Funding Strategy Statement

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1. Introduction

This section sets out the legislative context for the Funding Strategy Statement as well as the aims and purpose of the Fund and the responsibilities of the key parties.

1.1. Background

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.

1.2. 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 Solutions UK Limited, has also been consulted on the content of this FSS.

1.3. Purpose of the Funding Strategy Statement

The purpose of this FSS is 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.

The processes set out in this FSS detail the strategy which:

- 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.
- makes use of the provisions of Regulation 64(7A), 64A,and 64B

The overriding focus of the FSS are on those actions that are in the best long term interests of the Fund. Therefore, to ensure that all parties to the FSS share a common understanding, the aims and purpose of the Fund are set out below.

1.4. Aims of the Fund

The Fund has three main aims which are to:

- manage the employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due

- enable primary contribution rates to be kept 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 in Appendix 1.

1.5. 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 Pension Scheme (Management and Investment of Funds) Regulations 2016.

1.6. Roles and responsibilities of key parties

The efficient and effective management of the pension fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently. There are a wide range of stakeholders in LGPS funds, all of whom have a role in its effective management. For the purpose of the FSS, the roles and responsibilities of the three key parties; the administering authority, individual employer and the Fund actuary are set out in Appendix 2.

1.7. Links to 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).

1.8. 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.

2. Funding Strategy

2.1. 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 in sections 2.1.1 to 2.1.3 below.

2.1.1. Solvency

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.

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 secure scheduled bodies, and certain other bodies deemed to be of similarly sound covenant whose participation is indefinite in nature (including where the employer's liabilities would be funded by a secure scheduled body employer post-exit), the Solvency Target is set:

- at a level advised by the Fund Actuary as a prudent long-term funding objective for the Fund to achieve at the end of the Trajectory Period,
- based on continued investment in a mix of growth and matching assets intended to deliver a return above the rate of increases in

pensions and pensions accounts (CPI).

Thus the Solvency Target for secure Scheduled Body employers and certain other bodies generally assumes indefinite investment in a broad range of assets of higher risk than risk-free assets. At the 2019 valuation the Solvency Target was set at 2% above the long term assumed rate of CPI.

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 Solvency Target 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 where there is no commitment from a secure scheduled body to subsume the assets and liabilities on exit, particularly those which do not admit new members, anticipates the approach to valuing the liabilities on exit – the "ongoing orphan funding target" as defined later 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 – the ‘intermediate funding target(s)’.

For deferred employers it is expected that the Solvency Target will be set by considering the valuation basis which would be adopted once the Deferred Debt Agreement (DDA) ends. For most such bodies, the Solvency Target will be set commensurate with assumed investment in Government bonds at the end of the period of the DDA.

2.1.2. 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 for the secure scheduled bodies at the 2019 valuation.

When an actuarial valuation shows that an employer is in deficiency, the employer's 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 16 years for all employers in the Fund from 1 April 2020. The maximum recovery period is determined at each actuarial valuation by balancing the Fund’s solvency and long-term cost efficiency requirements against considerations of affordability and stability of contributions, taking account of the financial strength of the Fund’s main scheduled employers.

The same principles apply when an employer is in surplus except for employers of reduced covenant whose position is in deficit on an exit basis, where the Administering Authority may not permit reduced contributions below the primary contribution rate.

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 16 years for the secure scheduled bodies in the 2019 actuarial valuation. In determining the recovery period which applies to other employers the Administering Authority may take into account, without limitation, the following factors:

- the expected remaining period of participation
- the type/group of the employer
- the size of the funding shortfall or surplus;
- the business plans of the employer;
- the assessment of the financial covenant of the employer;
- any contingent security available to the Fund or offered by the employer such as a guarantor or bond arrangements, charge over assets, etc.
- the views of the subsuming employer where the funding target adopted is dependent upon another employer subsuming the assets and liabilities post-exit.

2.1.3. 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' 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.

2.2. 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. The discount rate is a key driver of the Funding Target and is set allowing for the assumed investment strategy and level of risk considered appropriate in light of the employer covenant and treatment of liabilities on exit. For the secure scheduled bodies who collectively comprise around 85% of the Fund's liabilities the discount rate is set by considering the Fund's long-term investment strategy and the Administering Authority's risk preference, measured via the chance of achieving the Solvency Target at the end of the Trajectory Period (defined above).

Different funding targets are adopted for different employers as set out in the Employer Policy. At the 2019 valuation the funding targets adopted were as follows:

- secure scheduled body funding target for scheduled bodies expected to participate indefinitely, and any employers with a subsumption commitment from such an employer, other than academy contractors admitted prior to 1 April 2019
- intermediate funding targets for Tier 3 scheduled bodies based on a risk assessment carried out by the Fund Actuary, and any employers with a subsumption commitment from such an employer
- ongoing orphan funding target for admission bodies expected to leave orphan liabilities on exit, and any academy contractors admitted prior to 1 April 2019
- low risk (gilts) funding target for the liabilities of former employers where these are orphaned

Employers who are able to provide security, including but not limited to a charge over assets may be permitted to pay ongoing contributions below the appropriate target level. The employer should recognise that underpayment of contributions is more likely to lead to additional contributions being required at subsequent reviews.

