Public Document Pack

To: **Pensions Committee**:- Councillor Malik, Convener; Councillor Reynolds, Vice Convener; Councillor Barney Crockett, the Lord Provost; Councillor Alan Donnelly, the Depute Provost; and Councillors Bell and Delaney; and 3 SNP Members to be advised.

Pension Board:- Mr A Walker, Chair; Ms M Hart, Vice Chair; Councillors Cowe and McKelvie; and Mr S Clunes, Ms M Lawrence and Mr K Masson and 1 vacancy (Aberdeen City Council).

Town House,
ABERDEEN, 8 March 2018

PENSIONS COMMITTEE AND PENSION BOARD

The Members of the **PENSIONS COMMITTEE AND PENSION BOARD** are requested to meet in **Committee Room 2 - Town House** on **FRIDAY, 16 MARCH 2018 at 10.30 am**.

FRASER BELL
HEAD OF LEGAL AND DEMOCRATIC SERVICES

B U S I N E S S

DETERMINATION OF URGENT BUSINESS

1 Determination of Urgent Business

DETERMINATION OF EXEMPT BUSINESS

2 Determination of Exempt Business

DECLARATIONS OF INTEREST

3 Declarations of Interest (Pages 5 - 6)

COMMITTEE BUSINESS

FINANCE, PERFORMANCE, RISK AND SERVICE WIDE ISSUES

GENERAL BUSINESS

EXEMPT BUSINESS - NOT FOR PUBLICATION

Should you require any further information about this agenda, please contact Stephanie Dunsmuir, tel 01224 522503 or email sdunsmuir@aberdeencity.gov.uk

PENSIONS COMMITTEE

PURPOSE OF COMMITTEE

To discharge all the functions and responsibilities relating to the Council's role as administering authority for the North East Scotland Pension Funds (NESPF) including:-

1. overseeing the administration of the Local Government Pension Scheme (LGPS) in accordance with the LGPS (Scotland) Regulations 2014 and other relevant regulations,

2. managing the investment of the NESPF in accordance with the LGPS (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended);

3. receiving regular training to enable the Committee members to make effective decisions under the LGPS Regulations, other relevant legislation and to make decisions in compliance with the Pensions Regulator Code of Practice; and

4. working alongside the Fund's Local Pension Board, considering any pension compliance matters raised.

Where reference is made to 'the Fund', this refers to the Main Fund (the North East Scotland Pension Fund) and the Transport Fund (the Aberdeen City Council Transport Fund).

POWERS OF COMMITTEE

1. Risk Management

The Committee will:

1.1 ensure effective risk management of the Fund;

1.2 set the investment objective and strategy in light of the Funds liabilities and appoint or remove Fund Managers or new vehicles in furtherance of the strategy; and

1.3 ensure that an effective system of internal financial control is maintained.

2. Internal and External Audit

The Committee will:

2.1 approve the annual audit plans; and

2.2 consider all reports prepared by the Council's Internal and External Auditors in relation to the Pension Fund.

3. Annual Report and Accounts

The Committee will:

3.1 review and approve the annual report and accounting statement.

4. Legal obligations

The Committee will ensure:

4.1 compliance with the Local Government Pension Scheme (Scotland) Regulations as amended and with all other legislation governing the administration of the Fund; and

4.2 adherence to the principles set out in the Pension Regulator's Code of Practice.

5. Scrutiny

The Committee will:

5.1 monitor the performance of Fund Managers; and

5.2 determine applications for Admitted Body status.

JOINT WORKING WITH OTHER COUNCIL COMMITTEES:

The Committee, through its lead officers, will regularly consider key issues arising through other committees, in particular the City Growth and Resources and Staff Governance Committees.

JOINT WORKING WITH NON COUNCIL BODIES:

The Committee, through its lead officers, will work jointly with the Fund's Investment Consultant and Actuary in the management of the Fund and with external contacts such as the provider of the pensions IT programme.

Executive Lead: Director of Resources

You must consider at the earliest stage possible whether you have an interest to declare in relation to any matter which is to be considered. You should consider whether reports for meetings raise any issue of declaration of interest. Your declaration of interest must be made under the standing item on the agenda, however if you do identify the need for a declaration of interest only when a particular matter is being discussed then you must declare the interest as soon as you realise it is necessary. The following wording may be helpful for you in making your declaration.

I declare an interest in item (x) for the following reasons …………..
For example, I know the applicant / I am a member of the Board of X / I am employed by…
and I will therefore withdraw from the meeting room during any discussion and voting on that item.

OR

I have considered whether I require to declare an interest in item (x) for the following reasons ………….. however, having applied the objective test, I consider that my interest is so remote / insignificant that it does not require me to remove myself from consideration of the item.

OR

I declare an interest in item (x) for the following reasons ………….. however I consider that a specific exclusion applies as my interest is as a member of xxxx, which is

(a) a devolved public body as defined in Schedule 3 to the Act;
(b) a public body established by enactment or in pursuance of statutory powers or by the authority of statute or a statutory scheme;
(c) a body with whom there is in force an agreement which has been made in pursuance of Section 19 of the Enterprise and New Towns (Scotland) Act 1990 by Scottish Enterprise or Highlands and Islands Enterprise for the discharge by that body of any of the functions of Scottish Enterprise or, as the case may be, Highlands and Islands Enterprise; or
(d) a body being a company:-
i. established wholly or mainly for the purpose of providing services to the Councillor’s local authority; and
ii. which has entered into a contractual arrangement with that local authority for the supply of goods and/or services to that local authority.

OR

I declare an interest in item (x) for the following reasons……and although the body is covered by a specific exclusion, the matter before the Committee is one that is quasi-judicial / regulatory in nature where the body I am a member of:

- is applying for a licence, a consent or an approval
- is making an objection or representation
- has a material interest concerning a licence consent or approval
- is the subject of a statutory order of a regulatory nature made or proposed to be made by the local authority…. and I will therefore withdraw from the meeting room during any discussion and voting on that item.

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PENSIONS COMMITTEE AND PENSION BOARD
1 December 2017

ABERDEEN, 1 December 2017. Minute of Meeting of the PENSIONS COMMITTEE AND PENSION BOARD**.** Present:- Councillor Reynolds, Convener; Councillor Barney Crockett, the Lord Provost; and Councillors Allard, Cooke, Delaney, MacGregor and Malik (Pensions Committee), Mr A Walker; Councillors Cowe and McKelvie; Ms M Lawrence; and Mr K Masson (Pension Board).

Also in attendance:- Steve Whyte, Head of Finance; Graham Buntain, Investment Manager; Claire Mullen, Employee Relationship Team Manager; Mairi Suttie, Governance Manager; David Hughes, Chief Internal Auditor; and Colin Morrison, Senior Auditor, Audit Scotland.

The agenda and reports associated with this minute can be found at:- https://committees.aberdeencity.gov.uk/ieListDocuments.aspx?CId=506&MId=4356

Please note that if any changes are made to this minute at the point of approval, these will be outlined in the subsequent minute and this document will not be retrospectively altered.

DETERMINATION OF URGENT BUSINESS

1. The Convener advised that there were no items of urgent business to be considered.

DETERMINATION OF EXEMPT BUSINESS

2. The Committee was requested to determine that the following items of business, which contained exempt information as described in Schedule 7(A) of the Local Government (Scotland) Act 1973, be taken in private – items 13 (Asset and Investment Manager Performance Report) and 14 (Investment Strategy Update).

The Committee resolved:-
In terms of Section 50(A)(4) of the Local Government (Scotland) Act 1973, to exclude the press and public from the meeting during consideration of items 13 and 14, so as to avoid disclosure of exempt information of the class described in paragraph 6.

The Board resolved:-
to note the decision of the Committee.

DECLARATIONS OF INTEREST

3. There were no declarations of interest.

MINUTE OF PREVIOUS MEETING

4. The Committee had before it the minute of its previous meeting of 15 September 2017.

The Committee resolved:-
to approve the minute as a correct record.

The Board resolved:-
to note the decision of the Committee.

INTERNAL AUDIT REPORT AC1725 - PENSION FUND PAYROLL

5. The Committee had before it a report by the Internal Auditor which presented the planned Internal Audit report on the Pension Fund Payroll, with recommendations to be taken forward.

The Committee heard from David Hughes, Chief Internal Auditor, in respect of the report.

The report recommended:-
that the Committee review, discuss and comment on the issues raised within the report and the attached appendix.

The Committee resolved:-
to note the report.

The Board resolved:-
to note the decision of the Committee.

BUDGET FORECAST AND PROJECTED SPEND 2017/18 - PC/DEC17/BUD

6. With reference to Article 6 of the minute of the previous meeting, the Committee had before it a report by the Head of Finance which provided details of the Management Expenses Budget / Forecast and Projected Spend 2017/18 for the North East Scotland Pension Fund (NESPF).

It was noted that there was an underspend in respect of staff costs, and Members sought assurance that there were adequate staffing levels. Mr Whyte explained that he was in discussions with HR about some aspects of the recruitment and it was hoped that the vacancies could be filled soon.

Members highlighted that the transaction fees seemed to be relatively substantial, and officers advised that a breakdown could be provided.

The report recommended:-
that Committee –
(a) note the update on the NESPF Management Expenses Budget / Forecast and Projected Spend for 2017/18;
(b) note the update on the Pension Fund staff costs and staffing vacancies; and
(c) note the update on the Actuarial Fees, Direct Property Expenses and Transaction Costs shown in Appendix 1.

The Committee resolved:-
(i) to request that officers provide a breakdown in respect of the transaction fees; and
(ii) to approve the recommendations.

The Board resolved:-
to note the decision of the Committee.

2017 ACTUARIAL VALUATION AND FUNDING STRATEGY STATEMENT - INITIAL RESULTS - PC/DEC17/ACT

7. The Committee had before it a report by the Head of Finance which provided details of the initial results of the triennial valuation for the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF) as at 31 March 2017, which had been carried out by the scheme actuary. The report also provided an initial view of the 2017 Funding Strategy Statement for each Fund.

The report recommended:-
that Committee –
(a) note the initial valuation results of both Funds, as at 31 March 2017;
(b) note the draft Funding Strategy Statement (FSS) for both the NESPF and ACCTF, including the assumptions recommended by the scheme actuary to determine the value placed on the Fund liabilities as at 31 March 2017, and the individual employer contribution rates payable from 2018/19;
(c) instruct the Head of Finance to carry out a full consultation on the FSS as required by the scheme regulations and provide a report on the consultation outcome to the March Pensions Committee;

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(d) note the intention to disaggregate the remaining employer groupings within the Fund; and
(e) note the remainder of the report.

The Committee resolved:-
to approve the recommendations.

The Board resolved:-
to note the decision of the Committee.

STRATEGY - PC/DEC17/STRATEGY

8. With reference to article 8 of the minute of its previous meeting, the Committee had before it a report by the Pensions Manager which provided an update on any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies.

The report contained information and updates on the planned updates to the LGPS Regulations; the annual review of all the major Scheme policies and statements; a request for a delegation of power to the Pensions Manager; the proposed appointment of an external legal advisor; the review of the secure online area of NESPF website; and a series of requests for approval of overseas travel for one appointed Advisory Committee Officers to attend the following Advisory Committees:-

- Harbourvest – 5/6 December 2017, Boston
- Partners Group – 13/16 March 2018, Switzerland
- Harbourvest – May 2018, Boston
- RCP, June 2018, Chicago
- HarbourVest – December 2018, Boston

The report recommended:-
that Committee –
(a) approve the delegation of power to the Pensions Manager to authorise deviations from the Local Government Pension Scheme (Scotland) Regulations, as set out in 3.6.3 of the report;
(b) approve the appointment of an external legal advisor to the Fund, as set out in 3.6.4 of the report, following consultation with the Head of Commercial and Procurement Services and approve the associated expenditure;
(c) approve the overseas travel, as set out in 3.6.8 of the report; and
(d) otherwise note the report.

The Committee resolved:-
to approve the recommendations.

The Board resolved:-
to note the decision of the Committee.

UPDATE ON ANNUAL BENEFIT STATEMENTS - PC/DEC17/ABS

9. The Committee had before it a report by the Head of Finance which provided an update on the provision of the Annual Benefit Statements (ABSs) to the Fund's active and deferred members. The statements provided members with an estimate of their pension position at retirement age, based on data currently held by the Fund.

The report advised that 99.76% compliance had been achieved. Although this had fallen slightly short of 100% compliance, issues had been identified in the outstanding member records (56 records) which had prevented the target being met. The data issues with these member records would be addressed in preparation for the 2017/18 year. A problem with a further 3 records had been raised with the software provider and it was therefore hoped that the resolution of these issues would improve performance next year with the aim of achieving full compliance.

In line with the NESPF Breaches of Law Policy, the fact that the full 100% compliance was not achieved would be recorded as a breach in the Register, however as this was not a breach of material significance, it would not be reported to the Pensions Regulator.

The report recommended:-
that the Committee note the report.

The Committee resolved:-
to note the report.

The Board resolved:-
to note the decision of the Committee.

REQUEST FOR ADMITTED BODY STATUS - PC/DEC17/ADBOD

10. The Committee had before it a report by the Head of Finance which set out an application from Aberdeenshire Council to admit Aberdeenshire Sport and Culture Ltd (ACS Ltd) into the Local Government Pension Scheme administered by Aberdeen City Council.

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The report advised that Aberdeenshire Council planned to create a charitable trust from 1 April 2018 to provide sport and culture services within the Council. Around 700 staff would be transferred to the new body under TUPE arrangements.

The report recommended:-
that Committee agree to allow the employees transferring from Aberdeenshire Council to ACS Ltd to participate in the Local Government Pension Scheme administered by Aberdeen City Council.

At this juncture, Councillor McKelvie advised that although the report advised that the decision in respect of the above would be taken on 23 November 2017, the decision would in fact not be taken until January 2018.

The Committee resolved:-
(i) to agree in principle to allow the employees transferring from Aberdeenshire Council to ACS Ltd to participate in the Local Government Pension Scheme administered by Aberdeen City Council; and
(ii) to delegate authority to the Pensions Manager to make the necessary arrangements, subject to the decision being taken by Aberdeenshire Council in January.

The Board resolved:-
to note the decision of the Committee.

PROCUREMENT OF PENSION ADMINISTRATION SOFTWARE - PC/DEC17/ADMIN

11. The Committee had before it a report by the Head of Finance which sought approval to enter into a new contract with Aquila Heywood for the provision of pension administration software to the North East Scotland Pension Fund. The report explained that the existing contract was due to expire in 2018.

The report recommended:-
that Committee approve the award of a new contract with Heywood as the supplier of pensions administration software, using the Northumberland County Council Framework for a 10 year term.

At this juncture, the Committee heard from Steven Inglis, Team Leader, Legal and Democratic Services who advised that a slight amendment was required to the wording of the recommendation, namely:-

> "That Committee approve the award of a new contract to Heywood as the supplier of pensions administration software, using the Northumberland County Council Framework, for a 10 year term (or such shorter term as may be deemed appropriate by the Head of Finance following consultation with the Head of

Commercial and Procurement Services) and approve the total estimated expenditure as detailed in this report."

The Committee resolved:-
to approve the amended recommendation.

The Board resolved:-
to note the decision of the Committee.

In accordance with the decision recorded under article 2 of this minute, the following items were considered with the press and public excluded.

ASSET AND INVESTMENT MANAGER PERFORMANCE REPORT - PC/DEC17/AIMPR

12. With reference to article 9 of the minute of its previous meeting, the Committee had before it a report by the Head of Finance which provided a review of the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund for the three month period ending 30 September 2017.

The Committee heard from Mr Graham Buntain, Investment Manager, in respect of the detail contained in the report and Members then asked questions of Mr Buntain.

Councillor Allard highlighted the Corporate Social Responsibility Policy in respect of the responsibilities around good social and environmental practice, and requested that officers review the assets of the Pension Fund in light of these responsibilities and report back to Committee on a strategy to incorporate those responsibilities into the future investment strategy. Steven Whyte, Head of Finance, advised that the upcoming Mercer evaluation would mean that a new investment strategy would be brought back to Committee for approval and an evaluation and analysis of the investments would be undertaken as part of that work.

As part of a discussion on the activities of the Local Authority Pension Fund Forum it was suggested that a report on the Forum activities be taken to the next meeting of the Committee and Board for information.

The report recommended:-
that Committee note the report.

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The Committee resolved:-
(i) to note that a report in respect of an updated investment strategy would be brought to a future meeting of the Committee which would include an evaluation and analysis of the investments;
(ii) to request that a report on the activities of the Local Authority Pension Fund Forum be brought to the next meeting of the Committee; and
(iii) to otherwise note the report.

The Board resolved:-
to note the decision of the Committee.

INVESTMENT STRATEGY UPDATE - PC/DEC17/INVSTRAT

13. With reference to Article 10 of the minute of the previous meeting, the Committee had before it a report by the Head of Finance which provided an update on the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies.

The Committee heard from Mr Buntain in respect of the detail outlined in the report.

The report recommended:-
that Committee –
(a) approve the commitment of £40 million investment to the HarbourVest Co-Investment Overflow Opportunities Fund; and
(b) otherwise note the report.

The Committee resolved:-
to approve the recommendations.

