved if the regulatory requirements of setting employer contributions to ensure the solvency and long-term cost efficiency of the Fund would still be met.

Fund maturity

To protect the Fund, and individual employers, from the risk of increasing maturity producing unacceptably volatile contribution adjustments as a percentage of pay the administering authority will normally require defined capital streams from employers in respect of any disclosed funding surplus or deficiency.

Identification of risks and counter measures

The administering authority recognises that future events and investment income cannot be predicted with certainty. Instead, there is a range of possible outcomes, and different assumed outcomes will lie at different places within that range.

The more optimistic the assumptions made, the more that outcome will sit towards the 'favourable' end of the range of possible outcomes, the lower will be the probability of events actually matching or being more favourable than the assumed events, and the lower will be the Funding Target calculated using those assumptions.

The administering authority's overall policy on risk is to identify all risks to the Fund and to consider the position both in aggregate and at individual risk level. Risks to the Fund will be monitored and action taken to limit them as soon as possible. The main risks are as follows:

Investment risk

The risk of investments not performing (income) or increasing in value (growth) as forecast. Examples of specific risks would be:

- assets not delivering the required return (for whatever reason, including manager underperformance)
- systemic risk with the possibility of interlinked and simultaneous financial

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market volatility

- insufficient funds to meet liabilities as they fall due
- inadequate, inappropriate or incomplete investment and actuarial advice is taken and acted upon
- counterparty failure

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income - yield curve, credit risks, duration risks and market risks
- alternative assets – liquidity risks, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risk
- macroeconomic risks

The administering authority reviews each investment manager's performance quarterly and annually considers the asset allocation of the Fund by carrying out an annual review meeting with its Investment Advisers, Fund Managers and Fund's Actuary. The administering authority also annually reviews the effect of market movements on the Fund's overall funding position.

Employer risk

Those risks that arise from the ever-changing mix of employers, from short-term and ceasing employers, and the potential for a shortfall in payments and/or orphaned liabilities.

The administering authority will put in place a FSS which contains sufficient detail on how funding risks are managed in respect of the main categories of employer (e.g. scheduled and admission bodies) and other pension fund stakeholders.

The administering authority maintains a knowledge base on their employers, their basis of participation and their legal status (e.g. charities, companies limited by guarantee, group/subsidiary arrangements) and uses this information to inform the Funding Strategy Statement.

Liquidity and maturity risk

The LGPS is going through a series of changes, each of which will impact upon the maturity profile of the LGPS and have potential cash flow implications:

- The increased emphasis on outsourcing and other alternative models for service delivery may result in active members leaving the LGPS,
- transfer of responsibility between different public sector bodies,
- scheme changes which might lead to increased opt-outs
- spending cuts and their implications

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All of these may result in workforce reductions that would reduce membership, reduce contributions and prematurely increase retirements in ways that may not been taken into account in previous forecasts.

The administering authority's policy is to require regular communication between itself and employers and to ensure reviews of maturity at overall Fund and employer level where material issues are identified.

Liability risk

Inflation, life expectancy and other demographic changes, and interest rate and wage and salary inflation will all impact upon future liabilities.

The administering authority will make sure the Fund's Actuary investigates these matters at each valuation, or more often if necessary. The Fund's Actuary will report to the administering authority as appropriate. The administering authority will then agree with the Fund's actuary any necessary changes to the assumptions used in assessing solvency.

If significant liability changes become apparent between valuations, the administering authority will notify all participating employers of the likely effect on their contributions after the next full valuation, and consider whether any bonds that are in place for admission bodies require review.

Regulatory and Compliance risk

Occupational pensions in the UK are heavily regulated. Both general and LGPS-specific legislation mush be complied with.

The administering authority will keep abreast of all proposed changes and, whenever possible, comment on the Fund's behalf during consultation periods. The administering authority will ask the Fund's Actuary to assess the effect of any changes on employers' contribution rates.

The administering authority will then notify employers of how these rule changes are likely to affect their contribution rates at the next valuation, if they are significant.

Governance risk

This covers the risk of unexpected structural changes in the Fund's membership (for example, if an employer closes their scheme to new entrants or if many members withdraw or groups of staff retire), and the related risk of an employer failing to notify the administering authority promptly.

To limit this risk, the administering authority requires the other participating employers to communicate regularly with it on such matters. The administering authority also undertakes to inform the Fund's Actuary promptly of any such matters.

Recovery period

Allowing surpluses or deficiencies to be eliminated over a recovery period of up to 19years means there is a risk that too little will be done to restore solvency between successive actuarial valuations. The associated risk is reviewed with the

Fund's actuary as part of the three-yearly valuation process, to ensure as far as possible that enough is done to restore solvency and that deficit contributions are compared to the amount of interest accruing on the deficit.