For deferred employers where a DDA is in place, the funding target will take into account any likely change in the notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date the DDA is expected to end and any other factors considered to be relevant by the Administering Authority on the advice of the Actuary, which may include, without limitation:

- the agreed period of the DDA;
- the type/group of the employer;
- the business plans of the employer;
- an assessment of the financial covenant of the employer;
- any contingent security available to the Fund or offered by the employer such as a guarantor or bond arrangements, charge over assets, etc.

Consistent with the aim of enabling employers' 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.

2.3. Grouping of Employers

2.3.1. Group funding framework

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.

The group funding framework is set out in more detail in Appendix 3.

2.3.2. Funding principles applying to grouped employers

Risk sharing exists within groups. 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 percentage of pay contribution rate for employers in the group
- Only the group funding target is relevant when producing a common primary contribution rate
- Funding targets used to assess ongoing contributions at the triennial valuation are set using an ongoing actuarial basis that assumes participation is indefinite (or, if participation is not indefinite, that a secure scheduled body has committed to subsume the assets and liabilities of the employer on exit)
- Employers are liable to fund deficiencies emerging at each valuation in

proportion to their own liabilities at the time of the valuation

- When employers exit the Fund they will be assumed to leave the group, even where a DDA is entered into. The funding target adopted at that time will depend on whether the 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).

2.4. Further aspects of funding strategy

2.4.1. 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.

2.4.2. 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.

2.4.3. 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.

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.

The Fund is not formally unitised for the purpose of notionally allocating assets to employers. The Fund Actuary calculates a notional asset allocation for each employer (or group of employers) at each triennial valuation, or at interim dates as may be required, based on cashflows relating to the employer (or group of employers) and investment returns earned by the Fund. Unless the Fund Actuary is notified of specific and material one-off payments, including bulk transfers and prepayment of employer contributions, cashflows in each scheme year ending

31 March will be assumed to be accrued evenly over the scheme year and will attract half of the investment returns earned over that year. For specific and material one-off payments such as bulk transfers and advance payment of employer contributions (see below), investment returns on those payments (estimated where appropriate) for the relevant scheme year will be credited from the date of payment to the end of the relevant scheme year, unless otherwise

notified by the Administering Authority.

For additional employer contributions, investment returns on those payments will be credited from the first day of the next quarter following payment to the end of the relevant scheme year.

2.4.4. 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 deficiency.

2.4.5. Advance payment of employer contributions

The Administering Authority will allow any employer apart from those in the Academies Group to pre-pay secondary contributions. In addition, any employer who is not part of a group can choose to pre-pay their primary contributions.

Pre-payments can be made annually or triennially in advance, and will attract a discount as agreed with the Administering Authority on the advice of the Fund's Actuary. Pre-payments of primary contributions will be subject to an annual true up once actual annual pensionable payroll is known.

To adhere to the LGPS Regulations all employers must contribute at least an amount in each scheme year equivalent to the administration charge of 0.3% of payroll each year. Employers who pay their primary contributions triennially in advance must make a payment equal to 0.3% of payroll on 1 April in years 2 and 3. This payment will also attract a discount and be subject to an annual true up once actual annual pensionable payroll is known.

Any employer wishing to enter into a pre-payment arrangement must engage with the Administering Authority prior to the scheme year in which the pre-payment is being made.

Full details of how the discount is calculated and the administrative process for the payment of the annual administration charge and the end of year true up procedure will be made available to employers who wish to consider taking this option.

2.4.6. Additional payments by employers

Employers must contribute the amounts certified by the Fund's Actuary in each valuation period. However, these are the minimum contributions required and employers (other than those in the Academies Group) can choose to make additional payments.

The additional payment will be credited to the employer and will be allocated investment returns from the start of the quarter following the receipt of the payment.

3. Security

3.1. Guarantors

Some employers may have been admitted to 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, although in determining the contributions the Administering Authority would have regard to the intentions of the Guarantor and its agreement with the Admission Body. The Guarantor should ensure that it is clear what would happen to any surplus arising on the subsequent exit of the Admission Body, in particular whether or not an exit credit would become payable.

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 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.

3.2. 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 regularly, at least once a year.

In relation to existing employers, including Scheduled Bodies, the Administering Authority will consider whether provision of security, including but not limited to a charge over assets; Government guarantee; or subsumption commitment from a long-term secure scheduled body is sufficient to justify reviewing an employer's contributions between triennial valuations in line with Regulation 64A and its policy on use of these provisions.

4. Exiting the fund

4.1. Exiting the Fund

Where an employer meets the relevant criteria, an exit valuation will be carried out in accordance with Regulation 64. The exit valuation and any associated exit payment due 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, including any agreement to spread the exit payment or Deferred Debt Agreement.

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.

"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 and, for transfers on or after 1 April 2019, more than 10 employees transferred to the admission body. For all other employers, and for transfers on or after 1 April 2019 where 10 or fewer employees transfer from an academy to an admission 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.

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, unless a Deferred Debt Agreement is entered into, 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.

An allowance for the costs of the McCloud remedy and GMP equalisation will be included for exit payments calculated on or after 27 September 2019. As an interim measure given the uncertainty, exit payments will be calculated assuming that McCloud will lead to a 0.4% increase in the liabilities, and GMP indexation will be provided in full for all of the exiting employer’s members whose State Pension Age is on or after 1 April 2016. This allowance will be kept under review and will be updated as agreed by the Administering Authority on the advice of the Fund Actuary.

4.2. Spreading exit deficits

Any exit deficit would normally be levied on the departing employer as a single capital payment although the Administering Authority may allow phased payments as permitted under Regulation 64B. The Administering Authority's policy in relation to the spreading of exit payments under Regulation 64B is summarised below and set out in more detail in Appendix 4. below.