The Board resolved:-
to note the decision of the Committee.
- **COUNCILLOR JOHN REYNOLDS, Convener**

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ABERDEEN CITY COUNCIL

COMMITTEE	Pensions Committee
DATE	16 March 2018
TITLE OF REPORT	Internal Audit Plan 2018/19
REPORT NUMBER	IA/18/005
LEAD OFFICER	David Hughes
AUTHOR	David Hughes

1. PURPOSE OF REPORT

1.1 The purpose of this report is to seek approval of the attached Internal Audit plan for 2018/19.

2. RECOMMENDATION

2.1 It is recommended that the Committee approve the attached Internal Audit Plan for 2018/19.

3. BACKGROUND/MAIN ISSUES

3.1 It is one of the functions of the Audit, Risk and Scrutiny Committee to review the activities of the Internal Audit function, including the approval of the Internal Audit Plan for Aberdeen City Council. However, the remit of that Committee does not extend to Internal Audit issues relating to the Pension Fund. This is reserved to the Pensions Committee.

3.2 The Internal Audit plan for Aberdeen City Council for 2018/19, along with the methodology for determining the areas to be reviewed, has already been approved by the Audit, Risk and Scrutiny Committee. This followed consultation with management through the Corporate Management Team.

3.3 The audit included in the attached plan, as well as those in previous and future plans, will help familiarise Internal Audit with the Pension Fund's control environment and governance arrangements, allowing assurance to be provided regarding those arrangements. Where opportunities for improvement in controls and their application, or improvements in value for money, are identified these will be reported along with recommendations for management to consider. Where appropriate, Internal Audit will obtain assurance from other sources, for example external audit, based on their work and reported outcomes.

3.4 Internal Audit's work will be undertaken in compliance with Public Sector

Internal Audit Standards and Aberdeen City Council's Internal Audit Charter as approved by the Audit, Risk and Scrutiny Committee on 22 June 2017.

4. FINANCIAL IMPLICATIONS

4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are detailed in the resultant Internal Audit reports. The purpose of this report is to seek approval for the Internal Audit plan.

7. IMPACT SECTION

7.1 **Economy** – The proposals in this report have no direct impact on the local economy.

7.2 **People** – There will be no differential impact, as a result of the proposals in this report, on people with protected characteristics. An equality impact assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcomes of a review that the Committee requested Internal Audit undertake. The proposals in this report will have no impact on improving the staff experience.

7.3 **Place** – The proposals in this report have no direct impact on the environment or how people friendly the place is.

7.4 **Technology** – The proposals in this report do not further advance technology for the improvement of public services and / or the City as a whole.

8. APPENDICES

8.1 Appendix A – Internal Audit Plan 2018/19

8.2 Appendix B – Analysis of NESPF Risk Register.

9. REPORT AUTHOR DETAILS

David Hughes, Chief Internal Auditor
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(01224) 664184

Appendix A

INTERNAL AUDIT PLAN 2018/19

NORTH EAST OF SCOTLAND PENSION FUND

Area	Scope	Objective	Link to RR
Governance arrangements including risk management.	Governance arrangements including risk management.	To provide assurance over the governance arrangements procedures in place including risk management and performance management.	KP1 KP2

APPENDIX B

ANALYSIS OF RISK REGISTER

Key

	No Previous IA Coverage
	Some Previous IA Coverage
	Previous IA Coverage as Detailed
	Proposed Inclusion in IA Plan

Risk No.	Risk	Definition	NESPF Assessment of Risk	Previous Internal Audit Coverage	Proposed Inclusion in 2018/19 Internal Audit Plan	Management Comment
Key Priorities						
KP1	Lack of effective risk management	Failure to identify and respond to risks with the potential to impact on our ability to achieve our objectives	Medium risk. Regular review	None	Proposed review of Governance Arrangements including Risk Management and Performance Management	CMT 18.01.18: Agreed
KP2	Poor Governance	Failure to ensure the Fund has in place a sound organisational framework, identifies responsibilities, manages its systems and processes and support the Council's culture and values	Low risk. Annual review and new f/w from April15	AC1725 Pension Fund Payroll October 2017; AC1620 Pensions Investment Strategy & Management May 2016.	Proposed review of Governance Arrangements including Risk Management and Performance Management	CMT 18.01.18: Agreed
KP3	Lack of performance measures	Failure to measure how successful we are at delivering the Pension Fund Business Plan priorities and achieving improved outcomes for our scheme members	Medium risk. Statutory and local PI's being reported.	Looked at partly in AC1620 Pensions Investment Strategy & Management May 2016 (reporting of fund managers' performance)	Proposed review of Governance Arrangements including Risk Management and Performance Management	CMT 18.01.18: Agreed
KP4	Actuarial valuation – market volatility	Increase in employer contributions to meet unfunded position	Low risk. Valuations interim and final. 2017 tbc	None	No	CMT 18.01.18: Agreed

Risk No.	Risk	Definition	NESPF Assessment of Risk	Previous Internal Audit Coverage	Proposed Inclusion in 2018/19 Internal Audit Plan	Management Comment
KP5	GMP Equalisation	Failure to ensure that future member benefits are calculated correctly. Audit criticism and financial loss to the Fund	Low risk. Staff appointed to do this.	None	No	CMT 18.01.18: Agreed
KP6	Annual Review of workings of Pension Board and Pension Committee	Failure to ensure effective joint working of the Pension Board and Pension Committee, not compliant with Scheme Regs and Pension Regulator requirements	Low risk. Currently being reviewed by SPPA.	None	No – current review by SPPA	CMT 18.01.18: Agreed
KP7	New Global Custody Services	Failure to manage transition between old and new custodial arrangements. Financial loss through delay in service or errors in data	Medium risk. Has its own plan and risk register, regular reporting to Cttee.	None	No	CMT 18.01.18: Agreed

Risk No.	Risk	Definition	NESPF Assessment of Risk	Previous Internal Audit Coverage	Proposed Inclusion in 2018/19 Internal Audit Plan	Management Comment
Pensions Regulator Requirements						
PR1	Pension Administration system failure	Staff downtime, loss of service delivery	Low risk Externally hosted and backed up	2017/18 review of Pension Systems	No	CMT 18.01.18: Agreed
PR2	Unable to access workplace	Staff downtime, loss of service delivery	Medium risk. Council's disaster recovery policy.	August 2017 – IA Report AC1804 "Business Continuity Planning"	No	CMT 18.01.18: Agreed
PR3	Overpayment of pension benefits	Audit criticism, legal challenge, reputational risk	Low risk. Supervisory and segregation controls	AC1725 Pension Fund Payroll October 2017;	No	CMT 18.01.18: Agreed
PR4	Failure to maintain member records and comply with regulations	Incorrect pension payments, incorrect assessment of actuarial liabilities	Low risk. Regular checks of employers' data	AC1725 Pension Fund Payroll October 2017;	No	CMT 18.01.18: Agreed
PR5	Failure to carry out effective member tracing	Incorrect pension payments, incorrect assessment of actuarial liabilities	Low risk. ATMOS tracing system	AC1725 Pension Fund Payroll October 2017;	No	CMT 18.01.18: Agreed
PR6	Fraud/Negligence	Overpayment, unauthorised payments, system corruption, audit criticism, reputational damage	Low risk. Supervisory and segregation controls	AC1725 Pension Fund Payroll October 2017;	No	CMT 18.01.18: Agreed

Risk No.	Risk	Definition	NESPF Assessment of Risk	Previous Internal Audit Coverage	Proposed Inclusion in 2018/19 Internal Audit Plan	Management Comment
PR7	Failure to recruit and develop staff	Reduction in service delivery, poor operation of risk management controls	Medium risk. New structure 2016, training 2017	None	Proposed review of ACC workforce planning could cover this area (in 2019/20).	CMT 18.01.18: Agreed
PR8	Fund's investments fail to deliver returns in line with anticipated returns required to meet the valuation of the long term liabilities	Increase in employer contributions	Medium risk. Regular updates and reviews to committee	AC1620 Pensions Investment Strategy & Management May 2016.	No	CMT 18.01.18: Agreed
PR9	Fall in bond yields, leading to risk in value placed on liabilities	Increase in employer contributions	Medium risk. Regular updates and reviews to committee	AC1620 Pensions Investment Strategy & Management May 2016.	No	CMT 18.01.18: Agreed
PR10	Pay and price inflation valuation assumptions either higher or lower	Increase in employer contributions	Low risk.	AC1620 Pensions Investment Strategy & Management May 2016.	No	CMT 18.01.18: Agreed
PR11	Longevity issues	Increase in employer contributions	Low risk. Actuarial assessments 3 yearly. Mentions 'strategy review to consider matching liabilities'	None	No	CMT 18.01.18: Agreed

Risk No.	Risk	Definition	NESPF Assessment of Risk	Previous Internal Audit Coverage	Proposed Inclusion in 2018/19 Internal Audit Plan	Management Comment
PR12	Employers leaving scheme/closing to new members due to cost	Residual liabilities could fall to other scheme employers	Medium risk. Monitoring and seeking 'guarantors'	None	No	CMT 18.01.18: Agreed
PR13	Failure to recover unfunded payments from employers, cross subsidy by other employers	Residual liabilities could fall to other scheme employers	Medium risk. Escalation process in place.	None	No	CMT 18.01.18: Agreed
PR14	Failure of world stock markets	Increase in employer contribution rates	Medium risk. Diversification and review.	AC1620 Pensions Investment Strategy & Management May 2016.	No	CMT 18.01.18: Agreed
PR15	Early retirement strategies by scheme employers	Pressure on cash flow	Medium. Engagement with employers	None	No – although proposed work on ACC VSER Scheme will cover this.	CMT 18.01.18: Agreed
PR16	Negligence, fraud, default by investment managers	Loss of value of the Fund, reputational damage	Low risk. Contract managed and 'audit' notices.	AC1620 Pensions Investment Strategy & Management May 2016.	No	CMT 18.01.18: Agreed

Risk No.	Risk	Definition	NESPF Assessment of Risk	Previous Internal Audit Coverage	Proposed Inclusion in 2018/19 Internal Audit Plan	Management Comment
PR17	Failure of Global Custodian	Loss of investments or control of investment	Low risk. Contract managed and 'audit' notices.	AC1620 Pensions Investment Strategy & Management May 2016.	No	CMT 18.01.18: Agreed
PR18	Failure to monitor investment managers and assets	Audit criticism, legal challenge, reputational risk	Medium risk. Regular review and reporting	AC1620 Pensions Investment Strategy & Management May 2016.	No	CMT 18.01.18: Agreed
PR19	Failure to comply with LGPS Regulations, Pensions Act, HMRC and other overriding regulations	Audit criticism, legal challenge, reputational risk, financial loss/financial penalties	Medium risk. Subject to 6 monthly compliance review	None	Proposed review of Governance Arrangements including Risk Management and Performance Management	CMT 18.01.18: Agreed
PR20	Investment options restricted by introduction of European Directive MiFIDII	Legal challenge, financial loss, increase in costs	Medium risk. Engagement, awareness and training	None	No	CMT 18.01.18: Agreed

Risk No.	Risk	Definition	NESPF Assessment of Risk	Previous Internal Audit Coverage	Proposed Inclusion in 2018/19 Internal Audit Plan	Management Comment
PR21	Potential risks and conflicts of interest between ACC and NESPF	Audit criticism, legal challenge, reputational risk	Medium risk. Regular meetings and register maintained.	None	Include testing in proposed review of Governance Arrangements (see risk KP2)	CMT 18.01.18: Agreed
PR22	Breach of Data Protection –theft or loss of data	Audit criticism, legal challenge, reputational risk	Low risk.	September 2016 – IA Report AC1707 "Data Protection" relating to ACC procedures which cover NESPF – staff have to complete ACC training.	Review of Council's arrangements to ensure that the Council's arrangements for GDPR compliance are adequate included in ACC IA Plan.	CMT 18.01.18: Agreed
PR23	Failure to comply with FOI requests	Audit criticism, legal challenge, reputational risk	Low risk.	None – although Audit Risk and Scrutiny Committee has requested that IA review elements of FOI and report back to Committee.	No	CMT 18.01.18: Agreed
PR24	Failure to meet annual audit deadlines	Audit criticism, legal challenge, reputational risk	Low risk.	None	No. This would be picked up by external audit.	CMT 18.01.18: Agreed
PR25	Failure to monitor AVC arrangements	Audit criticism, legal challenge, reputational risk	Low risk. Annual review and some changes to be made.	None	No	CMT 18.01.18: Agreed
PR26	Failure to monitor employer covenants	Residual liabilities could fall to other scheme employers	Medium risk. Ongoing discussions	None	No	CMT 18.01.18: Agreed

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North East Scotland Pension Fund

Annual Audit Plan 2017/18

Prepared for members of Aberdeen City Council Pensions Committee

March 2018

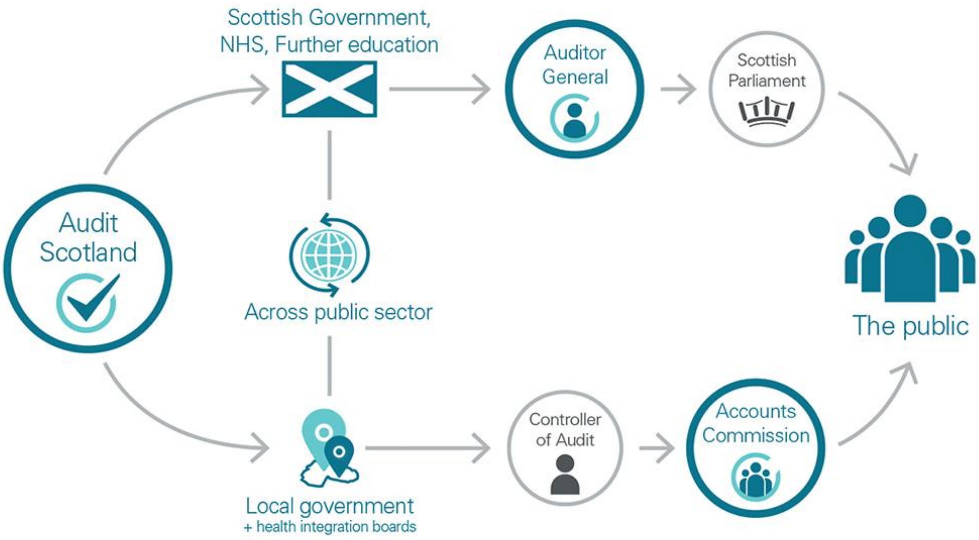
Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non – executive board chair, and two non – executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world – class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Risks and planned work

1. This annual audit plan contains an overview of the planned scope and timing of our audit and is carried out in accordance with International Standards on Auditing (ISAs), the *Code of Audit Practice*, and any other relevant guidance. This plan identifies our audit work to provide an opinion on the financial statements and related matters and meet the wider scope requirements of public sector audit.

2. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

Audit risks

3. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for North East Scotland Pension Fund. We have categorised these risks into financial risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in Exhibit 1.

Exhibit 1
2017/18 Key audit risks

Audit Risk	Source of assurance	Planned audit work
Financial statement issues and risks		
1 **Assurances on administering authority key financial systems used by NESPF** Aberdeen City Council (ACC) is the administering authority for the North East Scotland Pension Fund. Several ACC key financial systems (general ledger; accounts payable; accounts receivable) underpin the NESPF accounting records. We are dependent on the council's external auditor, KPMG, for audit assurances on these systems.	• Pension fund officers will ensure arrangements are in place for the external auditor of the administering authority to provide assistance to the external auditors of the pension fund.	• Assurances will be agreed with and obtained from KPMG on key Aberdeen City Council financial systems which underpin NESPF accounting records.
2 **Risk of management override of controls** ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of	• Owing to the nature of this risk, assurances from management are not applicable.	• Detailed testing of journal entries. • Review of accounting estimates. • Evaluation of significant transactions that are outside the normal course of business.

Audit Risk	Source of assurance	Planned audit work
controls in order to change the position disclosed in the financial statements.		
3 **Risk of fraud over income and expenditure** ISA 240 presumes a risk of fraud over income; this is expanded to include the risk of fraud over expenditure in the public sector by the Code of Audit Practice and the Financial Reporting Council's Practice Note 10 (revised). The North East Scotland Pension Fund receives a significant amount of investment income from third party sources. This presents a risk due to the extent and complexity of income. The Pension Fund also makes a high volume of payments, including high value payments, which can constitute a risk of misstatement of expenditure.	• Monthly reasonableness checks of employers' contributions and timeliness of payments. • Reconciliations of contributions received with monthly and year end returns from employers and pension administration system. • Annual assurance requested from key employers. • Monthly cash reconciliations. • Segregation of duties between fund staff for any income transactions keyed into the custodian system. • Reconciliations between custodian and fund manager records.	• Evaluating the effectiveness of systems for income recognition and recording. • Conduct a review of third party service providers, where relied upon by management, including review of service auditor reports. • Analytical procedures on income and expenditure streams. • Agree income to third party confirmation. • Substantive testing of expenditure. • Assurances on contributions obtained from scheduled body external auditors.
4 **Estimation and judgements** There are two areas with a significant degree of subjectivity: • the measurement and valuation of investments; • the actuarial valuation. Investments include level 3 investments such as unquoted equity (private equity) where valuations use techniques that require significant judgement in determining appropriate assumptions. The actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions. This subjectivity represents an increased risk of misstatement in the financial statements.	• Quarter 2 (June 2018) custodian's valuation reports. • Triennial Review Report by the Actuary. • Supporting documents relating to the Triennial Review.	• Confirm valuations to valuation reports and/or other supporting documentation. • Completion of 'review of the work of an expert' in accordance with ISA500, for the work of the actuary and the custodian. • Consideration of the report by PwC in their capacity as consulting actuary to Audit Scotland on actuarial assumptions in use in 2017/18. • Consideration of GAD reports under Section 13 of the Local Government Pension Scheme (Scotland) of LGPS Scotland funding valuations and employer contribution rates.
5 **Changes to financial reporting** Pension funds will be required to disclose information on	• Relevant guidance and regulations will be reviewed to ensure the 2017/18 annual report	• Communication of technical changes with officers. • Agree amounts in

Audit Risk	Source of assurance	Planned audit work
investment management transaction costs, including the amount for each asset class, their nature, and how they arise for different types of investment. It is essential that the pension fund is in a position to capture these costs.	and accounts meet their requirements.	primary financial statements to supporting documentation from third parties.