Stepping

Increasing employers' contribution rates in annual steps rather than immediately introduces a risk that too little will be done to restore solvency in the early years of the process or, in relation to the primary rates of contributions, that employers are not paying enough to meet the cost of benefits being accrued in future. The administering authority's policy is to limit the number of permitted steps to four. In addition, it accepts that a slightly higher final rate may be necessary at the end of the stepping process to help make up the shortfall.

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Links to investment policy set out in the Fund's Investment Strategy Statement

The administering authority has produced this Funding Strategy Statement having taken an overall view of the level of risk in the investment policy set out in the Investment Strategy Statement (available from the Pension Fund's website).

Both documents are subject to regular review.

Future monitoring

The administering authority plans to review this FSS as part of the three-yearly actuarial valuation process unless circumstances arise that require earlier action.

The administering authority and the Fund's Actuary will monitor the Fund's solvency position at regular intervals between valuations. Discussions will be held with the Fund's Actuary to establish whether any changes are significant enough to require further action, such as informing employers of the need for different employers' contribution rates after the next valuation.

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1. Background

1.1. This policy explains the Fund's policies and procedures in the treatment of employers including the admission and exit of employers in the Hampshire Pension Fund. Hampshire Pension Fund is administered by Hampshire County Council.

1.2. The purpose of this policy is to ensure that, as the Administering Authority of the Hampshire Pension Fund, we will minimise the risk that any employer places on the Fund before agreeing to admit any new employers to the Fund. It is also intended to provide clarity on the decisions made by the Fund and provide consistency in the way types of employers are dealt with.

1.3. This policy should be read in conjunction with the Fund's Funding Strategy Statement (FSS).

1.4. The policy will be reviewed from time to time and at least every three years in line with the FSS. It will also be reviewed following changes in the regulations relating to employers in the Fund.

1.5. It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

1.6. Where the information relates to a particular type of employer, this will be explained. If no type of employer is indicated the information relates to all employers in the Fund.

2. Aims

2.1. Our aim is to minimise risk to the Fund by ensuring that the employers participating in the Fund are managed in a way that ensures they are able to adequately fund the liabilities attributable to them and, in particular to pay any deficit due when leaving the Fund. In managing this risk we will have regard to the aims of the FSS:
- to manage the employer's liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due,
- to enable primary contribution rates to be kept as nearly constant as possible (subject to the administering authority not taking undue risk) at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies

2.2. The Administering Authority has an obligation to pursue all liabilities owed so that this deficit does not fall on other employers.

3. Principles

3.1. For funding purposes, the Administering Authority will treat employers in different ways depending on how they participate in the Fund and its views on their financial strength.

3.2. As set out in the FSS Scheduled body employers under Part 1 of Schedule 2 of the Regulations which are deemed to be secure public sector bodies, and Town and Parish Councils under paragraph 2 of Part 2 of Schedule 2, will be part of the Scheduled body group. Decisions made by employers in the group must be in accordance with the group behaviours as set out in paragraph 4.1 below. Employers in the group will pay the same future service rate and share the funding risks of the group as set out in the FSS.

3.3. Some existing Admitted bodies may be part of the Scheduled body group on the understanding that, where considered appropriate, a formal agreement will be put in place to protect the other grouped employers from the actions of the admission body and the effect of the admission agreement being closed to new entrants. The Administering Authority may remove those employers from the Group if satisfactory agreement cannot be reached or the terms of any agreement are not adhered to by the employers concerned.

3.4. Some existing Admitted body employers may be part of the Admitted body group.

3.5. Some employers will be in neither group and will be set an individual employer contribution.

3.6. Employers who are part of a group need to act in accordance with the group behaviours. The Fund will monitor the funding / membership experiences of the employers from time to time. If the Fund considers an employer is not acting in accordance with the group behaviours it will consider taking appropriate action which may include requiring the employer to pay additional contributions so the impacts of the decisions made by the employer do not adversely affect other employers in the group.

3.7. Regardless of whether they are grouped or ungrouped individual employers will pay for any legal and actuarial costs incurred on their behalf.

4. Responsibilities of employers in the Fund

4.1. We will expect all employers in the Fund to take into consideration the effect of their behaviours on the group, for example when considering;
- Discretions policies
- Outsourcing decisions
- Salary increases

Employers should have regard to the Fund's administration strategy at all times.

Changes/mergers

4.2. All employers, whether Admission or Scheduled bodies, need to inform the Fund of any changes to the organisation that will impact on their participation in the Fund. This includes change of name or constitution, mergers with other organisations, or other decisions which will or may materially affect the employer's Fund membership.

Admission agreements

4.3. All employers must inform the Fund of any outsourcings and allow sufficient time for an admission agreement to be completed prior to the contract start date.

5. Managing risk

5.1. Our aim is to minimise employer related risk to the Fund across all the employers in the Fund.

5.2. There must be no significant additional risk to the Fund from any outsourcing by a scheme employer or admission of any other new body for which a scheme employer is guarantor. We would want to ensure that the decisions made by an employer when outsourcing services or providing a guarantee have no adverse impact on the Fund or on other employers in the Fund. We would look to protect both the Fund and other employers in these circumstances.