It is envisaged that spreading of exit payments will only be considered at the request of an employer. The Administering Authority will then engage/consult with the employer to consider its application and determine whether or not spreading the exit payment is appropriate and the terms which should apply.

In determining whether or not to permit an exit payment to be spread, the Administering Authority will consider factors including, but not limited to:

- the ability of the employer to make a single capital payment;
- whether any security is in place, including a charge over assets, bond, guarantee or other indemnity;
- whether the overall recovery to the Fund is likely to be higher if spreading the exit payment is permitted.

In determining the employer's ability to make a single payment the Administering Authority will seek actuarial, covenant or legal advice as required. Where the Administering Authority considers that the employer is financially able to make a single capital payment it will not normally be appropriate for the exit payment to be spread.

4.3. Deferred debt agreements

Regulation 64(7A) permits the Administering Authority to enter into a written agreement with an exiting Scheme employer for that employer to defer their obligation to make an exit payment and continue to make contributions at the secondary rate ("a deferred debt agreement," or "DDA"). An employer which has entered into a DDA is known as a 'deferred employer'.

The Administering Authority's policy in relation to the entering into DDAs under Regulation 64(7A) is set out in Appendix 4 and summarised below.

In determining whether or not to enter into a DDA with an employer the Administering Authority will take into account the following factors, including but not limited to:

- the materiality of the employer and any exit deficit in terms of the Fund as a whole;
- the risk to the Fund of entering into a DDA, in terms of the likelihood of the employer failing before the DDA has ended, based on information supplied by the employer and supported by a financial risk assessment or more detailed covenant review carried out by the Fund Actuary or other covenant adviser
- the rationale for the employer requesting a DDA, particularly if the Administering Authority believes it would be able to make an immediate payment to cover the exit deficit; and
- whether an up front payment will be made towards the deficit, and/or any security is, or can be put, in place, including a charge over assets, bond, guarantee or other indemnity, to reduce the risk to other employers.

Where it is expected that the employer's covenant may materially weaken over time, or where the employer's financial capacity to support an increase in the exit debt is limited, the Administering Authority is very unlikely to consider entering into a DDA with that employer. Further, where an employer can demonstrably meet the exit payment in a single instalment, the Administering Authority would be unlikely to enter into a DDA unless it was clear that this wouldn't increase risk to the Fund, e.g. if the employer was fully taxpayer-backed and sufficient assurance was in place that all contributions due, including any residual deficit at the end of the DDA, would be met in full. The Administering Authority is also unlikely to enter into a DDA for very small employers where it considers the administration and advisory costs of doing so are disproportionate.

4.4. Surpluses

Where an employer exits on or after 14 May 2018 and the exit valuation determines that the departing employer is in surplus, the payment of an exit credit will be made at the discretion of the Administering Authority, after taking into account the factors set out in the LGPS 2013 regulations namely;

a) the extent to which there is an excess of assets in the fund relating to that employer over the liabilities
b) the proportion of this excess of assets which has arisen because of the value of the employer’s contributions;
c) any representations to the administering authority made by the exiting employer or letting authority;
d) any other relevant factors.

Other relevant factors include but are not limited to the basis of the exit valuation, the extent to which the exiting employer was responsible for the funding risk during their participation in the Fund and the existence or otherwise of a commitment from another ongoing employer in the Fund to subsume liabilities on exit.

This may mean that no exit credit is due 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 a secure scheduled employer to subsume the liabilities on exit.

Employers who are letting contracts need to ensure their contractual arrangements cover the treatment of exit credits and that they notify the Fund if these arrangements mean that a surplus should be retained by the letting authority. Representations from employers will be considered on a case by case basis although if a contract pre dates 14 May 2018 and is silent on the treatment of an exit credit, payment will usually only be made to the departing employer if they would have also paid for an exit deficit.

Where an exit valuation is carried out on a low risk basis, the exit credit will usually be equal to the excess of assets over the liabilities, less any costs.

The exit credit will be paid to the departing employer within six months of the date of exit or such longer period as is agreed with the exiting employer. It will be deemed that an employer agrees to a longer period where all relevant information is not provided within one month of the exit date.

Any actuarial or legal costs of the exit will be deducted from the exit credit before payment, unless there is a good reason to accept separate payment for these.

4.5. 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.

4.6. Interim reviews for employers which may exit the Fund

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 participation is assumed to be indefinite, interim valuations under Regulation 64(4) 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 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 (using Regulation 64A if required – see next section).
- 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.

The Administering Authority reserves the right to request an interim valuation of any employer's liabilities at any time in accordance with Regulation 64(4).

4.7. Inter-valuation funding valuations

Regulation 64A enables employer contributions to be reviewed between triennial valuation where:

(i) it appears likely to the administering authority that the amount of the liabilities arising or likely to arise has changed significantly since the last valuation;

(ii) it appears likely to the administering authority that there has been a significant change in the ability of the Scheme employer(s) to meet the obligations of employers in the Scheme; or

(iii) a Scheme employer(s) has requested a review of Scheme employer contributions and have undertaken to meet the costs of that review.

The Administering Authority's policy on use of these provisions is set out in Appendix 4.

5. 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 summarised in Appendix 5.

Appendix 1 – Aims of the Fund

The Fund has three main aims:

- to manage the employers' liabilities effectively
- to enable primary contribution rates to be kept as nearly constant as possible
- to seek returns on investment within reasonable risk parameters.