Reporting arrangements

4. Audit reporting is the visible output for the annual audit. All annual audit plans and the outputs as detailed in Exhibit 2, and any other outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

5. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officers to confirm factual accuracy.

6. We will provide an independent auditor's report to the administering authority and the Accounts Commission setting out our opinions on the annual accounts. We will provide the Aberdeen City Council Pensions Committee and the Accounts Commission with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

Exhibit 2
2017/18 Audit outputs

Audit Output	Target date	Committee Date
Annual Audit Plan	6 March 2018	16 March 2018
Annual Audit Report	4 September 2018	14 September 2018
Independent Auditor's Report	14 September 2018	14 September 2018

Audit fee

7. The proposed audit fee for the 2017/18 audit of North East Scotland Pension Fund is £40,000 (2016/17 £33,420; 2015/16 £46,130). In determining the audit fee we have taken account of the risk exposure of North East Scotland Pension Fund, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited financial statements, with a complete working papers package on 29 June 2018.

8. Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

Responsibilities

Aberdeen City Council Pensions Committee and Head of Finance

9. Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

10. The audit of the financial statements does not relieve management or the Aberdeen City Council Pensions Committee, as those charged with governance, of their responsibilities.

Appointed auditor

11. Our responsibilities as independent auditor are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

12. Auditors in the public sector give an independent opinion on the financial statements and other specified information accompanying the financial statements. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

Audit scope and timing

Financial statements

13. The statutory financial statements audit will be the foundation and source for the majority of the audit work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of North East Scotland Pension Fund and the associated risks which could impact on the financial statements
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how North East Scotland Pension Fund will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free of material misstatement.

14. We will give an opinion on the financial statements as to whether they:

- give a true and fair view of the financial transactions of the fund during the year ended 31 March 2018 and the amount and disposition as at that date of its assets and liabilities
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union, as interpreted and adopted by the Code of Practice on Local Authority Accounting in the UK and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Materiality

15. We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements, on the financial statements and in forming our opinion in the auditor's report.

16. We calculate materiality at different levels as described below. The calculated materiality values for North East Scotland Pension Fund are set out in Exhibit 3.

Exhibit 3
Materiality values

Materiality level	Amount
Planning materiality This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 10% of contributions receivable (based on the latest audited accounts, for the year ended 31 March 2017).	Main Fund £13.0 million Transport Fund £0.25 million
Performance materiality This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 75% of planning materiality.	Main Fund £9.7 million Transport Fund £0.1 million
Reporting threshold - We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 2.5% of planning materiality (with a maximum level of £100,000).	Main Fund £100,000 Transport Fund £10,000

17. We review and report on other information published with the financial statements including the management commentary and annual governance statement. Any issue identified will be reported to the Aberdeen City Council Pensions Committee.

Timetable

18. To support the efficient use of resources it is critical that a financial statements timetable is agreed with us for the production of the unaudited accounts. An agreed timetable is included at Exhibit 4 which takes account of submission requirements and planned Pensions Committee meeting dates:

Exhibit 4
Financial statements timetable

Key stage	Date
Consideration of unaudited financial statements by those charged with governance	22 June 2018
Latest submission date of unaudited financial statements with complete working papers package	30 June 2018
Latest date for final clearance meeting with Pensions Manager and ACC Head of Finance	24 August 2018
Agreement of audited unsigned financial statements; Issue of Annual Audit Report including ISA 260 report to those charged with governance	14 September 2018

Independent auditor's report signed	14 September 2018

Internal audit

19. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an assessment of the internal audit function. Internal audit is provided by the Aberdeenshire Council internal audit service, overseen by the Chief Internal Auditor.

Adequacy of internal audit

20. We carried out an early assessment of the internal audit function and concluded that it has sound documentation standards and reporting procedures in place and complies with the main requirements of the Public Sector Internal Audit Standards (PSIAS).

21. We do not plan to place reliance on internal audit's work for our 2017/18 financial statements audit. The scope of the internal audit work will not reduce the level of our audit testing in support of our audit opinion on the financial statements. We will however take account of internal audit's findings to inform our wider Code responsibilities.

Audit dimensions

22. Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in Exhibit 5.

Exhibit 5

Audit dimensions

Source: Code of Audit Practice

Financial sustainability

23. As auditors we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on the body's financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years) sustainability. We will carry out work and conclude on:

- the effectiveness of financial planning in identifying and addressing risks to financial sustainability in the short, medium and long term
- the appropriateness and effectiveness of arrangements in place to address any identified funding gaps
- whether the fund can demonstrate the affordability and effectiveness of funding and investment decisions it has made.

Financial management

24. Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. We will review, conclude and report on:

- whether the fund has arrangements in place to ensure systems of internal control are operating effectively
- whether the fund can demonstrate the effectiveness of budgetary control system in communicating accurate and timely financial performance
- how the fund has assured itself that its financial capacity and skills are appropriate
- whether the fund has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

Governance and transparency

25. Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision – making and transparent reporting of financial and performance information. We will review, conclude and report on:

- whether the fund can demonstrate that the governance arrangements in place are appropriate and operating effectively.
- whether there is effective scrutiny, challenge and transparency on the decision – making and finance and performance reports.
- the quality and timeliness of financial and performance reporting.

Value for money

26. We will review, conclude and report on whether the fund can provide evidence that it is demonstrating value for money in the use of its resources, has a focus on improvement and that there is a clear link to the outcomes delivered.

Independence and objectivity

27. Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual "fit and proper" declaration for all members of staff. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

28. The engagement lead for The North East Scotland Pension Fund is Gillian Woolman, Assistant Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of The North East Scotland Pension Fund.

Quality control

29. International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

30. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice (and relevant supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland conducts peer reviews, internal quality reviews and have recently secured new arrangements for external quality reviews.

31. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time and this may be directed to the engagement lead.

Adding Value

32. Through our audit work we aim to add value to the North East Scotland Pension Fund. We will do this by ensuring our Annual Audit Report provides a summary of the audit work done in the year together with clear judgements and conclusions on how well the North East Scotland Pension Fund has discharged its responsibilities and how well it has demonstrated the effectiveness of its arrangements. Where it is appropriate we will recommend actions that support continuous improvement and summarise areas of good practice identified from our audit work.

North East Scotland Pension Fund

Annual Audit Plan 2017/18

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Local Government Pension Scheme 2016/17

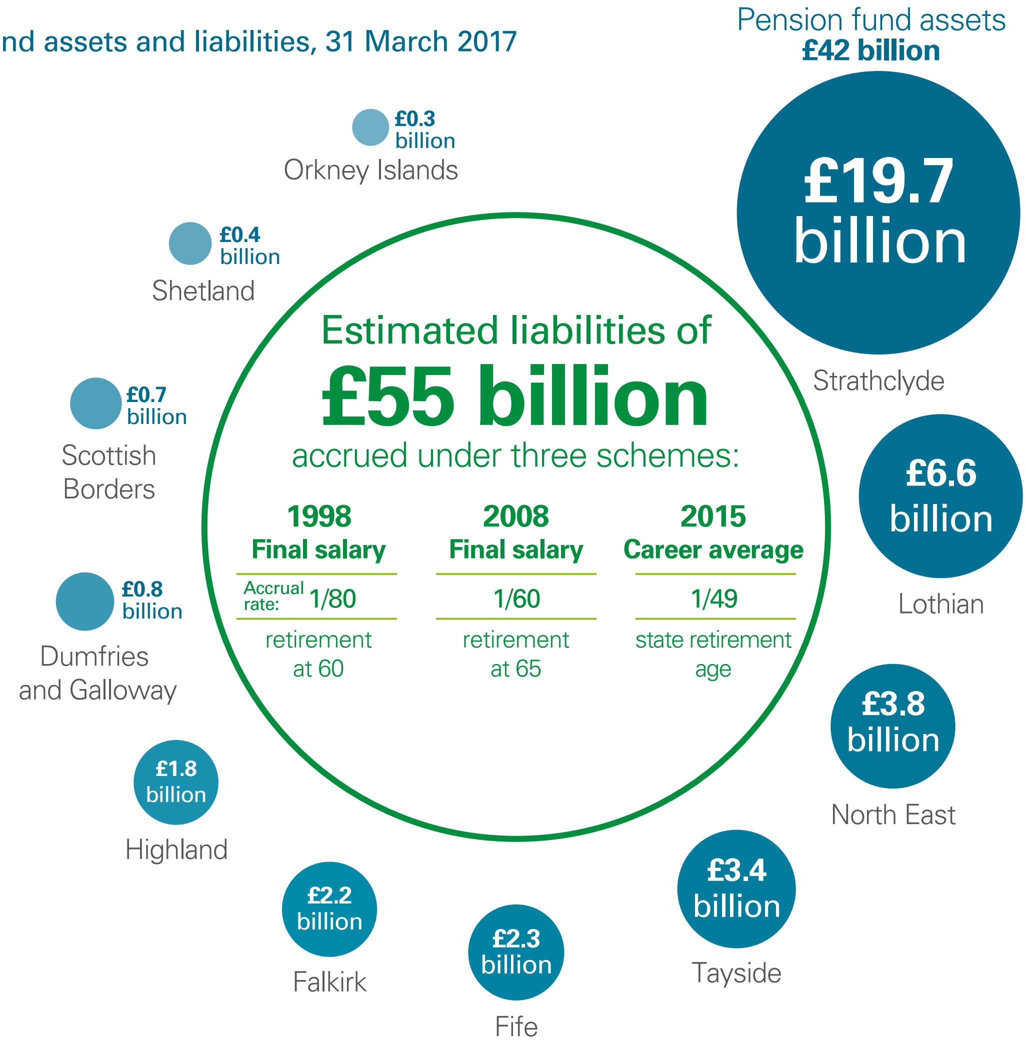
ACCOUNTS COMMISSION

Introduction

1. This supplement accompanies our Local Government in Scotland: Financial Overview 2016/17 and provides an overview of the LGPS in Scotland. We have drawn on the annual reports and accounts of the 11 pension funds administered by councils in Scotland and on the reports of their appointed auditors. In this, the first year of new five year auditor appointments, we are pleased that all 11 pension funds received an unqualified audit opinion on their accounts.

2. It was a good year for pension fund assets, which increased from £34.5 billion to £42 billion. However, the estimated value of liabilities also increased from £42 billion to almost £55 billion (Exhibit 1).

Exhibit 1
LGPS Scotland assets and liabilities, 31 March 2017



Source: Pension Fund Annual Accounts 2016/17

3. The estimated value of LGPS liabilities is in respect of all scheduled and admitted bodies not just councils. Councils have pension liabilities associated with added years awarded on retirement that do not fall on the pension fund and are not included in (Exhibit 1, page 1). Council net pension fund liabilities as at 31 March 2017 were estimated to be £11.5 billion (including unfunded liabilities).

Governance and administration

4. This is the second year of the LGPS 2015 scheme, which links pension benefits to career average earnings (a move away from final salaries under the previous LGPS schemes). We reported last year that pension funds had coped well with the introduction of the scheme and associated governance arrangements, but that the outlook remained challenging.

5. The new governance arrangements introduced under the 2015 scheme are more complex than under the previous LGPS schemes, with more stakeholders being involved. The range of stakeholders is shown in Exhibit 2 (page 3).

6. During 2016/17 the Scottish Scheme Advisory Board reported to the Scottish Minister on the future structure of the LGPS in Scotland. The report has not been made public so any proposed changes to the structure of the LGPS in Scotland are unclear. Irrespective of any proposed changes, a number of pension fund annual reports highlight plans for greater collaboration.

7. A survey[1] undertaken by the Pensions Regulator across all UK public service schemes found improvements in ensuring and demonstrating compliance with the public service code of practice on governance and administration. Auditors confirmed that LPGS pension funds in Scotland had improved arrangements and procedures in this area.

8. During the year the Scottish Public Pensions Agency (SPPA) commissioned KPMG to review governance across all public service pension schemes in Scotland.[2] One of the key issues raised by KPMG is whether there would be benefit in clarifying the role of the LGPS pension boards established under the 2015 LGPS scheme. The remit of LGPS pension boards goes beyond that for other public service schemes, requiring them to consider any pensions matters they deem relevant. The risk is that LGPS boards become overstretched and do not adequately assist scheme managers to comply with regulations and the public service code.

9. Councils rotated the chairs of their pension boards in 2016/17. They have also experienced wider changes in councillor membership of pension committees following the local elections in May 2017. Ensuring that elected members and appointed board members have the requisite skills and knowledge in this highly technical area is an ongoing challenge for pension funds.

Investment performance and pension fund assets

10. Overall, investments performed surprisingly well in a year where several high profile political events including the Brexit referendum and U.S. presidential results, affected investor confidence. The associated fall in the pound resulted in equity prices rising and this contributed to investment returns of around 22 per cent. Exhibit 3 (page 4) shows investment returns for the 11 pension funds.

11. The average return on LGPS investments in Scotland will be strongly influenced by the returns achieved by the larger funds, in particular the Strathclyde fund which accounts for almost 47 per cent of Scotland's £42 billion of LGPS assets.

1 *Public service governance and administration survey – Summary of results and commentary*, Pensions Regulator, May 2017.
2 *Scottish Public Service Pensions Governance Review*, KPMG, February 2017.

Exhibit 2
LGPS governance arrangements

UK

The Pensions Regulator

- Issues codes of practice on governance and administration
- Provides guidance and self assessment tool kits
- Undertakes governance and administration surveys
- Significant breaches of regulation must be reported

Scotland

Scottish Ministers

- Responsible for policy and regulations
- Currently considering a report on the future structure of LGPS

Scottish Public Pensions Agency

- Advise Scottish Ministers on public service policy and regulation
- Commissioned a review of governance in 2016/17

Scottish Scheme Advisory Board

- Advise Scottish Ministers on policy and changes
- Can advise scheme managers and pension boards
- Issued report to Scottish Ministers on future structure of LGPS

11 administering authorities

Pension Committees

- Responsible for decisions on pension fund policy
- Composed of Councillors but may include representatives and advisors
- New members in May 2017

Pension Boards

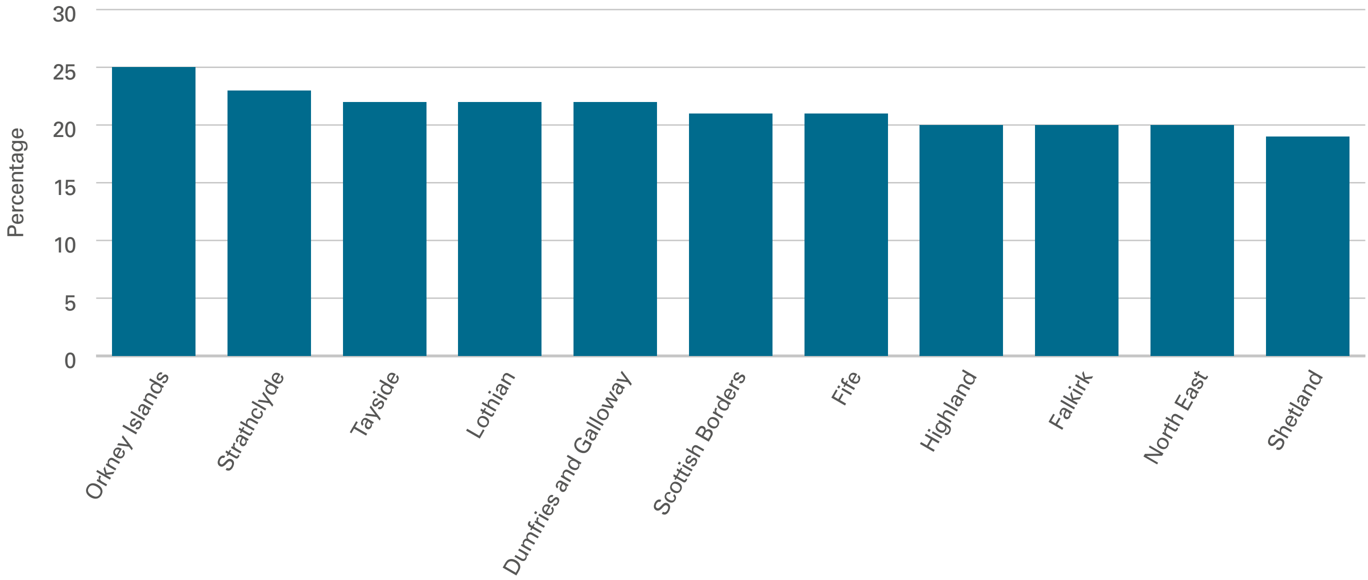
- Supports compliance with law and regulation
- Can consider any matter deemed relevant
- Membership 50:50 employer and union representation
- May request Pension Committee to review decisions

Source: Audit Scotland

Exhibit 3

Return on investments as a percentage of opening investment assets 2016/17

Orkney had the highest investment returns in the year but is the smallest fund.