5.3. In particular, where Scheduled body employers under Part 1 of Schedule 2 outsource services, there will be a presumption that the Scheduled body has agreed to subsume any assets and liabilities attributable to the new admission on its exit from the Fund (excluding any assets and liabilities transferring to another employer in the Fund).

5.4. Scheme employers must be prepared to manage any pension risk of an outsourcing.

6. New employers in the Hampshire Pension Fund

Admission bodies

6.1. Each Admitted body will be a stand alone body in the Fund with its own contribution rate.

6.2. Employers considering outsourcing any services should have regard to, and adhere to the requirements of the Fair Deal Policy/Best Value direction. They should also advise the Administering Authority at the earliest opportunity, and before any transfer of staff, so that the necessary paperwork and calculations can be completed in advance of the new body being admitted. More information on the process is available from the Fund.

6.3. The Administering Authority will have discretion to amend the contribution the scheme employer pays where they make decisions to outsource services if it is considered that there will be significant or material number of employee members moving from the scheme employer to a new employer, relative to the size of the scheme employer. The aim will be to ensure the transfer does not increase the risk to the Fund or the Scheduled body group.

6.4. The costs in terms of the contribution the new employer pays and the fees in relation to the solicitor and actuary costs will depend on the decisions made under this section. In particular, the funding target appropriate to the new employer will reflect the perceived strength of covenant of the scheme employer (including the existence or otherwise of a government guarantee) and whether or not the scheme employer has agreed to guarantee the new employer's participation and subsume its assets and liabilities in the Fund should that employer exit the Fund in future. The fees will depend on the legal and actuarial information required but an estimate will be provided prior to work being commissioned.

All outsourcings

6.5. The Administering Authority will have discretion to amend the contribution the scheme employer pays where they make decisions to outsource services if it is considered that there will be significant or material number of employee members moving from the scheme employer to a new employer, relative to the size of the scheme employer. The aim will be to ensure the transfer does not increase the risk to the Fund or the Scheduled body group. Unless the circumstances dictate otherwise, the change in the scheme employer's contribution will generally be implemented as part of the next triennial valuation of the Fund when new contributions for all employers will be implemented.

Paragraphs 5 & 6, Part 2, Schedule 2 bodies

6.6. To be an employer under paragraph 5 of part 2 of Schedule 2, the new employer would be connected with scheme employer, where connected means:
a) it is an entity other than the local authority; and .
b) according to proper practices in force at that time, financial information about the entity must be included in the local authority's statement of accounts for the financial year in which that time falls.

6.7. To be an employer under paragraph 6 of part 2 of Schedule 2, the new employer would be "under the control of" the scheme employer, where under the control of has the same meaning as in section 68 or, as the case may be, 73 of the Local Government and Housing Act 1989.

6.8. For the purposes of this policy, paragraphs 5 and 6 Part 2 Schedule 2 bodies are referred to as 'wholly owned companies'.

6.9. Unless any of the situations listed below apply, the default arrangement will be for the wholly owned company to be a stand alone employer subject to the ongoing orphan funding target. On exit, unless a subsumption commitment is in place, a low risk ("gilts") basis will be used to value the liabilities in accordance with the Funding Strategy Statement.

6.10. If a wholly owned company is set up by a tax raising authority in the Scheduled Body Group, that employer can provide a subsumption commitment which will allow the company to be set up with the Scheduled Body Group funding target. The company will still be a stand alone employer with its own contribution rate.

6.11. If a wholly owned company is set up by an ungrouped Part 1 Schedule 2 employer the Fund will accept the scheme employer being pooled with its wholly owned company, provided the bodies share the same financial covenant and attributes, and the arrangement does not materially increase the risk to the Fund. This will allow the company to have the same funding target as the scheme employer. A parent company guarantee and subsumption agreement will need to be put in place for pooling to be acceptable to the Fund and the Administering Authority will reserve the right to review the contributions for the pool on the establishment of the wholly owned company.

6.12. If a scheme employer has a stronger financial covenant than the wholly owned company (i.e. a MAT/academy with a DfE guarantee that does not extend to the company) then the company will have to be a stand alone employer subject to the ongoing orphan funding target regardless of whether or not a subsumption commitment is in place.

6.13. Contribution rates for closed employers will be calculated using the attained age methodology (closed contribution rate) with a recovery period equal to future working

life. This approach may also be taken for those employers where, in the opinion of the Administering Authority, access to the LGPS is being restricted. The Administering Authority will monitor the number of active members and in particular the number of new entrants in forming this opinion. If the scheme employer enters into a pooling arrangement with the wholly owned company under 6.11 above, but one of either the scheme employer or the wholly owned company is closed (or restricts access), the default position for the pool will be to use the attained age methodology with a recovery period equal to the future working lifetime. A period of transition or other easement may be agreed where the number of active members is expected to reduce only slowly over time and new entrants are still expected to be admitted to the group and, where in the Administering Authority's view, such period of transition or easement does not constitute a material risk to the Fund/other employers.