These are detailed 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. For the purpose of determining the Solvency Target for individual employers, the Administering Authority may without limitation, take into account the following factors:

- the type/group of the employer;
- the business plans of the employer;
- an assessment of the financial covenant of the employer;
- any contingent security available to the Fund or offered by the employer such as a guarantor or bond arrangements, charge over assets, etc.;
- whether the employer has set up a subsidiary company to employ staff which does not participate in, or admit new employees to, the Fund

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 publishes an Employer Policy which explains in more detail the funding policies for certain categories of employer

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 funding 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.

In determining the extent to which stability measures are needed to keep primary contributions as nearly constant as possible, the Administering Authority will also consider how secondary contributions are changing, i.e. where possible, and consistent with other regulatory objectives, this objective will in practice relate to employers' total contributions (primary and secondary).

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 phasing in of changes to employers' contribution rates over a period of up to three years. Care needs to be taken in relation to employers closed to new entrants and other bodies whose participation in the Fund could potentially be of limited duration through known constraints or reduced covenant (for example, non-local authority employers awarded contracts to provide local authority services, and less secure scheduled bodies), where use of phasing to smooth contribution rate changes is less appropriate.

The Administering Authority recognises that a balance needs to be struck regarding the financial demands made of scheme employers of reduced covenant. On the one hand, the Administering Authority requires all scheme employers 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 bodies. On the other hand, requiring contributions to target full funding at all times, without further smoothing (phasing), may cause failure of the body in question in periods of extreme economic conditions, leading to significant costs for other participating employers. The Administering Authority will therefore consider phasing periods longer than three years 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.

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 investment advisors and its investment managers.

The Fund's funding strategy, based on the discount rate adopted for the majority of employers/liabilities at the 2019 actuarial valuation, requires the assets to deliver a long-term return above 4.4% p.a., (the discount rate) compared to the Fund Actuary's best estimate for the Fund's average return of 5.7% p.a. as at March 2019. 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 updated structure and managers are in the Investment Strategy Statement.

Appendix 2 – Roles and responsibilities of key parties

The 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 pension fund the relevant entitlements as stipulated in LGPS Regulations
- invest surplus monies in accordance with the LGPS Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- take measures as set out in the regulations to safeguard the fund against the
- consequences of employer default
- manage the valuation process in consultation with the fund's actuary
- prepare and maintain an FSS and an SIP/ISS, 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 fund administrator and scheme employer
- enable the local pension board to review the valuation process as set out in their terms of reference.

The individual employer is required to:

- deduct contributions from employees' pay correctly
- pay all ongoing contributions, including employer contributions determined by the actuary and set out in the rates and adjustments certificate, promptly by the due date
- develop a policy on certain discretions and exercise those 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 funding aspects of individual benefit-related matters such as pension strain costs, ill health, retirement costs, compensatory added years costs, etc
- provide advice and valuations on the exiting of employers from the fund
- provide advice 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.

Appendix 3 - Group funding framework

Group funding framework

Prior to 1 April 2019 all the secure scheduled bodies in the Fund participated in a grouped funding arrangement called the 'Scheduled Body Group'. With effect from 1 April 2019 the Scheduled Body Group was disbanded, with employers either entering new group funding arrangements (see below) or having their contributions assessed on an individual basis.

With effect from 1 April 2019 there are three groups of employers for funding purposes; the Town and Parish Councils Group (TPCG), the Academies Group (AG) and the Admission Body Group (ABG). Employers within a group share all risks of participation with other employers in the group, with the exception of liability for:

- ill health pensions, partner's pensions and lump sum benefits payable on death in service (which are shared across all employers in the Fund)
- secondary contributions (in relation to the ABG and TPCG only).

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.

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

Town and Parish Council Group

The Town and Parish Council Group was created on 1 April 2019. The Group was credited with a notional asset transfer from the Scheduled Body Group based on a share of Fund of the Scheduled Body Group at 31 March 2019.

The TPCG includes Town and Parish Council employers under Part 2 (paragraph

2) of Schedule 2 of the Regulations who, due to being relatively small employers, benefit from being able to share risks with a wider pool.

A Town or Parish Council was able to elect by 15 August 2019 to opt out of the TPCG at the 2019 valuation and instead have an individual contribution rate. An option to leave the TPCG will be given as part of all subsequent valuations. An election to leave the TPCG is irrevocable.

Employers within the TPCG share all risks arising in the TPCG since the previous valuation in proportion to liabilities at the valuation date. The first such valuation date at which this risk sharing will be calculated will be 31 March 2022. There is an exception for secondary contributions paid by employers over the intervaluation period, which will not be shared, and will be credited to each employer's notional asset allocation of the TPCG.

Most employers within the TPCG will have a common recovery period for deficit contributions, which was set as 16 years at the 2019 valuation. Where an employer in the TPCG notifies the Administering Authority of a decision to stop designating posts as being eligible for membership of the LGPS a shorter recovery period may be used.

Employers of the TPCG will be credited with a notional asset allocation at each valuation for the purposes of setting contribution rates. The asset allocation will be determined based on the risk sharing framework set out above. This notional asset allocation will also be relevant for calculating an exit valuation or calculations under FRS102/IAS19.

Academies Group

The Academies Group (AG) was created on 1 April 2019. The Group was credited with a notional asset transfer from the Scheduled Body Group based on a share of Fund of the Scheduled Body Group at 31 March 2019.