Source: Pension fund annual accounts 2016/17

12. There has been a continued interest across the pensions sector in the transparency of investment management costs. We welcome developments in this area, as even small reductions in cost arising from a better understanding and level of scrutiny can make a difference when compounded over time. In last year's supplement we expressed our support for full disclosure of costs in pension fund annual reports.

Present value of promised retirement benefits

13. Estimates of the present value of promised retirement benefits or 'pension liabilities' are required under both the pension regulations for funding valuations (forming the basis for employer contributions) and under accounting standards (for disclosure in the pension fund accounts). Funding valuations are carried out every three years whilst estimates of pension liabilities for accounting purposes are updated each year. Pension funds are currently awaiting their final funding valuations for 31 March 2017.

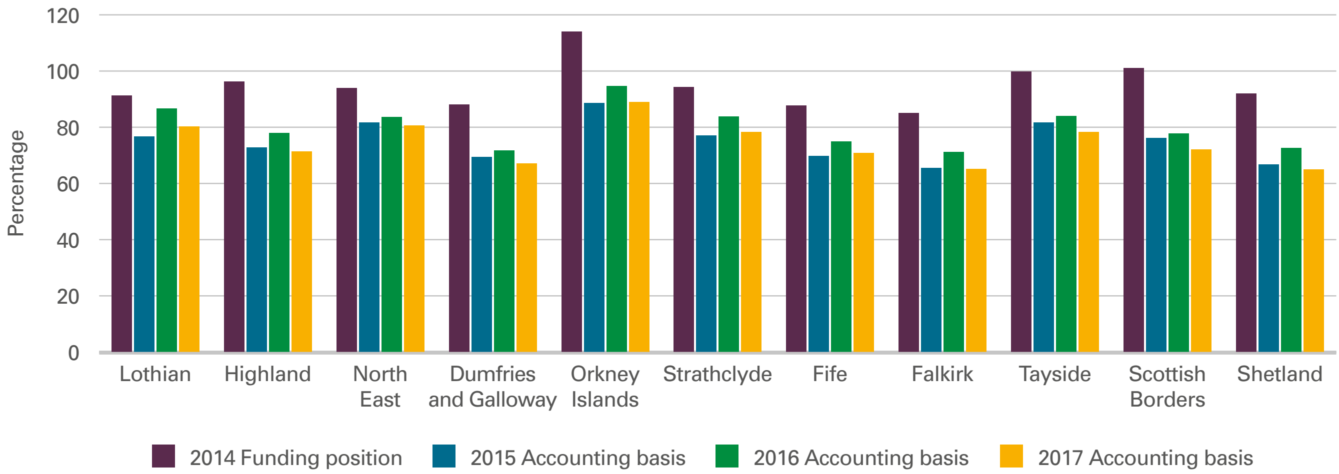
14. Accounting valuations produce higher estimations of liabilities and lower indicative funding levels as a result. Indicative funding levels on an accounting basis for 2017 are broadly similar to those in 2015 (Exhibit 4, page 5).

15. Actuaries will revisit their assumptions and use up to date data to calculate funding valuations as at 31 March 2017. It is this triennial funding valuation that will determine whether employer contributions will need to increase over the next three year period from 2018/19. Any increases for employers will be limited under the cost sharing mechanism in the LGPS 2015.

Exhibit 4

Pension fund assets as a percentage of estimated liabilities 2014 to 2017

Accounting valuations result in lower funding levels than those for funding purposes (2014).



Source: Pension fund annual reports and accounts

Cost control and the employer cost cap

16. Under Section 13 of the Public Service Pension Act 2013 (the 2013 Act) the Government Actuaries Department (GAD) will review the 2017 triennial valuation on behalf of Scottish Ministers. This review will look at the consistency with which actuaries have undertaken valuations in Scotland and their compliance with regulations. The review will also look at the solvency and long term efficiency of the funds and may make recommendations in relation to future cost sharing between employers and active members of the scheme.

17. The cost sharing mechanism in the LGPS 2015 is designed to ensure that the LGPS remains affordable for employers. Under this mechanism (GAD) has established a Scotland wide LGPS employer cost cap of 15.5 per cent. If the cost of providing benefits to members increases by more than two per cent above the employer cost cap then employee contributions and/or benefits will be reviewed.

18. GAD recently undertook a 'dry run' review[3] based on the 2014 funding valuations. This raised no concerns about the solvency or longer term efficiency of the LGPS in Scotland but did raise concerns about inconsistencies in valuations by different actuaries across Scotland's 11 pension funds. We understand that actuaries are looking to address GAD's concerns before reporting in 2018.

3 LGPS SCOTLAND Section 13 Dry Run Report.

Outlook

19. Pension funds face ongoing administrative pressures including those arising from:

- councils severances
- complexities of the new career average scheme.
- guaranteed minimum pension reconcilliations (with HMRC records)
- pensions auto enrolment.

20. To help to reduce their costs and improve services, pension funds are increasingly providing online services to employers and members through programmes of digitalisation. As services evolve pension funds will need to be alert to cyber security risks.

21. New regulatory arrangements for financial markets arising from Markets in Financial Instruments Directive (MIFID 2) will also impact on pension funds from 1 January 2018. MIFID 2 requires all local authorities to be treated as 'retail clients' by their asset managers which would severely limit the ability of pension funds to invest. However, the Financial Conduct Authority rules allow local authorities to opt up to 'professional investor' status allowing fund managers to continue to offer the full range of investments. MIFID 2 was designed to protect the interests of local authorities and care will be needed to ensure that opting up for pension investments does not expose the wider council to increased risks.

22. Delivering investment returns will no doubt remain a challenge for pension funds and pension fund managers. It is unclear to what extent further collaboration between funds will reduce costs and improve performance. It is also unclear whether the Scottish Minister will require pension funds to formally collaborate or propose any structural change following the recent report on the structure of the LGPS in Scotland.

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COMMITTEE	PENSIONS COMMITTEE
DATE	16 MARCH 2018
REPORT TITLE	BUDGET/FORECAST & PROJECTED SPEND 2017/18
REPORT NUMBER	PC/MAR18/BUD
DIRECTOR	DIRECTOR OF RESOURCES
REPORT AUTHOR	MICHAEL SCROGGIE

1. PURPOSE OF REPORT:-

1.1 The purpose of this report is to give the Pensions Committee details of the Management Expenses Budget/Forecast and Projected Spend 2017/18 for the North East Scotland Pension Fund (NESPF).

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Note the update on the NESPF Management Expenses Budget/Forecast and Projected Spend for 2017/18;
ii. Note the update on Pension Fund Staff Costs and staffing vacancies,
iii. Note the update on Actuarial Fees, Direct Property Expenses, Custody Fees and Transaction Costs shown in Appendix I.

3. BACKGROUND/MAIN ISSUES

3.1 BUDGET / FORECAST AND PROJECTED SPEND 2017/18 (APPENDIX I)

3.1.1 Administrative Expenses – all staff costs of the pension administration team are charged direct to the Fund quarterly. Associated management, accommodation and other overheads are apportioned to this activity and charged annually as expenses to the Fund.

3.1.2 Oversight and Governance Expenses – all staff costs associated with oversight and governance are charged direct to the Fund quarterly. Associated management costs are apportioned to this activity and charged annually as expenses to the Fund.

3.1.3 The Administrative and Investment Staff Cost Budgets are consistent with the Direct Staff Costs Budget 2017-18 that was reported to Full Council in February 2017. A potential underspend has been identified. However, this underspend, which has largely been associated with staffing vacancies, has been mostly offset by Voluntary Severance and Strain Costs.

3.1.4 Investment Management Expenses – Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or decrease as the market value of these investments change. Fund Managers charge their fees quarterly in arrears. In addition, the Fund has negotiated performance related fees with a number of its investment managers. If applicable, performance fees are charged annually at the year end. The unpredictability of market forces for these elements makes forecasting extremely difficult with any degree of accuracy.

3.1.5 The Chartered Institute of Public Finance and Accountancy (CIPFA) has reviewed and revised their guidance to Pension Funds on Accounting for Scheme Management Costs. As a result, the Fund no longer accounts for indirect limited partnership fees.

3.1.6 Transaction Costs and Direct Property Expenses are included within the section 'Investment Management Expenses'. Other investment related expenses (e.g. Investment advice and litigation, etc.) are included within the section 'Oversight & Governance Expenses'.

3.1.7 It is a requirement of the 'Code of Practice on Local Authority Accounting in the United Kingdom 2017/18' that Transaction Costs are broken down by all of the major asset classes, e.g. Fixed Income and Equities.

3.2 **GOVERNANCE**

3.2.1 The Pension Fund projected costs for salaries and direct costs are included in monthly monitoring reports to the Service and Corporate Management Teams. The Chief Officer-Finance reports to the Pensions Committee on a quarterly monthly basis.

4. FINANCIAL IMPLICATIONS

4.1 All Pension Fund costs are paid for by the Fund.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 There are no direct risk implications arising from the recommendations of this report.

7. IMPACT SECTION

7.1 The Pension Fund Budget or Forecast promotes accountability and gives reassurance to the stakeholders in the Pension Fund. This report ensures transparency in costs from the administrator of the Fund.

8. BACKGROUND PAPERS

8.1 North East Scotland Pension Fund (NESPF) Annual Report & Accounts (2016/17) and Fund Governance Policy Statement.

9. APPENDICES (if applicable)

9.1 **Appendix I**, Budget/Forecast and Projected Spend 2017/18

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Appendix I – 2017/18 BUDGET/FORECAST AND PROJECTED SPEND

The Budget and Projected Spend for NESPF Administration Expenses are shown below:

	Notes	Full Year Budget 2017/18	Budget to 31/12/17	Actual Spend to 31/12/17	Accrual to 31/12/17	Amended Spend to 31/12/17	Over or (Under) to 31/12/17	Proj Annual Spend 2017/18	Proj Over or (Under) Spend 2017/18
		£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Administrative Staff Costs	1	1,144	858	614	247	861	3	1,125	(19)
Support Services inc IT		575	431	374	104	478	47	575	0
Printing & Publications		30	23	30	0	30	7	30	0
Administration Expenses Total		**1,749**	**1,312**	**1,018**	**351**	**1,369**	**57**	**1,730**	**(19)**

Note (Spend Variance ± 5%):

1. Under spend – The previously reported variance of ± 5% arising from new posts yet to be advertised and filled has since been offset against Voluntary Severance and Strain Costs.

Appendix I – 2017/18 BUDGET/FORECAST AND PROJECTED SPEND (continued)

The Budget and Projected Spend for NESPF Oversight & Governance Expenses are shown below:

	Notes	Full Year Budget 2017/18	Budget to 31/12/17	Actual Spend to 31/12/17	Accrual to 31/12/17	Amended Spend to 31/12/17	Over or (Under) to 31/12/17	Proj Annual Spend 2017/18	Proj Over or (Under) Spend 2017/18
		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Investment Staff Costs		157	118	72	41	113	(5)	150	(7)
Pension Fund Committee		15	11	3	3	6	(5)	15	0
Pension Board		5	4	1	0	1	(3)	5	0
External Audit Fee	1	35	26	0	11	11	(15)	33	(2)
Internal Audit Fee		10	7	0	7	7	0	10	0
Actuarial Fees	2	100	75	75	43	118	43	157	57
General Expenses	3	150	113	73	47	120	7	165	15
Oversight & Governance Expenses Total		**472**	**354**	**224**	**152**	**376**	**22**	**535**	**63**

Note (Spend Variance ± 5%):

1. Under spend – Reduction in Audit Scotland Fee in real terms.
2. Over spend – Projection based upon current spend trend. Although, this spend trend is unlikely to be constant and may increase or decrease in response to actions taken elsewhere within the Pension Fund. However, if the trend of current spend continues, an over spend is anticipated.
3. Over spend – Projection based upon current spend trend. Although, this spend trend is unlikely to be constant and may increase or decrease in response to actions taken elsewhere within the Pension Fund. However, if the trend of current spend continues, an over spend is anticipated.

Appendix I – 2017/18 BUDGET/FORECAST AND PROJECTED SPEND (continued)

The Forecast and Projected Spend for NESPF Investment Management Expenses are shown below:

	Notes	Full Year Forecast 2017/18	Forecast to 31/12/17	Actual Spend to 31/12/17	Accrual to 31/12/17	Amended Spend to 31/12/17	Over or (Under) to 31/12/17	Proj Annual Spend 2017/18	Proj Over or (Under) Spend 2017/18
		£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Investment Management		11,200	8,400	2,212	5,423	7,635	(765)	11,760	560
Performance Fees		4,620	3,465	(608)	4,099	3,491	26	4,655	35
Direct Property Expenses	1	400	300	171	23	194	(106)	265	(135)
Transaction Costs	2	1,200	900	1,458	417	1,875	975	2,499	1,299
Custody Fees	3	135	101	54	33	87	(14)	120	(15)
Investment Management Expenses Total		**17,555**	**13,166**	**3,287**	**9,995**	**13,282**	**116**	**19,299**	**1,744**

Note (Spend ± 5%):

1. The Projected Spend for 2017/18 is based upon the Fund Manager's estimation for the year. The Fund Manager does not foresee the same level of 'lease surrender' as previously experienced in 2016-17. However, caution should be exercised regarding this 'underspend'. Predicting the property market is extremely difficult especially when seeking to determine whether or not there will be an element of the unknown, i.e. 'lease surrender', in the spend for the year.

2. Transaction Costs are reported by the Custodian (BNPP) as at the reporting date then projected for the remaining part of the year. Albeit a useful guide, using past transaction activity as a basis for projecting costs carries the risk of over/under stating the spend for the year. If current transaction activity continues, including Fund Manager transitions, an over spend is anticipated.

Analysis of Transaction Costs Actual Spend for the period 1 April 2017 to 31 December 2017:

	Commission (£)	Fees/Tax (£)	**Total (£)**
Equities	146,880	529,467	**676,347**
Fixed Income	781,375	0	**781,375**
Grand Total (£)	**928,255**	**529,467**	**1,457,722**

3. Under spend – Less Custody fees as a result of there being more pooled funds and less active Fund Managers.

Important to Note

Appendix I is a forecast of costs for Investment Management Expenses rather than a traditional budget. This is due to the level of estimation involved and the extent of the unknown, especially given that Investment Management and Performance Fees are based upon an unpredictable Market Value. This terminology has been adopted following discussions with the CIPFA Pensions Network.

ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	16 MARCH 2018
REPORT TITLE	UPDATE ON THE DRAFT FUNDING STRATEGY STATEMENT
REPORT NUMBER	PC/MAR18/FSS
DIRECTOR	DIRECTOR OF RESOURCES
REPORT AUTHOR	CLAIRE MULLEN

1. PURPOSE OF REPORT:-

1.1 To seek approval for the draft Funding Strategy Statements for both the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF) in order to allow the scheme actuary to sign off the 2017 triennial valuation and set the employer contribution rate requirements in time for the deadline of 31 March 2018.

2. RECOMMENDATIONS

2.1 It is recommended that the Committee:

i. Approve the draft NESPF Funding Strategy Statement including the proposed assumptions that have been recommended by the scheme actuary
ii. Approve the draft ACC Transport Fund Funding Strategy Statement including the proposed assumptions that have been recommended by the scheme actuary
iii. Approve the proposal to disaggregate the ‘Council’s Group’ and the ‘Other Employers Group’ from 1 April 2017
iv. Note the remainder of the report.

3. BACKGROUND/MAIN ISSUES

3.1 **2017 Actuarial Valuation and Funding Strategy Statement(s)**

3.1.1 A report to the Pensions Committee in December 2017 (Appendix III) provided details of the valuation carried out by the scheme actuary for both the NESPF and the ACC Transport Fund as at 31 March 2017.

3.1.2 In accordance with the scheme regulations a full consultation with all participating employers was carried out from 8 November 2017 to 31 January 2018 to invite comments on the new 2017 Funding Strategy Statement and the proposed assumptions used by the scheme actuary to calculate the value of the liabilities held within the Funds.

3.2 **NESPF Consultation**

3.2.1 During the consultation period a pleasing amount of employers engaged with the Fund in order to seek adjustments to their proposed contribution rates, to request further information or to provide comments on the assumptions applied.

3.2.2 The Fund was given scope by the scheme actuary to make adjustments to the individual employer contribution rates where it was deemed appropriate. Adjustments that could be made by the Fund were in relation to short term pay restraint assumptions, phasing any increase over the valuation period and making adjustments to the deficit recovery/surplus spread period.

3.2.3 As a result of the consultation the Fund agreed to apply a short term pay restraint assumption of 1% per annum or CPI+0% for several employers where they could provide evidence that the standard assumption of CPI+1.5% would be overly generous.

3.2.4 Where the proposed rates had increased by more than 3% phasing of the increase was applied for employers that made this request on the grounds of affordability.