6.14. The Administering Authority will reserve the right to amend the contribution paid by the scheme employer if it is considered that there will be significant or material number of employee members moving to the wholly owned company, relative to the size of the scheme employer. This assessment will take place as part of the triennial valuation.

6.15. Employers considering outsourcing any services to a wholly owned company should also advise the Administering Authority at the earliest opportunity and before any transfer of staff so that the necessary paperwork and calculations can be completed in advance of the new body being admitted. More information on the process is available from the Fund.

6.16. The Fund actuary will determine the employer contribution payable for such a body as an ungrouped employer (or for the group where the employer is grouped with the relevant Part 1 Schedule 2 body) and if necessary revise the contributions payable by the scheme employer outsourcing or otherwise transferring staff to a Part 2 Schedule 2 body with the aim of ensuring the transfer does not increase the risk to the Fund or the Scheduled body group. Unless the circumstances dictate otherwise, the change in the scheme employer's contribution will generally be implemented as part of the next triennial valuation of the Fund when new contributions for all employers will be implemented.

6.17. As with Admission bodies, the costs in terms of the contribution the new employer pays and the legal and actuarial fees will depend on the decisions made under this section. In particular, the funding target appropriate to the new employer will reflect the perceived strength of covenant of the new employer and the scheme employer, and whether or not the scheme employer has agreed to guarantee the new employer's participation and subsume its assets and liabilities in the Fund should that employer exit the Fund in future and, where relevant, whether the new employer has a government guarantee. Should a guarantee and subsumption commitment not be given by the scheme employer, the Administering Authority may need to take a more

prudent approach to setting contribution rates for the new employer to take account of any perceived increased risk to the Fund. The fees will depend on the legal and actuarial information required but an estimate will be provided prior to work being commissioned.

Town and Parish Councils

6.18. Town and Parish Councils joining the Fund will automatically join the Scheduled body group.

When a Town or Parish Council designates to join an employee to the Fund, they have no current active members and are not currently subject to a suspension notice (see section 12 below), a standard employer rate equal to the prevailing future service rate of the Scheduled body group (currently 16.9% of pay) will be payable until the contributions from the next triennial valuation come into force.

Academies

6.19. Schools and colleges converting to academy status will retain the position in the Fund held by the former establishment. This means that an academy created from the conversion of an LEA school will be part of the Scheduled body group. An academy created from a 6th form college, or where there is no former establishment, will be a standalone employer in the Fund. A new free school will also become a standalone employer in the Fund.

6.20. Similarly new multi academy trusts (MATs) will become standalone employers in the Fund unless at the point of creation they wholly consist of former LEA schools (in which case the MAT will stay in the Scheduled body group). Academies which join a MAT will become part of that MAT. An exception may be made for a former LEA school which joins a MAT which is a standalone employer. The MAT can choose for the LEA school to remain part of the Scheduled body group. This will mean that the school continues to share the experience of the Scheduled body group and may pay a different contribution rate to the rest of the MAT.

6.21. The DfE guarantee extends to all academies and free schools, including those created from 6th form colleges. While this guarantee is in force, contribution rates for all academies will be set using the same risk basis as for the Scheduled body group, even if the academy or MAT is a standalone employer.

6.22. A MAT which participates in the Scheduled Body Group will be treated as a single employer in the Group and will receive a single contribution rate and fixed contribution amount. A single report will be provided for IAS19 and will not be split between the academies which are part of the MAT.

6.23. New academies that are formed from an LEA school will also be asked to take responsibility for a portion of the local education authority's deficit contributions in line with the proportion of pensionable payroll which is transferring from the local education authority to the academy. If an academy moves to a MAT, the MAT will become responsible for those deficit contributions in addition to its own.

6.24. Where academies outsource services or set up a wholly owned company and the new admission body or new Part 2 Schedule 2 body is not backed by a guarantee from the Department for Education or the Local Education Authority, the new employer will be treated as an ungrouped employer subject to the ongoing orphan funding target as set out in the Funding Strategy Statement.

7. Bonds and guarantors

Guarantor

7.1. A guarantor takes responsibility for the assets and liabilities of the Fund which are attributable to the admission body or wholly owned company. In the event that liabilities of the admission body or wholly owned company remain unpaid, the Fund will seek payment from the guarantor.

7.2. Under The Local Government Pension Scheme Regulations 2013[1] every employer who outsources services becomes an ultimate guarantor for the pension liabilities of the new employer. It is the Administering Authority's preferred approach that all wholly owned companies which participate in the Fund as Part 2 Schedule 2 bodies are guaranteed by the Part 1 Schedule 2 employer to which they are related. Should a guarantee not be provided, the contribution rate of the Part 2 Schedule 2 bodies will be set at a level to take account of any perceived increased risk to the Fund (see section 6.17).