The AG includes all Academies, Free Schools and Multi Academy Trusts under Part 1 (paragraph 20) of Schedule 2 of the Regulations, which are covered by the Department for Education guarantee.

For the avoidance of doubt, the AG includes any academy created from a former higher or further education body. However, the organisation can choose to make an irrevocable decision not to join the AG at the later of the date of conversion or the signing of the 2019 valuation rates and adjustments certificate.

Employers within the AG share all risks in proportion to liabilities. Employers will be responsible for paying a share of the deficit contributions to the AG in proportion to their liabilities in the AG at the relevant valuation.

Employers in the AG will have a common recovery period for deficit contributions which was set as 16 years at the 2019 valuation.

Employers of the AG are not credited with individual notional asset allocations at each valuation for the purposes of setting contribution rates, as deficit contributions are certified based on the funding level of the group. For the purpose of calculating an exit valuation or calculations under FRS102/IAS19, employers in the AG are 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.

Admission Body Group

The Admission Body Group (ABG) consists of a number of charitable and not for profit admission bodies. The Administering Authority views the purpose of the ABG 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. With effect from 1 April 2019 all employers within the ABG have a commitment from a secure scheduled employer to subsume their liabilities on exit.

Employers participating in the ABG on 31 March 2019 without such commitment exited the grouped funding arrangement on that date and became stand-alone employers. Those employers were credited with a notional asset allocation equal to a share of Fund of the Admission Body Group at 31 March 2019.

From 1 April 2019 employers within the ABG will share all risks arising in the ABG since the previous valuation in proportion to liabilities at the valuation date. The first such valuation date at which this this risk sharing will be calculated will be

31 March 2022. There is an exception for secondary contributions paid by employers over the intervaluation period, which will not be shared, and will be credited to each employer's notional asset allocation of the ABG.

Employers in the ABG will have individual recovery periods for deficit contributions based on the average future working lifetime of their active members. This will be subject to the maximum 16 year recovery period set at the 2019 valuation for secure scheduled body employers.

Employers of the ABG will be credited with a notional asset allocation at each valuation for the purposes of setting contribution rates. The asset allocation will be determined based on the risk sharing framework set out above. This notional asset allocation will also be relevant for calculating an exit valuation or calculations under FRS102/IAS19.

Appendix 4 – Employer flexibilities and exits

The Administering Authority's policy on the use of Regulation 64 in relation to employer flexibilities is set out below.

Spreading exit payments

The spreading of exit payments will only be considered at the request of an employer. Where there is a guarantor, the guarantor will also be consulted and any agreement to spread the exit deficit may be conditional on the guarantee continuing in force during the spreading period. Whilst the Administering Authority's preference would be for an employer to request spreading of any exit payment in advance of the exit date, it is acknowledged that a final decision by the employer (and the Administering Authority) on whether this will be financially beneficial/appropriate may not be possible until the employer has exited.

The employer will be required to provide details of its financial position, business plans and financial forecasts and such other information as required by the Administering Authority in order for it to make a decision on whether or not to permit the exit payment to be spread. This information must be provided within 2 months of request.

In determining the appropriate length of time for an exit payment to be spread, the Administering Authority will consider the affordability of the instalments using different spreading periods for the employer. The default spreading period will be three years but longer periods of up to ten years may be considered where the Administering Authority is satisfied that this doesn't pose undue risk to the Fund in relation to the employer's ability to continue to make payments over the period.

Whilst the Administering Authority's preference would be for an employer to request spreading of any exit payment in advance of the exit date, it is acknowledged that a final decision by the employer (and the Administering Authority) on whether this will be financially beneficial/appropriate may not be possible until the employer has exited. Exiting employers will be advised of the exit deficit and the spreading of any payment will only be considered at the request of the employer. Where there is a guarantor, the guarantor will also be consulted and any agreement to spread the exit deficit may be conditional on the guarantee continuing in force during the spreading period.

The amount of the instalments due under an exit deficit spreading agreement will generally be calculated as level annual amounts allowing for interest over the spreading period in line with the discount rate used to calculate the exit liabilities. Where the exit amount is significant, monthly payments may be required or the Administering Authority may require a higher initial payment with lower annual payments thereafter to reduce the risk to the Fund. Alternative payment arrangements may be made in exceptional circumstances as long as the Administering Authority is satisfied that they don't materially increase the risk to the Fund.

Where the Administering Authority has agreed to spread an exit payment the Administering Authority will advise the employer in writing of the arrangement, including the spreading period; the annual payments due; interest rates applicable; other costs payable* and the responsibilities of the employer during the spreading period. Where a request to spread an exit payment has been denied the Administering Authority will advise the employer in writing and provide a brief explanation of the rationale for the decision. The Administering Authority will endeavor to notify the employer of its decision within 2 months of the provision of the required information by the employer. The employer will be given a period of 1 month to respond to the decision. Payments will be expected to commence by the later of 2 months following the Administering Authority's decision, or 6 months of the exit date. If there is no agreement between both parties within this timeframe the Administering Authority will instruct the Fund Actuary to certify the exit payment due as an immediate capital payment.

*Employers will be asked to pay all advisory costs associated with the spreading agreement as well as calculation of the exit deficit (these costs will not be spread).