3.2.5 For employers that were to see a significant increase to their rate, and where membership profiles allowed, the scheme reduced the surplus spread period or increased the deficit recovery period from the standard period of 16 years in order to reduce the employer contribution requirement.

3.2.6 Where there continued to be issues for any employers the scheme actuary was consulted to allow consideration to a reduction in contribution rates on the grounds of affordability, taking into account employer covenant.

3.2.7 Although affordability continues to be a concern for a lot of the participating employers, many of the respondents to the consultation commented that long term stability of rates was particularly desirable and they were supportive of the prudent approach adopted by the Fund and scheme actuary.

3.2.8 As a result of the consultation responses from the participating employers the Fund do not propose to make any changes to the assumptions outlined in the 2017 Funding Strategy Statement (Appendix I)

3.3 ACC Transport Fund Consultation

3.3.1 As the only participating employer within the ACC Transport Fund, First Group took the opportunity to respond to the consultation on the draft FSS (Appendix II). They are content with the continued low risk approach to the valuation of the Transport Fund given the maturity of the Fund but had comments on the appropriateness of two of the assumptions used by the actuary.

3.3.2 In response to the comments the scheme actuary was comfortable with making amendments to the assumption used for salary growth but did not accept that any changes should be made to the assumptions for longevity.

3.3.3 The 2017 ACC Transport Fund FSS has been amended to reflect the accepted changes.

3.3.4 Due to the maturity of the Transport Fund and the de-risking flight plan that is currently in place with the Fund Manager Schroders continuous monitoring of the Fund will continue throughout the inter-valuation period.

3.4 Disaggregation of the remaining valuation groups

3.4.1 Due to the positive outcome of the 2017 valuation and the increased emphasis by the Pensions Regulator (tPR) on solvency and long term cost efficiency the Fund proposes to disaggregate the remaining valuation groups with effect from the valuation date. This would mean that from 1 April 2017 the employers within the 'Councils' group and the 'other employers' group will stand alone and all employers will now have their own employer contribution rate based on their individual membership profile, fund experience and funding level.

3.4.2 The participating employers have been supportive of the intention to disaggregate all groups, understanding that it will bring transparency to the valuation process and a better understanding of how liabilities are calculated and how individual employer experience affects funding levels.

4. FINANCIAL IMPLICATIONS

4.1 The actuarial valuation sets the employer contribution rates for all participating employers within the Funds. It is essential that the underlying assumptions used to determine the contribution requirements are set in such a way that ensures that the Funds remain solvent whilst also taking into consideration the desirability to create stability for employers.

4.2 Whilst the Funds recognise that affordability is a concern with all employers that actively participate within the scheme the regulations require that the emphasis is put on overall solvency of the scheme and minimising risk for the Funds as a whole.

4.3 Failure to set accurate assumptions or set high expectations on the future investment performance will mean that employer rates are not set accurately and will have a detrimental effect on the funding levels for future valuations.

4.4 The Fund is aware that the scheme actuary continues to apply prudent assumptions to the calculation of the liabilities for both the NESPF and the ACC Transport Fund and remain comfortable with this approach.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 There are no direct risk implications arising from the recommendation of this report.

7. IMPACT SECTION

7.1 The Fund's Statement of Investment Principles has been revised following the 2017 tri-ennial valuation to ensure that the investment returns continue to meet the requirements of the Fund to achieve the funding target.

8. BACKGROUND PAPERS

8.1 None

9. APPENDICES

9.1 **Appendix I**, NESPF Fund Funding Strategy Statement 2017 (draft)
Appendix II, ACCTF Funding Strategy Statement 2017 (draft)
Appendix III, Valuation Report brought to Committee December 2017

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DRAFT

FUNDING STRATEGY STATEMENT

NORTH EAST SCOTLAND PENSION FUND

FEBRAURY 2017

Aberdeen City Council

This Funding Strategy Statement has been prepared by Aberdeen City Council (the Administering Authority) to set out the funding strategy for the North East Scotland Pension Fund (the "Fund"), in accordance with Regulation 56 of the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

I

EXECUTIVE SUMMARY

Ensuring that the North East Scotland Pension Fund (the "Fund") has sufficient assets to meet its pension liabilities in the long term is the fiduciary responsibility of the Administering Authority (Aberdeen City Council). The Funding Strategy adopted by the North East Scotland Pension Fund will therefore be critical in achieving this.

The purpose of this Funding Strategy Statement ("FSS") is to set out a clear and transparent funding strategy that will identify how each Fund employer's pension liabilities are to be met going forward.

> The details contained in this Funding Strategy Statement will have a financial and operational impact on all participating employers in the North East Scotland Pension Fund.
>
> It is imperative therefore that each existing or potential employer is aware of the details contained in this statement.

Given this, and in accordance with governing legislation, all interested parties connected with the North East Scotland Pension Fund have been consulted and given opportunity to comment prior to this Funding Strategy Statement being finalised and adopted. This statement takes into consideration all comments and feedback received.

THE FUND'S OBJECTIVE

The Administering Authority's long term objective is for the Fund to achieve and maintain a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due. This objective is considered on an employer specific level also.

The general principle adopted by the Fund is that the assumptions used, taken as a whole, will be chosen sufficiently prudently for pensions already in payment to continue to be paid, and to reflect the commitments that will arise from members' accrued pension rights.

The funding strategy set out in this document has been developed alongside the Fund's investment strategy on an integrated basis taking into account the overall financial and demographic risks inherent in the Fund. The funding strategy includes appropriate margins to allow for the possibility of events turning out worse than expected. Individual employer results will also have regard to their covenant strength and the investment strategy applied to the asset shares of those employers.

SOLVENCY AND LONG TERM COST EFFICIENCY

Each employer's contributions are set at such a level to achieve full solvency in a reasonable timeframe. Solvency is defined as a level where the Fund's liabilities i.e. benefit payments can be reasonably met as they arise.

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time. Equally, the FSS must have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

When formulating the funding strategy, the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure its "solvency" and "long term cost efficiency" of the Local Government Pension Scheme (Scotland) (the "LGPS") so far as relating to the Fund.

DEFICIT RECOVERY PLAN AND CONTRIBUTIONS

As the solvency level of the Fund is 107% at the valuation date i.e. the assets of the Fund are greater than the liabilities, the surplus can potentially be used to reduce ongoing contribution requirements. However, the funding position at individual employer level will vary and for some employers a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall.

Deficit contributions paid to the Fund / surplus run off in respect of each employer will be expressed as a percentage of pensionable pay and it is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford given other competing cost pressures. This may result in some flexibility in recovery periods by employer which would be at the sole discretion of the Administering Authority. The recovery periods will be set by the Fund, although employers will be free to pay above the minimum contribution certified if they wish. Employers may also elect to make prepayments of deficit contributions which could result in a cash saving over the valuation certificate period. For employers in surplus this will be removed at a rate which depends on the circumstances of each employer. This will depend on the financial covenant and if the employer may potentially exit the Fund in the near future. In some cases this may mean the employer pays the primary contribution rate unadjusted.

The objective is to achieve 100% solvency over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the total contributions at a similar level from the preceding valuation. Full details are set out in this FSS.

The period for recovering any deficit will vary by employer and this is covered in further detail in Appendix B.

Where there is an increase in contributions required at this valuation the employer will be able to step-up their contributions over a period of 3 years, with effect from 1 April 2018.

ACTUARIAL ASSUMPTIONS

The actuarial assumptions used for assessing the funding position of the Fund and the individual employers, the "Primary" contribution rate, and any contribution variations due to underlying surpluses or deficits (i.e. the “Secondary” rate) are set out in an Appendix to this FSS.

The discount rate in excess of CPI inflation (the “real discount rate”) has been derived based on the expected return on the Fund’s assets based on the long term strategy set out in its Statement of Investment Principles (SIP). When assessing the appropriate prudent discount rate, consideration has been given to the level of expected asset returns in excess of CPI inflation (i.e. the rate at which the benefits in the LGPS generally increase each year). It is proposed at this valuation the real return over CPI inflation for determining the past service liabilities and future service (“Primary”) contribution rates is 1.75% per annum.

Where warranted by an employer’s circumstances, the Administering Authority retains the discretion to apply an adjusted discount rate to reflect the termination assumptions for that employer if it were to exit the Fund to protect the Fund as a whole. Such cases will be determined by the Section 95 Officer and reported to the Committee.

The demographic assumptions are based on the Fund Actuary’s bespoke analysis for the Fund, also taking into account the experience of the wider LGPS where relevant.

EMPLOYER ASSET SHARES

The Fund is a multi-employer pension scheme that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is necessary to make some approximations in the timing of cashflows and allocation of investment returns when deriving each employer’s asset share.

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation.

Other adjustments are also made on account of the funding positions of orphan bodies which fall to be met by all other active employers in the Fund.

FUND POLICIES

In addition to the information/approaches required by overarching guidance and Regulation, this statement also summarises the Fund’s practice and policies in a number of key areas:

1. Covenant assessment and monitoring

An employer’s financial covenant underpins its legal obligation and crucially the ability to meet its financial responsibilities to the Fund now and in the future. The strength of covenant to the Fund effectively underwrites the risks to which the Fund is exposed. These risks include underfunding, longevity, investment and market forces.

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital to the overall risk management and governance of the Fund. The employers’ covenants will be assessed and monitored objectively in a proportionate manner, and an employer’s ability to meet its obligations in the short and long term will be considered when determining its funding strategy.

After the valuation, the Fund will continue to monitor employers' covenants in conjunction with their funding positions over the inter-valuation period. This will enable the Fund to anticipate and pre-empt any material issues arising and thus adopt a proactive approach in partnership with the employer. More details are provided in Appendix D to this statement.

2. Admitting employers to the Fund

Various types of employers are permitted to join the LGPS under certain circumstances, and the conditions upon which their entry to the Fund is based and the approach taken is set out in Appendix C. Examples of new employers include:

- Scheme Employers
- Designated bodies - those that are permitted to join if they pass a resolution
- Admission bodies - usually arising as a result of an outsourcing or a transfer to an entity that provides some form of public service and their funding primarily derives from local or Scottish Government.

Certain employers may be required to provide a guarantee or alternative security before entry will be allowed, in accordance with the Regulations and Fund policies.

3. Termination policy for employers exiting the Fund

When an employer ceases to participate within the Fund, it becomes an exiting employer under the Regulations. The Fund is then required to obtain an actuarial valuation of that employer's liabilities in respect of the benefits of the exiting employer's current and former employees, along with a termination contribution certificate.

Where there is no guarantor who would subsume the liabilities of the exiting employer, the Fund's policy is that a discount rate linked to government bond yields and a more prudent longevity assumption is used for assessing liabilities on termination. Any exit payments due should be paid immediately although instalment plans will be considered by the Administering Authority on a case by case basis. The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it.

CONTENTS

APPENDICES

1
INTRODUCTION

The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) ("the 2014 Regulations") and the Local Government Pension Scheme (Transitional) Regulations 2014 ("the 2014 Transitional Regulations") (collectively; "the Regulations") provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the North East Scotland Pension Fund (the "Fund"), the Administering Authority will prepare and publish their funding strategy;
- In preparing the FSS, the Administering Authority must have regard to:
  - the guidance issued by CIPFA for this purpose; and
  - the Statement of Investment Principles (SIP) for the Fund published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy set out in the FSS or the SIP.

BENEFITS

The benefits provided by the Fund are specified in the governing legislation contained in the Regulations referred to above. Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure for members. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time facilitating scrutiny and accountability through improved transparency and disclosure.

The Fund is a defined benefit arrangement with principally final salary related benefits earned by contributing members up to 1 April 2015 and Career Averaged Revalued Earnings ("CARE") benefits earned thereafter. There is also a "50:50 Scheme Option", where members can elect to accrue 50% of the full scheme benefits in relation to the member only and pay 50% of the normal member contribution.

EMPLOYER CONTRIBUTIONS

The required levels of employee contributions are specified in the Regulations. Employer contributions are determined in accordance with the Regulations (which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate specifying the "primary" and "secondary" rate of the employer's contribution).

PRIMARY RATE

The "Primary rate" for an employer is the contribution rate required to meet the cost of the future accrual of benefits, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer's covenant.

The Primary rate for the whole Fund is the weighted average (by payroll) of the individual employers' Primary rates.

SECONDARY RATE

The “Secondary rate” is an adjustment to the Primary rate to arrive at the total rate of contribution each employer is required to pay. The Secondary rate may be expressed as a percentage adjustment to the Primary rate, and/or a cash adjustment in each of the three years beginning 1 April in the year following the actuarial valuation.

Secondary rates for the whole Fund in each of the three years shall also be disclosed. These will be the calculated weighted average based on the whole Fund payroll in respect of percentage rates and the total amount in respect of cash adjustments.

2
PURPOSE OF FSS IN POLICY TERMS

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due.

The purpose of this Funding Strategy Statement is therefore:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward by taking a prudent longer-term view of funding those liabilities;
- to establish contributions at a level to "secure the solvency" of the pension fund and the "long term cost efficiency",
- to have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the Administering Authority to implement and maintain.

3
AIMS AND PURPOSE OF THE FUND

THE AIMS OF THE FUND ARE TO:

- manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due
- enable employer contribution rates to be kept at a reasonable and affordable 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 profile of the Fund now and in the future due to sector changes
- maximise the returns from investments within reasonable risk parameters taking into account the above aims.

THE PURPOSE OF THE FUND IS TO:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of Fund benefits, transfer values, costs, charges and expenses as defined in the 2014 Regulations and the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended).

4
RESPONSIBILITIES OF THE KEY PARTIES

The efficient and effective management of the Fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently. The key parties for the purposes of the FSS are the Administering Authority (and, in particular the Pensions Committee), the individual employers and the Fund Actuary and details of their roles are set out below. Other parties required to play their part in the fund management process are bankers, custodians, investment managers, auditors and legal, investment and governance advisors, along with the Local Pensions Board created under the Public Service Pensions Act 2013.

KEY PARTIES TO THE FSS

The **Administering Authority** should:

- operate the pension fund
- collect employer and employee contributions, investment income and other amounts due to the pension scheme as stipulated in the Regulations
- pay from the pension fund the relevant entitlements as stipulated in the Regulations
- invest surplus monies in accordance the Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- take measures as set out in the Regulations to safeguard the fund against the consequences of employer default
- manage the valuation process in consultation with the Fund’s actuary
- prepare and maintain a FSS and an SIP, both after proper consultation with interested parties, and
- monitor all aspects of the Fund’s performance and funding, amending the FSS/SIP as necessary
- effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and a fund employer, and
- establish, support and monitor a Local Pension Board (LPB) as required by the Public Service Pensions Act 2013, the Regulations and the Pensions Regulator’s relevant Code of Practice.

The **Individual Employer** should:

- deduct contributions from employees’ pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)
- pay all contributions, including their own as determined by the actuary, 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 Fund benefits, early retirement strain, and
- have regard to the Pensions Regulator’s focus on data quality and comply with any requirement set by the Administering Authority in this context, and
- notify the Administering Authority promptly of any changes to membership which may affect future funding.

The **Fund Actuary** should:

- prepare valuations including the setting of employers' contribution rates at a level to ensure fund solvency after agreeing assumptions with the Administering Authority and having regard to their FSS and the Regulations
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill health retirement costs etc.
- provide advice and valuations on the termination of admission agreements
- provide advice to the Administering Authority on bonds and 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 required by the Regulations
- advise on funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the SIP, and
- ensure the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to the Fund Actuary's role in advising the Fund.

5

SOLVENCY FUNDING TARGET

Securing the “solvency” and “long term cost efficiency” is a regulatory requirement. To meet these requirements the Administering Authority’s long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the “funding target”) assessed on an ongoing past service basis including allowance for projected final pay where appropriate. In the long term, an employer’s total contribution rate would ultimately revert to its Primary rate of contribution.

SOLVENCY AND LONG TERM EFFICIENCY

Each employer’s contributions are set at such a level to achieve full solvency in a reasonable timeframe. Solvency is defined as a level where the Fund’s liabilities i.e. benefit payments can be reasonably met as they arise.

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time.

When formulating the funding strategy the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary’s Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the “solvency” of the pension fund and “long term cost efficiency" of the LGPS so far as relating to the Fund.

DETERMINATION OF THE SOLVENCY FUNDING TARGET AND RECOVERY PLAN

The principal method and assumptions to be used in the calculation of the funding target are set out in **Appendix A**. The Employer Recovery Plans are set out in **Appendix B**. This covers the recovery of deficits and the run off of any surplus assets over liabilities where applicable.

Underlying these assumptions are the following two tenets:

- that the Fund is expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

This allows the Fund to take a longer term view when assessing the contribution requirements for certain employers.

In considering this the Administering Authority, based on the advice of the Fund Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful potentially taking into account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2018 at the latest.

As part of each valuation separate employer contribution rates are assessed by the Fund Actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the distinct employers and employer groups in the Fund.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2017 actuarial valuation:

- The Fund does not believe it appropriate for contribution reductions to apply compared to the existing funding plan where deficits remain unless there is compelling reason to do so.

- Subject to consideration of affordability, where a deficit exists, as a general rule the deficit recovery period will reduce by at least 3 years for employers at this valuation when compared to the preceding valuation. This is to target full solvency over a similar (or shorter) time horizon. Employers will have the freedom to pay above the minimum contributions if they so wish. Subject to affordability considerations and other factors, a bespoke period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Recovery Plan in **Appendix B**).