7.3. In some circumstances, where the letting authority is not a tax raising authority the Fund will require a bond to be put in place to cover certain funding risks to the Fund on the advice of the Fund actuary.

7.4. The admission agreement ends if the new employer becomes an exiting employer[2]. The Fund will arrange for a valuation of the assets and liabilities of the exiting employer and, where appropriate, a revised rates and adjustment certificate.

7.5. Payment of the outstanding liabilities must be made by the exiting scheme employer. If the exiting scheme employer fails to make this payment and if there is a bond in place we will call on this in the first instance.

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[1] Schedule 2, Part 3, 1(d)

[2] The Local Government Pension Scheme Regulations 2013 Part 2 , 64

7.6. If there is no bond in place and the scheme employer fails to pay the outstanding liability we will pursue payment from the guarantor. If there is no guarantor the liability will fall to the letting authority who arranged for admission body status for the exiting employer.

7.7. Charitable bodies seeking admission to the Fund will need a tax raising authority to act as guarantor.

7.8. Any employer acting as guarantor will need to complete a guarantor agreement. The Fund will provide a template document for completion.

Bond

7.9. A bond is a way of insuring against the potential cost of the admission body failing by reason of insolvency, winding up or liquidation and being unable to meet its obligations to the Fund.

7.10. The Local Government Pension Scheme regulations provide that the risk assessment for bond cover must be carried out by the admission body. However, we will ask the Fund actuary to calculate the minimum risk to the Fund for any outsourcing. This information will be shared with the scheme employer but not with the admission body. However, it will not constitute advice for either the scheme employer or admission body, who should take their own actuarial advice as required.

7.11. Where there is a guarantor, the bond will be largely for that scheme employer's protection, in which case the scheme employer must decide if the admitted body will be required to provide a higher bond than that calculated by the Fund actuary.

7.12. The Administering Authority will require a bond or indemnity to be in place for any outsourcings that are arranged by scheme employers that do not have tax-raising powers. Where there is no bond the Fund will require the letting employer to sign a guarantee agreement.

7.13. The scheme employer needs to be aware of and manage the ongoing risks.

7.14. The scheme employer should review the bond cover annually.

7.15. In the event of an admitted body failing and there being insufficient bond cover, any outstanding liability will fall to the scheme employer.

8. Open or closed admission agreements

Open agreement

8.1. An open agreement allows any person employed in connection with the contract to join the LGPS.

8.2. The Fund will consider an open agreement for an outsourcing. It is for the scheme employer/admission body to ensure only those eligible are admitted to the Fund.

Closed agreement

8.3. A closed agreement relates to a fixed group of employees. Only the employees or roles that transfer to the admission body from the scheme employer can remain or be members of the Scheme.

8.4. Unless advised otherwise, we will assume the admission agreement is closed and there will be a default joining window of 6 months.

8.5. A scheme employer arranging an outsourcing may agree to vary from this position but they must be aware of their obligations under Best Value or recommendations of Fair Deal.

Designating employers

8.6. Part 2 Schedule 2 employers are "designating" employers in that they can designate which staff or posts are eligible for membership of the LGPS. Where a Part 1 Schedule 2 employer establishes a wholly owned company which participates in the Fund as a Part 2 Schedule 2 employer, it must advise the Administering Authority of its intentions as regards the eligibility of the company's current and future employees. This will enable the Administering Authority to determine whether the wholly owned company should be treated as an open or closed employer.

9. Funding targets

9.1. The funding target relates to what happens to the liabilities for the members being outsourced at the end of the contract, on termination of the admission agreement or other exit of an employer, and may also take into account the administering authority's view on the strength of the scheme employer's covenant.

9.2. The presumption will be that the scheme employer will provide a "subsumption commitment" (i.e. be responsible for the future funding of the liabilities post-exit). This will automatically apply to the non-active liabilities of admission bodies in Part 3 paragraph 1(d)9i) of Schedule 2 which commenced in the Fund after 1 April 2018, i.e. these liabilities and any associated assets will be subsumed by the relevant Scheme employer. This should be confirmed in all other cases.

Orphan (gilts) funding target

9.3. Outstanding liabilities of employers from whom no further funding can be obtained are known as orphan liabilities.

9.4. The Fund will seek to minimise the risk to other employers in the Fund of having to make good any deficiency arising on the orphan liabilities.

9.5. To achieve this, as set out in the Funding Strategy Statement, when an exiting employer would leave orphaned liabilities, the administering authority will seek sufficient funding from the outgoing employer to match the liabilities with low risk investments, generally Government fixed-interest and index-linked bonds.