The Administering Authority will generally review spreading agreements as part of its preparation for each triennial valuation and will take actuarial, covenant, legal and other advice as considered necessary. In addition, employers will be expected to engage with the Administering Authority during the spreading period and adhere to the notifiable events framework as set out in the Pensions Administration Strategy. If the Administering Authority has reason to believe the employer's circumstances have changed such that a review of the spreading period (and hence the payment amounts) is appropriate, it will consult with the employer and a revised payment schedule may be implemented. Whilst this review may also consider the frequency of payments, it should be noted that it is not envisaged that any review will consider changes to the original exit amount nor interest rate applicable. An employer will be able to discharge its obligations under the spreading arrangement by paying off all future instalments at its discretion. The Administering Authority will seek actuarial advice in relation to whether or not there should be a discount for early payment given interest will have been added in line with the discount rate used for the exit valuation.

Deferred debt agreements

It is envisaged that DDAs will only be entered into at the request of an employer. In all cases the Administering Authority will then engage/consult with the employer determine whether or not a DDA is appropriate and the terms which should apply. As part of its application for a DDA, the Administering Authority will require information from the employer to enable the Administering Authority to take a view on the employer's strength of covenant. Information will also be required on an ongoing basis to enable the employer's financial strength/covenant to be monitored. Employers should be aware that all advisory fees incurred by the Fund associated with a request for a DDA, whether or not this results in an agreement being entered into, and its ongoing monitoring, will be recharged to the employer.

The Administering Authority has a template agreement for DDAs, which it will require employers (and any guarantors) to sign up to. The matters which the Administering Authority will reflect in the DDA, include:

- an undertaking by the employer to meet all requirements on Scheme employers, including payment of the secondary rate of contributions, but excluding the requirement to pay the primary rate of contributions;

- a provision for the DDA to remain in force for a specified period, which may be varied by agreement of the Administering Authority and the deferred employer;
- a provision that the DDA will terminate on the first date on which one of the following events occurs-
  - (a) the deferred employer enrols new active members;
  - (b) the period specified, or as varied, elapses;
  - (c) the take-over, amalgamation, insolvency, winding up or liquidation of the deferred employer;
  - (d) the Administering Authority serves a notice on the deferred employer that it is reasonably satisfied that the deferred employer's ability to meet the contributions payable under the deferred debt arrangement has weakened materially or is likely to weaken materially in the next 12 months; or
  - (e) the Fund Actuary assesses that the deferred employer has paid sufficient secondary contributions to cover the exit payment that would have been due if the employer had become an exiting employer on the calculation date.
- the responsibilities of the deferred employer
- the circumstances triggering a cessation of the arrangement leading to an exit payment (or credit) becoming payable, in addition to those set out in Regulation 64 (7E) and above
- It is expected that the consultation process with the employer will include discussions on the precise details of the DDA, although the purpose of developing a template agreement is to make the process easier, quicker and cheaper and therefore it is not envisaged that there will be material changes to the Administering Authority's template.

The Administering Authority will monitor the funding position and risk/covenant associated with deferred employers on a regular basis. This will be at least triennially and most likely annually, but the frequency will depend on factors such as the size of the employer and any deficit and the materiality of movements in market conditions or the employer's membership.

The circumstances in which the Administering Authority may consider seeking to agree a variation to the length of the agreement under regulation 64(7D) include:

- where the exit deficit has reduced (increased) such that it is reasonable to reduce (extend) the length of the recovery period and associated period of the DDA assuming that, in the case of the latter, this does not materially increase the risk to the other employers/Fund
- where the deferred employer's business plans, staffing levels, finances or projected finances have changed significantly, as long as, in the case of a deterioration, the Administering Authority, having taken legal, actuarial, covenant or other advice as appropriate, does not consider that there is sufficient evidence that deferred employer’s ability to meet the contributions

payable under the DDA has weakened materially, or is likely to weaken materially in the next 12 months

- where the level of security available to the Fund has changed in relation to the DDA, as determined by the Administering Authority, taking legal, actuarial or other advice as appropriate

At each triennial valuation, or more frequently as required, the Administering Authority will carry out an analysis of the financial risk or covenant of the deferred employer, considering actuarial, covenant, legal and other advice as necessary. Where supported by the analysis and considered necessary to protect the interests of all employers, the Administering Authority will serve notice on the deferred employer that the DDA will terminate on the grounds that it is reasonably satisfied that the deferred employer's ability to meet the contributions payable under the DDA has weakened materially, or is likely to weaken materially in the next 12 months, as set out under regulation 64(7E)(d). It is expected that DDAs will be monitored on an annual basis unless circumstances dictate otherwise. Monitoring may be more frequent as the end of the period of the DDA approaches.

Employers should be aware that all advisory fees and administrative expenses incurred by the Fund associated with consideration of a DDA for an exiting employer, whether or not this results in a DDA being entered into, will be recharged to the employer. This will include actuarial, legal, covenant and other advice and the costs of monitoring the arrangement as well as the initial set up. Estimated costs can be provided on request. All fees must be paid up front and cannot be added to any secondary contributions payable under the DDA.

It is expected that employers will make a request to consider a DDA before they would otherwise have exited the Fund under Regulation 64(1) and that a DDA should be entered into within 3 months of that date. The employer should continue to make secondary contributions at the prevailing rate whilst the DDA is being considered unless the Administering Authority, having taken actuarial and other advice as appropriate, determines that increased contributions should be payable. In exceptional circumstances, e.g. where there has been a justifiable delay due to circumstances outside of the employer's control, and at the sole discretion of the Administering Authority, a DDA may be entered into more than 3 months after the exit date.