- Where an employer is in surplus this will be run off over a period determined by the Administering Authority on the advice of the Actuary. This will depend on the nature of employer, allowing for the financial covenant strength and reasonable affordability of contributions. The objective is to maintain stability of total contributions at this and future valuations.

- Individual employer contributions will be expressed and certified as two separate elements:
    - the **Primary rate**: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits
    - the **Secondary rate**: a percentage of pensionable payroll over 2018/21 in respect of an employer's surplus or deficit

  For any employer, the total contributions they are actually required to pay in any one year is the sum of the Primary and Secondary rates (subject to an overall minimum of zero). Both elements are subject to further review from April 2021 based on the results of the 2020 actuarial valuation.

- Where increases (or decreases) in employer contributions are required from 1 April 2018, following completion of the 2017 actuarial valuation, the increase (or decrease) from the rates of contribution payable in the year 2018/19 may be implemented in steps, over a maximum period of 3 years.

- On the cessation of an employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment. Any deficit in the Fund in respect of the employer will be due to the Fund as a termination contribution, unless it is agreed by the Administering Authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Fund to another participating employer. The termination policy is summarised in Appendix C.

- In all cases the Administering Authority reserves the right to apply a different approach at its sole discretion, taking into account the risk associated with an employer in proportion to the Fund as a whole. Such cases will be determined by the Section 95 Officer and notified to the Committee. The employer will also be notified.

FUNDING FOR NON-ILL HEALTH EARLY RETIREMENT COSTS

Employers are required to meet all costs of early retirement strain by capital payments into the Fund as determined on the advice of the Actuary.

7
LINK TO INVESTMENT POLICY AND THE STATEMENT OF INVESTMENT PRINCIPLES (SIP)

The results of the 2017 valuation show the liabilities to be 107% covered by the current assets.

In assessing the value of the Fund's liabilities in the valuation, allowance has been made for growth asset out-performance as described below, taking into account the investment strategy adopted by the Fund, as set out in the SIP.

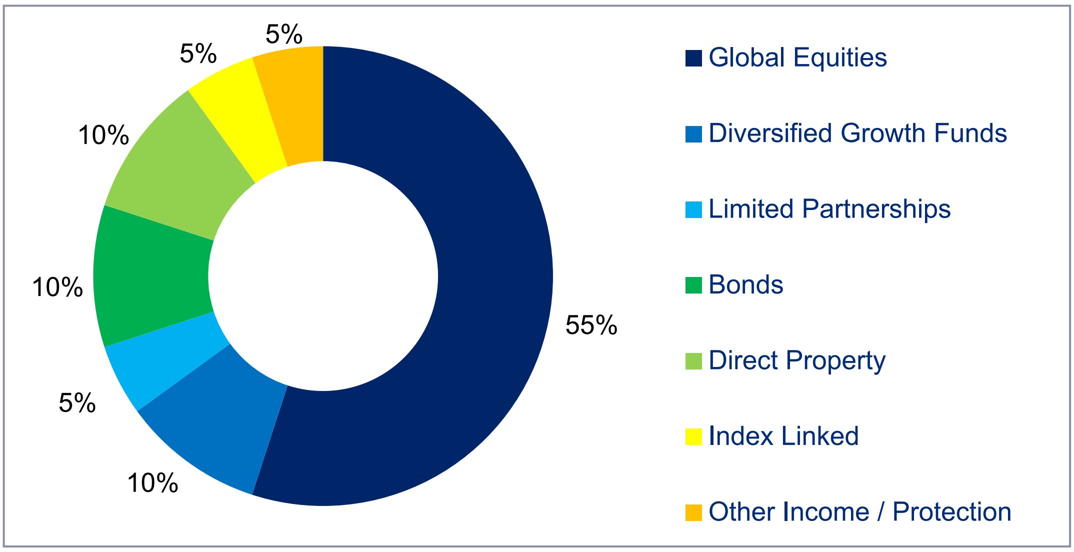
It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which represents the "minimum risk" investment position which would deliver a very high certainty of real returns above assumed CPI inflation. Such a portfolio would consist of a mixture of long-term index-linked, fixed interest gilts and possible swaps.

Investment of the Fund's assets in line with this portfolio would minimise fluctuations in the Fund's funding position between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out this valuation it would not be appropriate to make any allowance for growth assets out-performance. This would result in real return versus CPI inflation of nil per annum at the valuation date. On this basis of assessment, the assessed value of the Fund's liabilities at the valuation would have been significantly higher, resulting in a funding level of 79%.

Departure from a minimum risk investment strategy, in particular to include growth assets such as equities, gives a better prospect that the assets will, over time, deliver returns in excess of CPI inflation and reduce the contribution requirements. The target solvency position of having sufficient assets to meet the Fund's pension obligations might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The proposed long-term investment strategy is:



As documented in the SIP, the investment strategy and return expectations set out above equate to an overall best estimate average expected return of 1.75% per annum in excess of CPI inflation. For the purposes of setting funding strategy however, the Administering Authority believes that it is appropriate to take a margin for prudence on these return expectations.

8
IDENTIFICATION OF RISKS AND COUNTER-MEASURES

The funding of defined benefits is by its nature uncertain. Funding of the Fund is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the Fund Actuary that the greatest risk to the funding level is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that assumed in the long term.

FINANCIAL

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Market outlook moves at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated

Any increase in employer contribution rates (as a result of these risks), may in turn impact on the service delivery of that employer and their financial position.

In practice the extent to which these risks can be reduced is limited. However, the Fund's asset allocation is kept under constant review and the performance of the investment managers is regularly monitored.

DEMOGRAPHIC

The demographic risks are as follows:-

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)
- Unanticipated acceleration of the maturing of the Fund resulting in materially negative cashflows and shortening of liability durations
- The level of take-up of the 50:50 option at a lower level than built into the actuarial assumptions.

Increasing longevity is something which government policies, both national and local, are designed to promote. It does, however, result in a greater liability for pension funds.

Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, **employing bodies should be doing everything in their power to minimise the number of ill-health retirements**. Early retirements for reasons of redundancy and efficiency do not affect the solvency of the Fund because they are the subject of a direct charge.

With regards to increasing maturity (e.g. due to further cuts in workforce and/or restrictions on new employees accessing the Fund), the Administering Authority regularly monitors the position in terms of cashflow requirements and considers the impact on the investment strategy.

INSURANCE OF CERTAIN BENEFITS

The contributions for any employer may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund.

REGULATORY

The key regulatory risks are as follows:-

- Changes to Regulations, e.g. changes to the benefits package, retirement age, potential new entrants to Fund,
- Changes to national pension requirements and/or HMRC Rules

Membership of the LGPS is open to all local government staff and should be encouraged as a valuable part of the contract of employment. However, increasing membership does result in higher employer monetary costs.

GOVERNANCE

The Fund has done as much as it believes it reasonably can to enable employing bodies and Fund members to make their views known to the Fund and to participate in the decision-making process.

Governance risks are as follows:-

- The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated
- Administering Authority unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements) with the result that contribution rates are set at too low a level
- Administering Authority not advised of an employer closing to new entrants, something which would normally require an increase in contribution rates
- An employer ceasing to exist with insufficient funding or adequacy of a bond. Where there is a guarantor body in place, any outstanding funding deficit that is not recovered from the outgoing employer / bond will need to be paid by the guarantor (or the assets and liabilities for the outgoing employer will need to be subsumed by the guarantor). For cases where there is no guarantor or bond in place, any outstanding funding deficit that is not recovered from the outgoing employer will need to be subsumed by the Fund as a whole and spread across all employers.
- Changes in the Committee membership.

For these risks to be minimised much depends on information being supplied to the Administering Authority by the employing bodies. Arrangements are strictly controlled and monitored, but in most cases the employer, rather than the Fund as a whole, bears the risk. Nevertheless, where an employer defaults on its liabilities the risk in some cases may be borne by the whole Fund, so to that extent all Fund employers have joint and several liability to the Fund.

9
MONITORING AND REVIEW

The Administering Authority has taken advice from the actuary in preparing this Statement, and has consulted with the employers participating in the Fund.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of the current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example, if there:

- has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- have been significant changes to the Fund membership, or LGPS benefits
- have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy
- have been any significant special contributions paid into the Fund.

When monitoring the funding strategy, if the Administering Authority considers that any action is required, the relevant employing authorities will be contacted. In the case of admitted bodies, there is statutory provision for rates to be amended between valuations but it is unlikely that this power will be invoked other than in exceptional circumstances.

APPENDIX A - ACTUARIAL METHOD AND ASSUMPTIONS

METHOD

The actuarial method to be used in the calculation of the solvency funding target is the Projected Unit method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the Fund on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted, which makes advance allowance for the anticipated future ageing and decline of the current closed membership group potentially over the period of the rates and adjustments certificate.

FINANCIAL ASSUMPTIONS – SOLVENCY FUNDING TARGET AND THE COST OF FUTURE ACCRUAL (OR PRIMARY RATE)

Investment return (discount rate)

The discount rate has been derived based on the expected return on the Fund assets based on the long term strategy set out in the Statement of Investment Principles (SIP). It includes appropriate margins for prudence. When assessing the appropriate discount rate consideration has been given to the returns in excess of CPI inflation (as derived below). The discount rate at the valuation has been derived based on an assumed return of 1.75% per annum above CPI inflation i.e. a real return of 1.75% per annum equating to a total discount rate of 4.15% per annum. This real return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics.

Where warranted by an employer's circumstances, the Administering Authority retains the discretion to apply a discount rate based on a lower risk investment strategy for that employer to protect the Fund as a whole.

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Fund's accrued liabilities.

A reduction of 1.0% per annum due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index has been made.

Salary increases

In relation to benefits earned prior to 1 April 2015, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint for some employers as budgeted in their financial plan. The allowance for short term pay restraint, where applicable, is a salary increase assumption of 1.0% or CPI +0% per annum for the period up to 2020.

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions where the LGPS is not required to provide full indexation).

DEMOGRAPHIC ASSUMPTIONS

Mortality/Life Expectancy

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the Fund. The mortality tables used are set out below, with a loading reflecting Fund specific experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. Current members who retire on the grounds of ill health are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 4 years older whereas for existing ill health retirees we assume this is at an age 3 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a level of longevity 'improvement' year on year in the future in line with the CMI projections with a long-term improvement trend of 1.75% per annum for males and 1.5% per annum for females.

The mortality before retirement has also been adjusted based on LGPS wide experience.

Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up.

Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the incidence of ill health retirements, withdrawal rates and the proportions married/civil partnership assumption have been modified from the last valuation. In addition, no allowance will be made for the future take-up of the 50:50 option (this is the same assumption as at the last valuation). Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate for the next 3 years. Other assumptions are as per the last valuation.

Expenses

Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by adding 0.4% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

The costs of any discretion exercised by an employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation

EMPLOYER ASSET SHARES

The Fund is a multi-employer pension scheme that is not formally unitised and so individual employer asset shares are calculated at each actuarial valuation. This means it is necessary to make some approximations in the timing of cashflows and allocation of investment returns when deriving the employer asset share.

In attributing the overall investment performance obtained on the assets of the Fund to each employer a pro-rata principle is adopted. This approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Fund as a whole unless agreed otherwise between the employer and the Fund at the sole discretion of the Administering Authority.

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation.

Other adjustments are also made on account of the funding positions of orphan bodies which fall to be met by all other active employers in the Fund.

SUMMARY OF KEY WHOLE FUND ASSUMPTIONS USED FOR CALCULATING FUNDING TARGET AND COST OF FUTURE ACCRUAL (THE "PRIMARY RATE") FOR THE 2017 ACTUARIAL VALUATION

Long-term yields	
Market implied RPI inflation	3.4% p.a.
Investment return/Discount Rate	4.15% p.a.
CPI price inflation	2.4% p.a.
Long Term Salary increases	3.9% p.a.
Pension increases/indexation of CARE benefits	2.4% p.a.

Life expectancy assumptions

The post retirement mortality tables adopted for this valuation, along with sample life expectancies, are set out below:

	Base Table	**Improvements (M / F)**	**Adjustment (M / F)**
Current pensioners:			
Normal health	S2PA	CMI_2015 [1.75%] / [1.5%]	103% / 98%
Ill-health	S2PA	CMI_2015 [1.75%] / [1.5%]	Normal health +3 years
Dependants	S2PMA / S2DFA	CMI_2015 [1.75%] / [1.5%]	129% / 113%
Future dependants	S2PMA / S2DFA	CMI_2015 [1.75%] / [1.5%]	125% / 114%
Current active / deferred:			
Active normal health	S2PA	CMI_2015 [1.75%] / [1.5%]	100% / 90%
Active ill-health	S2PA	CMI_2015 [1.75%] / [1.5%]	Normal health +4 years
Deferred	S2PA	CMI_2015 [1.75%] / [1.5%]	128% / 104%
Future dependants	S2PMA / S2DFA	CMI_2015 [1.75%] / [1.5%]	107% / 104%

Other demographic assumptions are set out in the Actuary's formal report.

APPENDIX B – EMPLOYER RECOVERY PLANS

If the assets of an Employer are less than the liabilities at the effective date, a deficit recovery plan needs to be adopted such that additional contributions are paid into the Fund to meet the shortfall. For Employers with assets greater than their liabilities, the surplus can be run off to reduce ongoing contribution requirements.

Deficit contributions paid to the Fund by each employer will be expressed as a percentage of pensionable pay and it is the Fund's objective that any funding deficit is eliminated as quickly as the participating employers can reasonably afford based on the Administering Authority's view of the employer's covenant and risk to the Fund. Where an employer is in surplus the period over which it will be run off will depend on the type of employer, its financial covenant strength and the objective of maintaining stability of contributions for future valuations in light of the market outlook.

Recovery periods to remove deficit will be set by the Fund on a consistent basis across employer categories where possible and communicated as part of the discussions with employers. This will determine the minimum contribution requirement and employers will be free to select higher contributions if they wish, including the option of prepaying deficit contributions in one lump sum either on annual basis or a one-off payment.

The determination of the recovery periods is summarised in the table below:

Category	Average Deficit Recovery / Surplus Spreading Period	Derivation
Scheme Employers	16 years	Determined by ensuring overall contributions are reasonably stable relative to the current funding plan allowing for any affordability constraints.
Open Admitted Bodies	Minimum of 9 years and the remaining contract period	Determined by ensuring overall contributions are reasonably stable relative to the current funding plan allowing for any affordability constraints.
Closed Employers	Minimum of 3 years, the remaining contract period and the future working lifetime of the membership	Determined by ensuring overall contributions are reasonably stable relative to the current funding plan allowing for any affordability constraints.
Employers with a limited participation in the Fund	Determined on a case by case basis	Length of expected period of participation in the Fund

In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:

- The size of the funding shortfall / surplus;
- The business plans of the employer;
- The assessment of the financial covenant of the Employer, and security of future income streams;
- Any contingent security available to the Fund or offered by the Employer such as guarantor or bond arrangements, charge over assets, etc.

The objective is to recover any deficit or remove any surplus over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the contributions at the expected levels from the preceding valuation.

Other factors affecting the Employer Recovery Plans

As part of the process of agreeing funding plans with individual employers, the Administering Authority will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities. All other things equal this could result in a longer recovery period or a quicker surplus run off being acceptable to the Administering Authority. Employers in a deficit position will still be expected to at least cover expected interest costs on the deficit.

It is acknowledged by the Administering Authority that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Administering Authority therefore would be willing to use its discretion to accept an evidence- based affordable level of contributions for the organisation for the three years 2018/2021. Any application of this option is at the ultimate discretion of the Section 95 Officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.

For those bodies identified as having a weaker covenant, the Administering Authority will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans. As a minimum, the annual deficit payment must meet the on-going interest costs to ensure, everything else being equal, that the deficit does not increase in monetary terms.

Notwithstanding the above, the Administering Authority, in consultation with the actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

APPENDIX C - ADMISSION AND TERMINATION POLICY

INTRODUCTION

This document details the North East Scotland Pension Fund's (NESPF) policy on the methodology for assessment of ongoing contribution requirements and termination payments in the event of the cessation of an employer's participation in the Fund. This document also covers NESPF's policy on admissions into the Fund and sets out the considerations for current and former admission bodies. It supplements the general policy of the Fund as set out in the Funding Strategy Statement (FSS).

- Admission bodies are required to have an "admission agreement" with the Fund. In conjunction with the Regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.

- Scheme Employers have a statutory right to participate in the LGPS and their staff therefore can become members of the LGPS at any time, although some organisations (Part 2 Scheme Employers) do need to designate eligibility for its staff.

A list of all current employing bodies participating in the NESPF is kept as a live document and will be updated by the Administering Authority as bodies are admitted to, or leave the NESPF.

Please see the glossary for an explanation of the terms used throughout this Appendix.

ENTRY TO THE FUND

Prior to admission to the Fund, an Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Administering Authority. If the risk assessment and/or bond amount is not to the satisfaction of the Administering Authority (as required under the LGPS (Scotland) Regulations) it will consider and determine whether the admission body must pre-fund for termination with contribution requirements assessed using the minimum risk methodology and assumptions.