9.6. Where an admission body is admitted and there is no subsumption commitment from a tax raising employer or the Administering Authority determines that the scheme employer which would subsume the assets and liabilities on the admission body's exit is not of sufficiently strong covenant, the new employer will be set ongoing contributions calculated to meet the 'ongoing' orphan funding target. This funding target takes account of the approach taken to value orphan liabilities on exit and will be reviewed at each triennial valuation on the advice of the actuary. Where the 'ongoing' orphan funding target applies the value of the transferring liabilities, and hence notional asset transfer sufficient (where a fully funded transfer applies) will be higher than using a subsumption basis. Similarly, the contribution rate payable by the admission body will be higher than payable by the scheme employer, potentially materially so. Whilst this approach does not guarantee that there will be no exit payment due, it should materially reduce this risk.

9.7. The exit valuation for admission bodies under paragraph 1(d)(i) of Schedule 2 Part 3 which commenced in the Fund after 1 April 2018 and where the ongoing orphan funding target was used to determine the transferring assets on commencement, will be undertaken on the ongoing orphan funding target, notwithstanding the presumption that the scheme employer will subsume the non-active liabilities and associated assets on exit

Scheduled Body Group funding target

9.8. Where an employer is leaving the Fund another employer or group of employers may agree to provide future funding for any liability.

9.9. In that case, any funding deficit arising in future in relation to the exited employer's liabilities will be subsumed by the accepting employer or group.

9.10. Where the subsuming employer is a tax raising body or is deemed to be of similar covenant to a tax raising body the Administering Authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of the liabilities of the accepting employer or group. Generally this will mean assuming continued investment in more risky investments than Government bonds. In other cases a more prudent funding target will apply, for example in relation to admission bodies following an outsourcing by an academy or other educational establishment where the admission body is not subject to a guarantee from the Department for Education or Local Education Authority, as set out in paragraph 6.22

above.

Intermediate funding target

9.11. The actuary also has the option to place an employer on an intermediate funding target if they deem it appropriate. In the case of scheduled bodies without a government guarantee which are deemed to be of weaker covenant than the local authorities, the administering authority will normally adopt a funding target which produces a higher chance of achieving solvency/funding success through adoption of a lower discount rate than adopted for the local authorities.

9.12. Where an employer subject to the intermediate funding target outsources services under 1(d)(i) of Schedule 2 Part 3 or transfers employees to a wholly owned company with a commitment to subsume the liabilities of the company on exit, the funding target for the new employer will be the same as that applicable to the scheme employer, (i.e. will be the scheme employer's intermediate funding target) unless the ongoing orphan funding target is considered by the Administering Authority to be more appropriate to the circumstances.

10. Pass-through

10.1. A scheme employer may agree a pass-through arrangement with an admitted body. In this case the employer contribution is still calculated by the Fund actuary and the admitted body will be expected to pay this to the Fund. Any arrangement to share the cost of this rate will be between the scheme employer and the admitted body.

10.2. New Admitted bodies will not be included in the scheduled body or admitted body group even if there is a pass-through arrangement in place between the letting authority and the admitted body.

11. Fully funded or share of fund

Fully funded

11.1. When a new employer starts in the Fund, they will usually start as fully funded. This means that any past deficit for the members who are transferring to the new employer remains with the scheme employer and does not transfer to the new employer.

11.2. This applies even where there is an onward outsourcing from an existing body. The new employer will start fully funded and the existing admission body will pay any deficit (unless specified otherwise in their contract with the scheme employer).

11.3. Where the funding target for the new employer is higher than that for the scheme employer, the Fund actuary will revise the contributions for the scheme employer to take this into account. Unless the circumstances dictate otherwise, the change in the scheme employer's contribution will generally be implemented as part of the next triennial valuation of the Fund when new contributions for all employers will be implemented.

Share of fund

11.4. In exceptional circumstances and only where agreed between the employers the Fund may consider starting a new employer with a share of fund. The Fund will only agree to this where it doesn't increase the risk to the Fund.

12. Exit from the Fund (terminations)

12.1. If an exit is triggered, the employer will be responsible for all costs (including any deficit).

12.2. An exit valuation will be carried out when an employer becomes an "exiting employer", i.e. it :
- ceases to be a Scheme employer (including ceasing to be an admission body participating in the Scheme), or
-no longer has an active member contributing towards the Fund

12.3. For admission bodies, this includes the following scenarios:

- an outsourcing contract ends or,
- for a closed agreement, when the last member leaves if it is before the contract end date, or
- the admission body becomes insolvent, is wound up or goes into liquidation.

12.4. For exits of a body admitted to the fund under Schedule 2 Part 3 paragraph 1(d) (or earlier regulations) or where a scheme employer is acting as guarantor, the scheme employer should notify the Administering Authority as soon as it knows the admission agreement is likely to be terminated.

12.5. The Fund will instruct the actuary to carry out an exit valuation. The costs of this will be added to the final exit valuation.