Deferred employers will be expected to engage with the Administering Authority during the period of the DDA and adhere to the notifiable events framework as set out in the Pensions Administration Strategy as well as providing financial and other information on a regular basis. This will be necessary to support the effective monitoring of the arrangement and will be a requirement of the DDA.

Inter-valuation funding valuations

Regulation 64A enables employer contributions to be reviewed between triennial valuation where:

(i) it appears likely to the administering authority that the amount of the liabilities arising or likely to arise has changed significantly since the last valuation;

(ii) it appears likely to the administering authority that there has been a significant change in the ability of the Scheme employer(s) to meet the obligations of employers in the Scheme; or

(iii) a Scheme employer(s) have requested a review of Scheme employer contributions and have undertaken to meet the costs of that review.

Factors used to determine when a review is appropriate

In determining whether or not a review should take place, the Administering Authority will consider the following factors (noting that this is not an exhaustive list):

- the circumstances leading to the change in liabilities arising or likely to arise, for example whether this is the result of a decision by the employer, such as the restructuring of a council due to a move to unitary status, the restructuring of a Multi-Academy Trust, a significant outsourcing or transfer of staff, closure to new entrants, material redundancies or significant pay awards, or other factors such as ill-health retirements, voluntary withdrawals or the loss of a significant contract
- the materiality of any change in the employer's membership or liabilities, taking account of the Actuary's view of how this might affect its funding position, primary or secondary contribution rate
- whether, having taken advice from the Actuary, the Administering Authority believes a change in ongoing funding target or deficit recovery period would be justified, e.g. on provision or removal of any security, subsumption commitment, bond, guarantee, or other form of indemnity in relation to the employer's liabilities in the Fund
- the materiality of any change in the employer's financial strength or longer-term financial outlook, based on information supplied by the employer and supported by a financial risk assessment or more detailed covenant review carried out by the Fund Actuary or other covenant adviser to the Fund
- the general level of engagement from the employer and its adherence to its legal obligations as set out in the Pensions Administration Strategy Statement and elsewhere, including the nature and frequency of any breaches such as failure to pay contributions on time and data quality issues due to failure to provide new starter or leaver forms

Assessment of the risk/impact on other employers

In determining whether or not a review should take place, the Administering Authority will generally focus on the materiality of any potential changes in the context of the employer concerned; its financial position and current contribution levels. As a matter of principle, the Administering Authority does not consider that a review is not justified just because an employer is small in the context of the Fund as a whole, noting that failure to act could make discussions at the next formal valuation more difficult and compound the risk to the Fund. However, in determining the extent and speed of any changes to the employer's contributions the Administering Authority will consider the effect on the overall funding position of the Fund, i.e. other Scheme employers.

Where contributions are being reviewed for an employer with links to another Fund employer, particularly where there is a formal organisational or contractual link, e.g.

there is a tripartite admission agreement, an ownership relationship or a formal guarantee or subsumption commitment is in place, the Administering Authority will consider the potential risk/impact of the contribution review on those other employer(s), taking advice from the Fund Actuary as required.

Employer involvement and consultation

It is expected that in most cases the employer will be aware of the proposed review of their contributions since this will be triggered by an employer's action and employers should be aware of the need to engage with the Fund in relation to any activity which could materially affect their liabilities or ability to meet those liabilities. A list of notifiable events is set out in the Administration Strategy.

In other cases information will be required from the employer, e.g. in relation to its financial position and business plans which could be the catalyst for informing the employer that a review is being proposed. In all cases the Administering Authority will advise the employer that a review is being carried out and share the results of the review and any risk or covenant assessment as appropriate. It should be noted that just because a review is being carried out does not automatically mean that contributions will be amended (up or down) since that will depend upon the materiality of the changes and other factors such as the outcome of discussions with the employer and any related/linked employer in the Fund and the proximity to the next formal valuation.

Where, following representations from the employer, the Administering Authority is considering not increasing the employer's contributions following a review, despite there being good reason to do so from a funding and actuarial perspective, e.g. if it would precipitate the failure of the employer or otherwise seriously impair the employer's ability to deliver its organisational objectives or it is expected that the employer's financial position will improve significantly in the near-term, the Administering Authority will consult with any employer which provides a guarantee or subsumption commitment or, if none exists, will take the decision on behalf of all employers noting Hampshire County Council is the largest employer in the Fund and any unmet liabilities on exit are shared in proportion to each employer's liabilities.

Process for requesting a review

Before requesting a review, employers should consider the regulatory requirements and the Fund's policy as set out above and satisfy themselves that there has been a relevant change in the expected amount of liabilities or their ability to meet those liabilities. The employer should contact Employer Services and complete the necessary information requirements for submission to the Administering Authority in support of their application.

The Administering Authority will consider the employer's request and may ask for further information or supporting documentation/evidence as required. If the Administering Authority, having taken actuarial advice as required, is of the opinion that a review is justified, it will advise the employer and provide an indicative cost. Employers should be aware that all advisory fees and administrative expenses incurred by the Fund associated with a contribution review request, whether or not this results in contributions being amended, will be recharged to the employer.

Other considerations

The Administering Authority will carry out an annual assessment of the risk for Tier 3 employers as considered appropriate. This will help identify whether a contribution review is required and is expected to be carried out as at each 30 September with any contribution changes effective from the following 1 April.