Some aspects that the Administering Authority may consider when deciding whether to apply a minimum risk methodology are:

- Uncertainty over the security of the organisation's funding sources e.g. the body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves;

- If the admitted body has an expected limited lifespan of participation in the Fund;

- The average age of employees to be admitted and whether the admission is closed to new joiners.

In order to protect other Fund employers, where it has been considered undesirable to provide a bond, a guarantee must be sought in line with the Regulations.

ADMITTED BODIES PROVIDING A SERVICE

Generally Admitted Bodies providing a service will have a guarantor within the Fund that will stand behind the liabilities. Accordingly, in general, the minimum risk approach to funding and termination will not apply for these bodies.

As above, the Admitted Body is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the Administering Authority. This assessment would normally be based on advice in the form of a “risk assessment report” provided by the actuary to the NESPF. As the Scheme Employer is effectively the ultimate guarantor for these admissions to the NESPF it must also be satisfied (along with the Administering Authority) over the level (if any) of any bond requirement. Where bond agreements are to the satisfaction of the Administering Authority, the level of the bond amount will be subject to review on a regular basis.

In the absence of any other specific agreement between the parties, deficit recovery periods for Admitted Bodies will be set in line with the Fund’s general policy as set out in the FSS.

Any risk sharing arrangements agreed between the Scheme Employer and the Admitted Body will be documented in the commercial agreement between the two parties and not the admission agreement.

In the event of termination of the Admitted Body, any orphan liabilities in the Fund will be subsumed by the relevant Scheme Employer.

An exception to the above policy applies if the guarantor is not a participating employer within the NESPF, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the NESPF the Administering Authority may in this case treat the admission body as pre-funding for termination, with contribution requirements assessed using the minimum risk methodology and assumptions

PRE-FUNDING FOR TERMINATION

An employing body may choose to pre-fund for termination i.e. to amend their funding approach to a minimum risk methodology and assumptions. This will substantially reduce the risk of an uncertain and potentially large debt being due to the Fund at termination. However, it is also likely to give rise to a substantial increase in contribution requirements, when assessed on the minimum risk basis.

For any employing bodies funding on such a minimum risk strategy a notional investment strategy will be assumed as a match to the liabilities. In particular the employing body’s notional asset share of the Fund will be credited with an investment return in line with the minimum risk funding assumptions adopted rather than the actual investment return generated by the actual asset portfolio of the entire Fund. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

EXITING THE FUND

TERMINATION OF AN EMPLOYER’S PARTICIPATION

When an employing body terminates for any reason, employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case the employees will retain pension rights within the Fund i.e. either deferred benefits or immediate retirement benefits.

In addition to any liabilities for current employees the Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members except where there is a complete transfer of responsibility to another Fund with a different Administering Authority.

In the event that unfunded liabilities arise that cannot be recovered from the employing body, these will normally fall to be met by the Fund as a whole (i.e. all employers) unless there is a guarantor or successor body within the Fund.

With the exception of grouped employers (see below), the NESPF's policy is that a termination assessment will be made based on a minimum risk funding basis, unless the employing body has a guarantor within the Fund or a successor body exists to take over the employing body's liabilities (including those for former employees). This is to protect the other employers in the Fund as, at termination, the employing body's liabilities will become orphan liabilities within the Fund, and there will be no recourse to it if a shortfall emerges in the future (after participation has terminated).

If, instead, the employing body has a guarantor within the Fund or a successor body exists to take over the employing body's liabilities, the NESPF's policy is that the valuation funding basis will be used for the termination assessment unless the guarantor informs the NESPF otherwise. The guarantor or successor body will then, following any termination payment made, subsume the assets and liabilities of the employing body within the Fund. (For Admission Bodies, this process is sometimes known as the "novation" of the admission agreement.) This may, if agreed by the successor body, constitute a complete amalgamation of assets and liabilities to the successor body, including any funding deficit on closure. In these circumstances no termination payment will be required from the outgoing employing body itself, as the deficit would be recovered via the successor body's own deficit recovery plan.

[The NESPF currently groups certain employers for contribution rate setting purposes. The NESPF's policy is that, on termination of participation within the group, the termination assessment will be based on a simplified share of deficit approach. This involves disaggregating the outgoing body from the group by calculating the notional deficit share as at the last actuarial valuation of the Fund, in proportion to the respective payrolls for the body and the group as a whole, and then adjusting to the date of exit. The share of deficit will be assessed based on the ongoing valuation funding basis for the group as a whole at the last actuarial valuation. The adjustment to the date of exit will normally be made in line with the assumptions adopted as at the last actuarial valuation unless the actuary and Administering Authority consider that the circumstances warrant a different treatment, for example, to allow for actual investment returns over the period from the last actuarial valuation to exit.

It is possible under certain circumstances that an employer can apply to transfer all assets and current and former members' benefits to another LGPS Fund in Scotland. In these cases no termination assessment is required as there will no longer be any orphan liabilities in the NESPF. Therefore, a separate assessment of the assets to be transferred will be required.

FUTURE TERMINATIONS

In many cases, termination of an employer's participation is an event that can be foreseen, for example, because the organisation's operations may be planned to be discontinued and/or the admission agreement is due to cease. Under the Regulations, in the event of the Administering Authority becoming aware of such circumstances, it can amend an employer's minimum contributions such that the value of the assets of the employing body is neither materially more nor materially less than its anticipated liabilities at the date it appears to the Administering Authority that it will cease to be a participating employer. In this case, employing bodies are encouraged to open a dialogue with the Fund to commence planning for the termination as early as possible. Where termination is disclosed in advance the Fund will operate procedures to reduce the sizeable volatility risks to the debt amount in the run up to actual termination of participation. The Fund will modify the employing body's approach in any case, where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

The Fund's standard policy is to recover termination deficits (including interest and expenses) as a one off payment. However, at the discretion of the Administering Authority, the deficit can be recovered over an agreed period as certified by the Actuary. This period will depend on the Administering Authority's view on the covenant of the outgoing employer.

MINIMUM RISK TERMINATION BASIS

The minimum risk financial assumptions that applied at the actuarial valuation date (31 March 2017) are set out below in relation to any liability remaining in the Fund. These will be updated on a case-by-case basis, with reference to prevailing market conditions at the relevant employing body's cessation date.

Least risk assumptions	31 March 2017
Discount Rate	1.6% p.a.
CPI price inflation	2.4% p.a.
Pension increases/indexation of CARE benefits	2.4% p.a.

All demographic assumptions will be the same as those adopted for the 2017 actuarial valuation, except in relation to the life expectancy assumption. Given the minimum risk financial assumptions do not protect against future adverse demographic experience a higher level of prudence will be adopted in the life expectancy assumption.

The termination basis for an outgoing employer will include an adjustment to the assumption for longevity improvements over time by increasing the rate of improvement in mortality rates to 2% p.a. from 1.75% for males and 1.5% for females used in the 2017 valuation for ongoing funding and contribution purposes.

APPENDIX D – COVENANT ASSESSMENT AND MONITORING POLICY

INTRODUCTION

This document sets out the Fund's approach to Employer risk management and in particular in respect of those bodies in the Fund defined as 'admission bodies'. This document supports the Fund's Employer Engagement Strategy

1.1 ADMISSION BODIES

Under the Local Government Pension Scheme (LGPS) (Scotland) Regulations, certain employers are allowed to participate in the North East Scotland Pension Fund (the Fund) if they satisfy the relevant criteria. These are known as admission bodies. An admission body is required to have an 'admission agreement' with the Fund. In conjunction with the regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.

In line with Schedule 2 of the Regulations, All new admission bodies are required to carry out, to the satisfaction of the administering authority, an assessment, taking account of actuarial advice, of the level of risk arising on premature termination of the provision of service or assets by reason of insolvency, winding up or liquidation of the admission body.

The admission body is required to enter into a bond to cover this risk but, where it is not possible for the admission body to enter into a bond then a guarantee can be obtained from another entity provided certain conditions are met.

It is acceptable for the original transferring employer to instruct in writing to the Administering Authority that they should waive the requirement for a bond/indemnity and/or other guarantee on the basis of the guarantee provided by the original scheme employer under the Regulations. The Administering Authority will consider if this is acceptable depending on the covenant of the original scheme employer.

1.2 EMPLOYER COVENANT

An employer's covenant underpins its legal obligation and ability to fund the Scheme now and in the future. The strength of covenant depends upon the robustness of the legal agreements in place and the likelihood that the employer can meet them. The covenant effectively underwrites the risks to which the Scheme is exposed, including underfunding, longevity, investment and market forces.

An Assessment of employer covenant focuses on determining the following:

- Type of body and its origins.
- Nature and enforceability of legal agreements.
- Whether there is a bond in place and the level of the bond.
- Whether a more accelerated recovery plan should be enforced.
- Whether there is an option to call in contingent assets.
- Is there a need for monitoring of ongoing and termination funding ahead of the next actuarial valuation?

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital.

2 RISK

2.1 DEFINITION OF RISK

Risk can be defined as the combination of the probability of an event and its consequences. In this instance, the probability centres around participation in the Fund coming to an end or being prematurely terminated and if employees are not transferred to another employer, pension rights will be retained within the Fund in respect of the outgoing employer These pension rights, deferred benefits, immediate retirement benefits or existing pensions in payment form the employer's liabilities. In the event that liabilities arise that cannot be recovered from the admission body, these will normally fall to be met by the original Scheme employer where they are acting as a guarantor, or the Fund as a whole where there is no guarantor in the Fund. Therefore, the consequence is that the Fund is exposed to risk where employers are unable to meet their liabilities and there is no cover provided by a guarantor.

Risk management includes identifying and assessing risks (the 'inherent risks') and responding to them.

Response to risk, which is initiated within the organisation, is through management of risk and may involve one or more of the following:

- Tolerating risk.
- Treating risk in an appropriate way to constrain the risk to an acceptable level.
- Transferring the risk.
- Terminating the activity giving rise to the risk.

The level of risk remaining after a review is that which has been accepted (the 'residual risk") and is the exposure in respect of that risk, and should be acceptable and justifiable.

2.2 IDENTIFYING RISK

The North East Scotland Pension Fund (the Fund) is exposed to a number of risks associated with admission bodies and other employers. In order to mitigate these risks, it is necessary to identify them and prescribe them certain levels so as to ascertain which are deemed tolerable and those that need to be addressed.

Broadly speaking the key risks specific to the Fund are as follows:

Financial - Market fluctuations, investment returns and pay/price inflation.

Demographic - Increased longevity and the cost of early retirements/death-in-service.

Regulatory - Changes to regulations and changes to national pension requirements and/or HMRC rules.

Governance - Administering authority unaware of structural changes in employer's membership, administering authority not advised of an employer closing to new entrants, and an employer ceasing to exist with insufficient funding or adequacy of a bond. In addition lack of quality data from the employer can impact of the risk profile.

Employers - Sustainability of an employer or their ability to meet their liabilities within the agreed funding strategy.

Clearly some of the risks identified are beyond the control of the Fund and, therefore, it is important to target those where it does have influence when mitigating risk. With this in mind, the focus of this document will be in the areas of governance and employers' activities or actions, but consideration should also be given to the cost of early retirements (including in ill health) and death in service and the potential for the transfer of such risk through appropriate insurance whether externally or internally within the Fund.

2.3 LEVELS OF RISK

The levels of risk facing the Fund can be generally classified as lower, medium and higher risk as illustrated below:

Participating Employers

Lower Risk	Medium Risk	Higher Risk
Local Authorities	Bodies which are part of a group or pooled bodies which share unfunded costs on default	Admission bodies with no guarantors and a significant deficit
Bodies with local authority guarantor	Admission bodies with small deficit or surplus of assets over liabilities	Bodies with potentially limited life span and in deficit
Bodies with long-term funding from local or central government		No active members or is closed with a significant deficit
		Relies on voluntary or charitable source of income with significant deficit

A key aspect of the risk categorisation will be the level of deficit in the Fund. This will be monitored as noted below.

The Fund will consider whether further banding of risk is required for employers and in certain cases it may be full assessment of potential risk is needed on a bespoke basis.

In addition in the context of those employers providing a guarantee to the Fund for certain employer liabilities (typically Local Authorities) the risk would be re-categorised ignoring the guarantee. This will be to show the guarantors the level of exposure in terms of their existing guarantees.

2.4 NATURE OF RISK

The principal risk facing the North East Scotland Pension Fund is the inability of an employer to be able to meet its regular pension contributions and/or its liabilities upon termination. A deficit upon termination of an admission agreement might arise in the following scenarios:

a) Non-payment of contributions to the Fund by an employer prior to closure

b) Premature termination of a contract where market values are depressed relative to the liabilities in respect of an admission body, assessed on consistent assumptions to those adopted in the previous actuarial valuation.

c) The reality is less favourable than the assumptions used in setting contribution rates for that employer – for instance, lower than expected investment returns, higher than expected rates of early retirement or excessive pay increases.

d) Additional liabilities created as a result of the body closing, in particular the possible payment of immediate retirement benefits to all those eligible at that time.

e) A pre-existing deficit in the Fund (past service liability).

f) A change from open to closed status.

3 ASSESSMENT OF RISK

3.1 RISK CRITERIA

The Pensions Regulator has set out prescribed guidelines detailing the assessment criteria upon which an employer should be reviewed:

- Nature and prospects of the employer’s industry.
- Employer’s competitive position and relative size.
- Management ability and track record.
- Financial policy of the employer.
- Profitability, capital structure, cashflow and financial flexibility.
- Employer’s credit rating.
- Position of the economy as a whole.

CIPFA also include information on how covenant and risk should be considered in their guidance Preparing and Maintaining a Funding Strategy Statement in the Local Government Pension Scheme.

Not all of the above would be applicable to assessing employer risk within the North East Scotland Pension Fund rather a balanced approach to consideration of the above criteria would be made, with further consideration given to the following:

The scale of obligations to the pension scheme relative to the size of the employer's operating cashflow.

The relative priority placed on the pension scheme compared to corporate finances.

An estimate of the amount which might be available to the scheme on insolvency of the employer as well as the likelihood of that eventuality.

3.2 RISK PARAMETERS

For the North East Scotland Pension Fund, the risk a particular employer represents will be quantified using a five pronged approach, governed by the assessment criteria or triggers outlined below. Where one or more of these triggers is engaged, such employers will be subject to a more detailed review by the Fund. These criteria, when analysed in conjunction with the strength of the employer covenant (Section 5), will provide the basis for the framework upon which risk will be continually assessed and employer stability monitored.

1. Employer with less than five active members
2. Employer where significant member movements are imminent
3. Employer with a known participation length of 18 months or less
4. Employer with a known deficit of a significant level, relative to size of its financial metrics
5. Employer with a funding level identified at the last review of less than [80%] or a deficit greater than [£0.5m]

4 MONITORING/SCREENING OF THE EMPLOYER COVENANT

4.1 ASSESSING THE EMPLOYER COVENANT

The employer covenant should be assessed objectively and the ability of employers or guarantors to meet their obligations should be viewed in the context of the Fund's exposure to risk and volatility, while preserving the interests of other employers within the Fund. The monitoring of covenant strength by itself does not strengthen the Fund's security; however, it does enable the Fund to anticipate and pre-empt employer funding issues and thus adopt a proactive approach with a view to reminding employers of their obligations and managing their expectations. In order to objectively monitor the strength of an employer's covenant, adjacent to the risk posed to the Fund, the proposal is for a number of fundamental financial metrics to be appraised to develop an overview of the employer's stability. These financial metrics center around the following:

- Does the employer have a guarantor within the Fund or employer structure?
- The employer's funding source and length (if known).
- The employer's cashflow forecast, ideally over the next three to five years.
- If the employer has any contingent assets which can be used by the Fund to provide security.

In order to accurately monitor employer covenant, it will be necessary for research to be carried out into employers' backgrounds and, in addition, for those employers to be contacted sensitively to gather as much information as possible. Focus will be placed on the continual monitoring of employers with a proactive rather than reactive view to mitigating risk.

An overview of the framework upon which an employer's covenant will be monitored is detailed in the diagram overleaf (4.4). It is considered that this will provide the basis for actions to be taken and ultimately the management of risk, covered in the next section.

4.2 FREQUENCY OF MONITORING

The funding position and contribution rate for each employer participating in the Fund will be reviewed as a matter of course with each triennial actuarial valuation. However, it is important that the relative financial strength of employers is reviewed regularly to allow for a thorough assessment of the financial metrics. There will be instances where known 'events' or individual employer circumstances are to be taken into consideration, and they will be incorporated into the monitoring framework.

Employers subject to a more detailed review, where a risk criterion is triggered, will be reviewed at least every six months, but more realistically with a quarterly focus. In such cases a more in depth analysis will be carried out taking into consideration all of the financial metrics and extenuating circumstances.

Separately the funding position will be monitored in conjunction with the Actuary to consider the potential exposure of the Fund in light of the covenant strength.