12.6. The Administering Authority will pursue all liabilities owing to the Fund. We will support employers to develop a strategy to exit the Fund where required and it is in the interests of the Fund to do so.

12.7. The Fund will pursue the body, any insurer providing a bond or any guarantor as appropriate but ultimately, if unsuccessful, the scheme employer will become liable for any outstanding costs. If there is no scheme employer (e.g. in relation to community admission bodies whose participation pre-dates the requirement for a guarantor), depending upon the circumstances the Scheduled Body Group may subsume the assets and liabilities, failing which they will fall to be funded by all employers in accordance with Regulation 64 (3)(b).

12.8. If the exit valuation shows a surplus, any exit credit will be paid to the exiting scheme employer within three months of the Fund receiving all the necessary information to process the payment.

12.9. Exit credits will generally be paid to the exiting employer, regardless of any side agreement between the exiting employer and associated scheme employer (i.e. the letting authority for outsourced contracts). Scheme employers should note that it is their responsibility to ensure that contracts and side agreements provide for the possibility of either a deficit or a surplus at the end of the contract when the exit valuation takes place.

12.10. The Administering Authority may deem that it in some circumstances it is not appropriate to make an exit payment to the exiting employer, for example if it is a stated condition of an employer providing a commitment to subsume the liabilities on exit that no surplus will be repaid to the exiting employer.

Town and Parish Councils

12.11. Under the Regulations an exit is triggered when the last active member leaves the Fund.

12.12. Given the unique nature of a Town or Parish Council, the Fund will not request an exit valuation immediately when the last member leaves as it may take some time to replace a member of staff and the Parish Council may wish to admit the new employers into the scheme. The Local Government Pension Scheme (Amendment) Regulations 2013 specifically introduced the power to suspend a demand for an exit payment for up to 3 years where the administering authority believes that the employer is likely to have one or more active members contributing to the fund within the period specified in the suspension notice. The Administering Authority considers that it would be appropriate to exercise that discretion in relation to Town and Parish Councils.

[3] Provision 22

12.13. The Fund will issue written notice of the period of the suspension notice. The employer must continue to pay any deficit payments and the actuary will recalculate any deficit at the next valuation.

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Panel and Board
Date:	28 September 2018
Title:	Governance: Pension Fund Costs 2017/18
Report From:	Director of Corporate Resources – Corporate Services

Contact name: Gemma Farley

Tel: 01962 847540 **Email:** Gemma.farley@hants.gov.uk

1. Recommendation

1.1. That the total cost of managing the Pension Fund for 2017/18 be noted.

2. Executive Summary

2.1. This report provides an overview of the costs of managing the Pension Fund in 2017/18.

3. Background

3.1. There are a variety of costs that are incurred in the management of the Pension Fund, which are disclosed in the Pension Fund's annual report and accounts under the following three categories:

- Investment management costs – the cost of managing the Fund's assets, which includes fees paid to the Fund's investment managers and its custodian. This includes the fees that are not paid directly for pooled and other investments, such as alternative investments like Hedge Funds and Private Equity that are netted off against investment income.
- Administration expenses – all activities the Administering Authority must perform to administer entitlements and provide members with scheme and benefit entitlement information.
- Oversight and governance – includes the costs of accounting for and monitoring the Pension Fund, plus the additional professional advice and support that is required by the Fund.

4. Total Pension Fund Management Costs

4.1. The total costs of managing the Pension Fund are shown in Table 1 below and also as a percentage of the average value of the Pension Fund in 2017/18 (2016/17 and 2015/16 costs are shown as a comparison):

Table 1: Total Pension Fund Management Costs

	2017/18		2016/17		2015/16	
	£000	%	£000	%	£000	%
Investment management	38,186	0.58	28,496	0.49	17,855	0.35
Administration	2,000	0.03	1,920	0.03	1,800	0.03
Oversight and governance	546	0.01	628	0.01	775	0.01
Total	40,732	0.63	31,044	0.53	20,430	0.39

4.2. Table 2 breaks down the investment management costs for 2017/18 by passive management, active management, and alternative investments (including property).

Table 2: Investment Management Costs for 2017/18

	£000	%
Passive investments	847	0.01
Active investments	10,419	0.16
Alternative investments (including Property)	26,513	0.41
Other (including custody and cash)	406	0.01
Total	38,186	0.58

4.3. The remainder of this report provides further detail on the three elements of the Pension Fund's management costs.

5. Investment management expenses

5.1. The Fund's business plan states that, as part of the Panel and Board's role it will make sure that its investment managers are providing value for money, it should review each year:

- the level of management fees paid to its investment managers in the previous financial year; and
- the level of transaction costs, in particular brokerage and stamp duty, incurred in the previous financial year.