More generally, the Administering Authority may carry out a review at any time during the valuation cycle where it becomes aware that a review is required. In such cases the employer will be expected to provide the requested information within one month of request and the review will be completed within 6 weeks of the provision of all requested information, or completion of the risk/covenant assessment if later.

The Administering Authority will consult with the employer on the timing of any contribution changes and there will be a minimum of 4 weeks' notice given of any contribution increases. In determining whether, and when, any contribution changes are to take effect the Administering Authority will also take into account the timing of contribution changes flowing from the next formal valuation. As a result, contribution reviews are unlikely to be carried out during the 12 month period from the valuation date although if there were any material changes to the expected amount of liabilities arising or the ability of the employer to meet those liabilities during that period, this should be taken into account when finalising the Rates and Adjustments Certificate flowing from the valuation.

Appeals process

In the event of any dispute, employers should contact Pension Services for an informal discussion. Any formal appeal will be heard under the Fund's Internal Dispute Resolution Process.

Appendix 5 – Risks and counter measures

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 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 taking advice from its Investment Advisors as appropriate. The Investment Strategy is considered annually and a formal review is also undertaken at least following each Actuarial Valuation, with advice taken from Investment Advisors and Fund Managers. The Administering Authority also reviews the effect of any significant market movements on the Fund's overall funding position between Actuarial Valuations.

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 where employers are unable to meet their obligations to the Scheme. The response to the COVID-19 pandemic may have adverse consequences in relation to employer finances and their ability to make contributions. The Administering Authority monitors employer payments and expects employers in financial difficulty to engage with the Fund, noting that contributions can be reviewed between formal valuations if the conditions in Regulation 64A and the terms of the Administering Authority's policy, as set out in the Employer Policy, are met.

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 FSS. In addition, the Administering Authority commissions the Fund Actuary to carry out a high level risk assessment for employers, as appropriate to inform its funding strategy. In due course it will also ask the Fund Actuary to review the funding position of any deferred employers on a regular basis between triennial valuations, noting that the Regulations specifically provide for a deferred debt agreement to end when the Actuary assesses that the deferred employer has paid sufficient secondary contributions to cover the exit payment that would have been due if the employer had become an exiting employer on the calculation (review) date.

Liquidity and maturity risk

The Fund's membership has matured in recent valuations and this, together with the improvement in the funding position and hence reduction in contributions from the long-term secure employers has potential cash flow implications. In addition, it is possible that proposed changes to cap exit payments may lead to employers bringing forward redundancy programmes, cuts and their implications resulting in workforce reductions that would reduce membership, reduce contributions and prematurely increase retirements in the short-term.

The Administering Authority reviews the Pension Fund’s cashflow position annually as part of setting the Fund’s budget and may commission further work on cashflow projections from the Fund's Actuary or Investment Advisors as required. In addition the Fund will engage in regular communication with employers to ensure it is informed of significant changes that would affect 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 and expects that the demographic assumptions will be largely based on experience of the Fund's membership, on which 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 must 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 as appropriate.

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:

- monitors the membership of employers on an annual basis; and
- requires the other participating employers to communicate regularly with it on such matters
- has formalised its notification requirements within the notifiable events section of the Pension Administration Strategy.

The Administering Authority also undertakes to inform the Fund's Actuary promptly of any such matters. How the Administering Authority generally engages and communicates with its employers is set out in its Communications policy. In addition, the Panel and Board includes members which represent employers in the Fund other than the Administering Authority.

Climate Change

The systemic risk posed by climate change and the policies implemented to tackle them will fundamentally change economic, political and social systems and the global financial system. They will impact every asset class, sector, industry and market in varying ways and at different times, creating both risks and opportunities to investors. The Fund's policy in relation to how it takes climate change into account in relation to its investments is set out in its Investment Strategy Statement and Statement of compliance with the UK stewardship code for institutional investors. In relation to the funding implications, the Administering Authority keeps the effect of climate change on future returns and demographic experience, e.g. longevity, under review and will commission modelling or advice from the Fund's Actuary on the potential effect on funding as required.

Recovery period

Allowing deficiencies to be eliminated over a recovery period of up to 16 years 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.

Phasing

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 three, but it may permit a longer period if the employer can demonstrate unusual and difficult budgetary constraints. 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.

Cost Management, McCloud / Sargeant judgement and GMP indexation and equalization

For the 2019 valuation there is currently significant uncertainty as to whether improvements to benefits and/or reductions to employee contributions will ultimately be required under the cost management mechanisms introduced as part of the 2014 Scheme, and the improvements that may be required to benefits consequent to the “McCloud” equal treatment judgement. There is also uncertainty regarding the nature of the steps that will need to be taken by the Scheme to compensate for the effects of Guaranteed Minimum Pensions being

unequal for men and women and there being no mechanism for increases in GMP to be topped up to full CPI for those reaching State Pension Age after 5 April 2021.

The Administering Authority will consider any guidance emerging on these issues during the course of the valuation process and will consider the appropriate allowance to make in the valuation, taking account of the Fund Actuary’s advice. At present the Administering Authority considers an appropriate course of action for the 2019 valuation is to include a fixed loading of 0.9% of Pay within the employer contribution rates certified by the Fund Actuary that reflects the possible overall extra costs to the Fund as advised by the Fund Actuary. It is possible that the allowance within contribution rates might be revisited by the administering authority and Fund Actuary at future valuations (or, if legislation permits, before future valuations) once the implications for Scheme benefits and employee contributions are clearer.