5.2. Fees paid to the investment managers in 2017/18 are summarised in the confidential appendix. Fees are split into three categories:

- Direct – fees paid to investment managers as a percentage of the portfolio they manage according to their investment management agreement. Higher fees are payable to the 'active' managers who are aiming for high performance returns, with portfolios run on a passive basis attracting the lowest fees.
- Indirect – the cost of broker commissions and any stamp duty (taxes) incurred in the purchase and sale of equities and bonds by the Fund's

active managers, plus the costs incurred in the management of the Fund's direct property portfolio, such as legal and professional fees for managing tenants' leases, surveyors costs and the cost of any property repairs and maintenance that fall on the Fund, as well as any expenses incurred by investing via pooled funds.

- Pooled funds – fees applied to investments that the Fund holds, such as pooled and alternative investments. These fees will be the funds recovering their own management costs, plus performance fees in some instances. These costs are netted off against the investment income that these investments return to the Fund, so no costs are directly paid by the Fund. These costs are typically quite high due to the nature of Hedge Fund, Private Equity and Infrastructure investments, but are considered as part of the overall investment decision for every investment.

5.3. As shown in Table 1 of the confidential appendix, the cost of investment management increased as a percentage of asset value in 2017/18 in comparison to 2016/17; this was due to the following factors:

Private equity investments

5.4. A standard fee structure for a private equity/infrastructure/hedge fund investment is "2 and 20". This means a 2% management fee, charged on commitments, and a 20% performance fee, or share of any profits. During 2017/18, the investment manager who manages the private equity portfolio made a significant number of new commitments to increase the size of the portfolio to nearer the Pension Fund's target allocation. This resulted in an overall increase in commitment of £126m and consequently the fees charged has increased, as fees are charged on the full amount committed as soon as the commitment is made, even if funds are yet to be drawn-down.

5.5. In addition the majority of the indirect costs of this portfolio during 2017/18 incurred were a one off expense due to equalisation payments. When the Pension Fund invests in a limited partnership later than the initial limited partners, the Fund is required to pay an equalisation payment in order to compensate existing investors for the Fund taking a share in assets which have gone up in value since they were originally purchased.

Direct property expenses

5.6. The direct property portfolio has associated indirect costs which vary greatly each year dependent upon the volume and value of purchases and sales, and changes in tenancy. These expenses include land registry charges, surveyors' fees, insurance revaluations, advertising, utilities charges, maintenance fees, service charge, insurance, the annual valuation, internal legal services fees, and pooled fund expenses. Included within the costs for 2017/18 were a number of refurbishments of properties which are carried out between tenancy periods.

6. Administration

6.1. The cost of administration represents the cost of the staff and systems required to record the pension benefits accrued by active and deferred

scheme members, and pay pensioners once they retire. The cost of pension administration is often described as a cost per member. For Hampshire's 167,176 scheme members this figure is £11.96. This figure is one of the lowest for an LGPS fund, which is in line with Hampshire being in the top ten largest funds.

The performance of the administration of the Pension Fund is regularly reported to the Panel and Board giving more detail on the administration of the Fund. Administration costs per member have reduced from £12.00 per member in 2016/17 to £11.96 per member in 2017/18 as the increase in administration costs for 2017/18 were slightly less than the increase in the number of members.

7. Governance and oversight

7.1. Governance costs include the costs of staff that produce the Fund's accounts, monitor the Fund's investment managers and support the Panel and Board. In addition it includes the various professional services, such as actuaries, lawyers, consultants and advisors, which are required in supporting the Fund's activities and the Pension Fund's share to the external costs of the creating the ACCESS pool.

7.2. Governance costs reduced in 2017/18 in comparison to 2016/17 due to the fact that 2016/17 was the year where the actuaries worked on the triennial valuation as at 31 March 2016, and in addition the Fund worked with the actuary on de-grouping on the Fund's employers which added additional one-off costs.

CORPORATE OR LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	yes/no
People in Hampshire live safe, healthy and independent lives:	yes/no
People in Hampshire enjoy a rich and diverse environment:	yes/no
People in Hampshire enjoy being part of strong, inclusive communities:	yes/no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because: For the ongoing management of the Hampshire Pension Fund.	

Other Significant Links

Links to previous Member decisions:	
Title	Date
Direct links to specific legislation or Government Directives	
Title	Date

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document	Location
None	

IMPACT ASSESSMENTS:

1. Equality Duty

1.1. The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited under the Act;
- Advance equality of opportunity between persons who share a relevant protected characteristic (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

Due regard in this context involves having due regard in particular to:

a) The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;

b) Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;

c) Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionally low.

1.2. **Equalities Impact Assessment:**

Equality objectives are not considered to be adversely affected by the proposals in this report.

2. Impact on Crime and Disorder:

2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime.

3. Climate Change:

a) How does what is being proposed impact on our carbon footprint / energy consumption*?*

No specific impact.

b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact.

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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Agenda Item 9

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Agenda Item 10

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