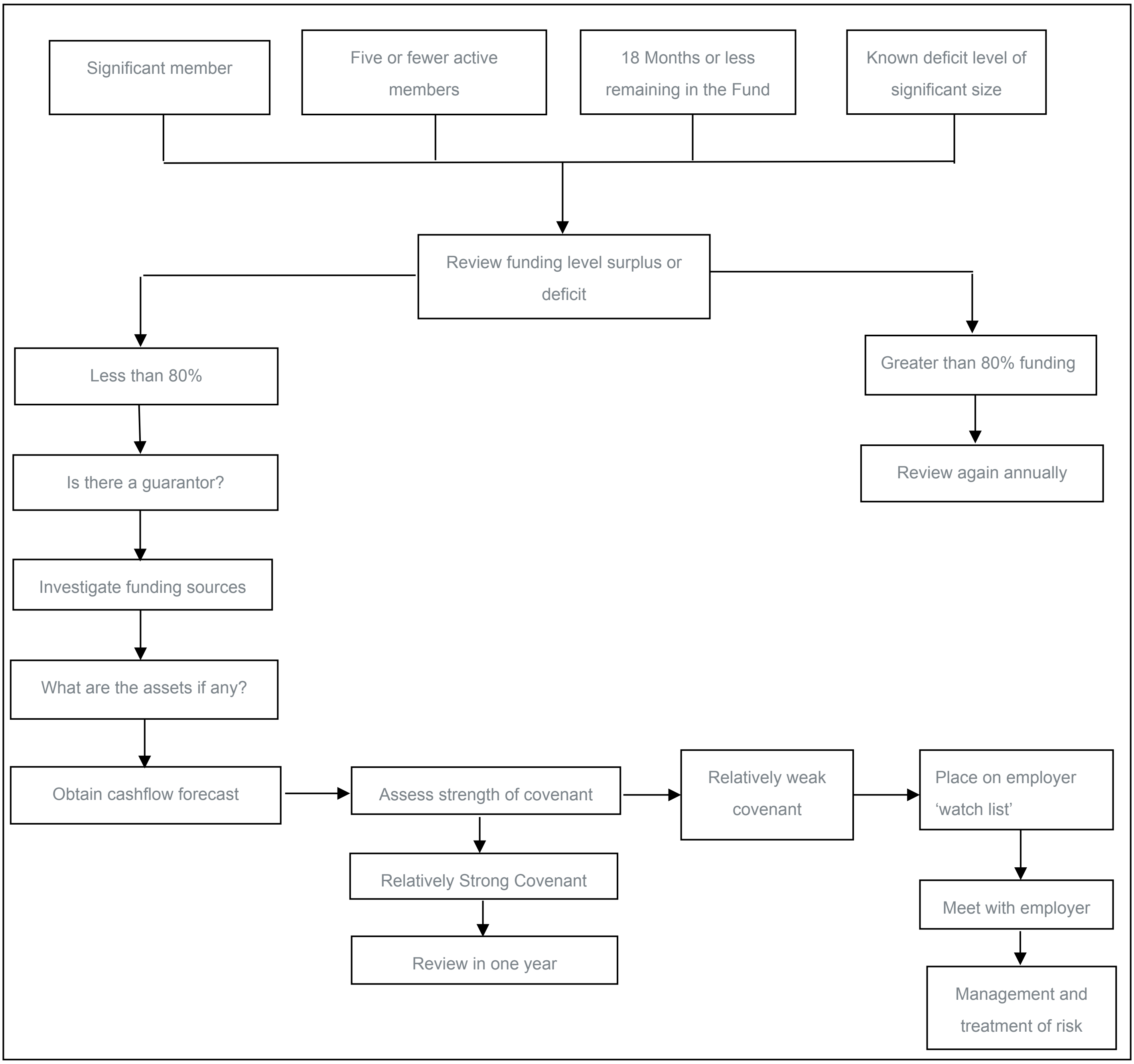
4.3 EMPLOYER MEETINGS

As a basis for the monitoring of employers within the Fund, meetings are to be scheduled with those organisations where there is a particular concern over strength of their covenant, accrual of liabilities and future funding levels. Priority will be given to those employers requiring a more detailed review and the aim would be for meetings to be scheduled every six months for such organisations. In addition, it will also be necessary to arrange meetings with employers where there is a need to gain an understanding of their financial position with a view to assisting the monitoring process.

It is recognised that meetings will be tailored to each employer's needs, in conjunction with the Fund's assessment of that organisation; however, it is anticipated that the payment of pension liabilities on termination will feature heavily in these discussions.

There may also be a requirement for such organisations to draft a payment proposal for the Fund's consideration, along with a projection of future cash flows and income/expenditure.

4.4 GUIDE TOWARDS MONITORING OF THE EMPLOYER COVENANT



5 MANAGEMENT OF RISK

5.1 OVERVIEW

The focus of the Fund's risk management is the identification and treatment of the risks. It will be a continuous and evolving process which runs throughout the Fund's strategy. This management of risk is not a linear process; rather it is the balancing of a number of interwoven elements which interact with each other and which have to be in balance with each other if the management is to be effective.

5.2 INITIAL STEPS

For new bodies seeking admission to the Fund, the Pension Fund will conduct an audit to review the financial strength of the organisation, based on their accounts and other key criteria (scored out of 100).

- Regulation requires that relevant admission agreements must contain a provision requiring all bodies to undertake an assessment of the level of risk posed to the Fund in the event that the service contract terminates prematurely as a result of the organisation's insolvency, winding up or liquidation. Such assessments must take into account actuarial advice and must be carried out to the satisfaction of the relevant administering authority.
- In respect of outsourcing bodies, the North East Scotland Pension Fund (the Fund) will send out a risk assessment form to be completed by the outsourcing body at their expense. In order for a risk assessment to be conducted by the Fund actuary, the Scheme employer will need to provide a standard data file of the transferring staff to include names, national insurance numbers and details of current salary.
- For admission bodies, upon receipt of the results of the risk assessment, which will include a calculation of the employer contribution rate, details of the contracted arrangement between the Scheme employer and organisation will be clarified. The Scheme employer will be required to confirm the responsibility for pension costs and any other contractual arrangements which may affect the participation and also whether a bond or separate guarantee is required. If there is a limit on the amount that should be reclaimed directly from the outgoing employer due to contractual arrangements then the Scheme employer must notify the Fund in writing that this needs to be taken into account. Any residual deficit (or surplus) will revert to the Scheme employer.
- On termination of the admission agreement, any contributions due will first be reclaimed from the organisation. If the organisation defaults on any payments then the bond (if a bond is in place) would be called on. Any outstanding monies would then fall back on the Scheme employer/guarantor.

The Fund will require confirmation of a suitable guarantor or indemnity for any admission body applications (see comments in 5.3 below).

5.3 BOND/GUARANTEE

In the event that an organisation becomes insolvent, it is unlikely to be able to meet its funding obligations to the Fund. Allowing organisations to become an admission body, therefore, creates an element of risk for the Fund, for other employers participating in the Fund and, in particular, for any outsourcing employing body.

If a risk assessment identifies a material level of risk, for an admission body, the administering authority will require the organisation to provide an indemnity or bond to protect against the identified risk or alternatively a separate guarantee.

Outsourcing employing bodies should regularly review the level of risk relating to an admission agreement, and require the admission body to put in place a revised bond or indemnity as appropriate.

The bond is the third party legal instrument required in respect of an organisation's admission to the LGPS (together with the service contract and the admission agreement). Organisations should consider employer rate and/or cost of bonds when making tender. Therefore, it is ideal these increased costs are considered early in contract/tender discussions.

Where a bond has been requested by the parent body or administering authority there will be a defined amount and timescale set. It is, therefore, important for the Fund to document the expiry date of such bonds and to monitor these closely. Bond information will be reviewed annually or when an expiry date is approaching. The aim would be to inform parent bodies where an expiry date is imminent to allow them to consider whether a revised bond is required. In cases where a revised bond is not required or cannot be obtained, it will be emphasised to the parent body that the potential for liability exists as ultimate guarantor.

As an alternative to a bond, the Fund will allow the organisation in question to set up an alternative guarantee or contingent assets e.g. an escrow account to which the Fund has direct claim upon in the event of insolvency or default, for the equivalent of the bond amount calculated by the Fund actuary. The Fund will require satisfactory evidence of such an alternative particularly on the understanding that it can only be closed or terminated via mutual consent. More detail is set out in 5.5 below.

5.4 SHORTENED RECOVERY PERIOD

The Fund actuary, in line with the Fund's Funding Strategy Statement (FSS), assumes a deficit recovery period based on the specifics of each employer group or individual employer. The Fund reserves the right to adjust this recovery period, where appropriate, dependent on the strength of an individual employer's covenant, its financial stability and future prospects.

In doing so, the Fund makes provision for any potential liability to be recouped over a shorter timescale, particularly where there is a risk the body in question may cease to exist. The shortening of the recovery period will of course increase the rates at which the employer must contribute and this needs to be weighed up in terms of its reasonable affordability vs impact on longer term covenant.

This involves a fine balancing act as it is not in the Fund's or guarantor's interest to impose an employer rate which is unaffordable and ultimately results in the premature cessation of that employer.

5.5 CONTINGENT ASSETS

Contingent assets are assets which exist upon the occurrence of one or more specified future events, at the behest of the Fund – for instance, the failure to achieve a specified funding level. They are not typically included as Scheme assets, for the purpose of assessing whether a scheme meets its funding objective, until they are transferred to the scheme. Examples of contingent assets include:

- a known guarantor, which agrees to cover all liabilities, or a proportion of those liabilities, arising upon termination (the contingent event). This can take place through the absorption of those liabilities by the guarantor to form part of its own liabilities or through the payment of a specified amount.
- security over other assets – for instance, property or securities, such that the asset is transferred to the Fund if the contingent event occurs.
- a letter of credit or a bond (see 5.3).
- sterling cash put aside in a bank account whereby some or all of the cash would be released to the Fund on the occurrence of the contingent event – for example, an escrow account.

The above list is not exhaustive and the Fund will consider alternatives as appropriate to each individual circumstance.

5.6 PHASED IMPLEMENTATION OF EMPLOYER CONTRIBUTION RATE

For certain bodies, the decision may be taken for the Fund's actuary to certify an employer rate lower than the target rate calculated for that particular body. This will usually involve the certified rate being set at the same level as that from the previous actuarial valuation and is with a view to providing that employer with a period of stability to alleviate short term cash funding issues. In such cases, the Fund will look for employers to increase their contributions on a phased basis, culminating in their reaching the Fund actuary's target rate at the end of an agreed period - typically a 3 year implementation period. The underpayment would be expected to be paid as soon as practical.

In order to calculate the annual increments applicable, the methodology will be based on the Fund actuary's target contributions, over the current contributions payable by the employer.

It will be stressed to employers that such rates still remain subject to change at the next triennial actuarial valuation and the approach will be taken on a case by case basis, including the treatment of the underpayment.

5.7 INFLATED EMPLOYER CONTRIBUTION RATE (RISK PREMIUM)

Consistent with the Funding Strategy Statement (FSS), the funding objective for triennial actuarial valuations is to achieve and then maintain assets equal to the funding target. The funding target is the present value of 100% of projected accrued liabilities, including allowance for projected final pay, on the appropriate assumptions applicable to that employer.

In practice, each new employer's position is assessed separately and their individual rates take into account the differing circumstances of each employer and the funding plan covered in the FSS.

It is an avenue open to the Fund that contributions for an admitted body, where there is a weak employer covenant and an associated concern, could be set relative to the funding target in excess of 100% of the liabilities. This higher target represents a "risk premium" against potential additional liabilities on failure of that admitted body. For example, the employer contributions could be based upon a funding target of 110% of projected accrued liabilities or set dependent upon the Fund's view towards each employer's risk.

6. TRANSFER OF RISK FOR OUTSOURCED BODIES

6.1 TRANSFER OF RISK

In order to preclude cross subsidy within the Fund between certain admitted bodies and other employers, the costs and financial effects of employers' participation in the Fund are separately identified ('separation basis'). One result of this approach is that the risks associated with a defined-benefit scheme promise in respect of the transferring staff, are transferred to the new employer. The costs relating to salary increases and early retirements also become the responsibility of the new employer. This allocation of risk to the new employer is very important to protect the position of other employers in the Fund, particularly the letting authority. There are ways in which risks can be shared with the original employer and new employer such as via the separate contractual arrangement. This can include fixing or limiting the contribution requirements on an ongoing or termination basis within certain parameters. Whilst not a direct party in these arrangements the Administering Authority would need to be notified of any such arrangements if these are to be taken into account at the termination of participation.

7. TREATMENT OF MATERIALISED RISK

7.1 OVERVIEW

The Fund recognises that there will be instances where, despite the monitoring of employer covenant and steps taken to both manage and transfer risk (where practical), this risk will nevertheless materialise. As identified previously, the principal risk facing the North East Scotland Pension Fund is the inability of an employer to be able to meet its liabilities upon termination or otherwise. Therefore, a prescribed set of measures need to be agreed to respond to this eventuality, in order to minimise the impact on the Fund.

7.2 TERMINATION OF AN ADMISSION AGREEMENT

In the event of termination of an admission agreement, for any one of the reasons covered in section 2.4, it will be necessary for the Fund actuary to calculate the associated deficit on a least-risk or gilts basis (unless the liabilities are to be transferred to another employer in the Fund e.g. where another body is acting as a guarantor in which case typically the assumptions would be on an ongoing actuarial valuation basis). The organisation in question will be responsible for paying the actuary's fee for this work, and the Administering Authority reserves the right to include it in the termination assessment and final contribution due from the employer or recharge it directly from the employer. The Fund will emphasise to employers their responsibility for remittance of the total deficit upon termination; however, in certain circumstances it may not be possible for an organisation to pay the total termination liabilities in one lump-sum. In this scenario, the Fund would request the organisation provides a payment plan for review and, if this is not satisfactory, consideration will be given to an independent financial and governance review (see 7.6).

Under the Regulations effective 1 April 2015 employers will automatically be deemed to terminate participation when the last active member leaves service.

7.3 CLOSED ADMISSION AGREEMENT WHERE NO ACTIVE MEMBERS REMAIN IN THE FUND

A closed admission agreement relates only to a fixed population of employees. In the case of an admission body, only those employees who transferred to the organisation from the outsourcing employing body can remain members of the LGPS through the admission agreement. Therefore, upon cessation of the last active member of a closed agreement, no further active members can be admitted and the approach for such cases would be the same as with 'Termination of an admission agreement' detailed in section 7.2.

7.4 OPEN ADMISSION AGREEMENT WHERE NO ACTIVE MEMBERS REMAIN IN THE FUND

An open admission agreement for an admission body potentially allows further employees of the organisation to become a member of the LGPS. In some cases however the employer may not propose employees do join.

As such, upon exit of the last active member from the Fund under an open agreement, it is entirely possible that a new active member might be admitted in the future. However, as a consequence of no active members remaining in the Fund, there will be no payroll upon which to base contributions. Therefore, it will be necessary for the Fund actuary to calculate an annual lump-sum amount equivalent to that organisation's target employer contribution rate, in order to address the associated liabilities. In order to protect the Fund's interests in such cases, the suggested approach would be for this calculation to be aligned to the strength of employer covenant, whereby the recovery period and consequently the size of such lump-sum payments would be tailored with this in consideration.

Under the proposed Regulations effective 1 April 2015 employers would automatically be deemed to terminate participation when the last active member leaves service. Such cases would be dealt with as per section 7.2.

All cases will be considered on their own merits and the Fund reserves the right to request full payment of the deficit assessed by the Fund Actuary. Set out below is a rule of thumb guide to the parameters that would be considered for a covenant based recovery period, where compliant with the parameters set out in the Funding Strategy Statement (FSS):

Weak employer covenant	A short recovery period (one or two valuation cycles i.e. [3-6] years) is preferable subject to contributions being reasonably affordable to the extent they do not impair the covenant.
Moderate employer covenant	As above but with perhaps [6-9] years being acceptable.
Strong employer covenant	As above but with perhaps [9-13] years being acceptable.

The covenant of the employer will be monitored on an ongoing basis as per section 4 above.

As with termination of an admission agreement, the costs of the Fund actuary's calculations will be the responsibility of the body in question. Agreement to the annual lump-sum payments will be required from the admitted body, in the same way that it would be sought in relation to ongoing employer rate contributions, calculated as part of the triennial actuarial valuation.

7.5 WINDING-UP, INSOLVENCY, OR CESSATION OF AN EMPLOYER

In the event an employer ceases to exist, the Fund would act as a creditor engaging with the administrator to recovery monies.

As part of the covenant assessment the Fund will consider the legal responsibility the employer has on termination in light of other legislation and priority order of other creditors.

7.6 INDEPENDENT FINANCIAL AND GOVERNANCE STANDING REVIEW BY THIRD PARTY AUDITOR

In addition to the Fund taking preventative steps towards risk and responding in the appropriate fashion to address materialising risk, it may be necessary for the Fund to appoint a third party agent to conduct an independent review.

This review would be centered upon the financial measures and wider robustness of the governance of the organisation, particularly with a view to instances of substandard management or negligent practice. The appraisal also provides the Fund with an external audit of the monitoring and risk aversion process employed, which is aimed at preserving the interests of all other participating employers and/or guarantor. The key objectives of this review will be to evaluate the financial standing and underlying governance arrangements, specifically:

- an assessment of the strength of the balance sheet and, based on this, drawing conclusions on the affordability of proposed termination payments. This element of the review will include, for example, structure/liquidity ratios; and
- a high-level evaluation of the body's overall governance structures and the adequacy of management's medium-term planning arrangements in addressing weaknesses and risks; and

- to develop an assessment methodology that can be applied to bodies in assessing their capability and capacity to manage and meet pension liabilities.

The above is not an exhaustive list of criteria that will be applied and each case will be considered on its own merits by the third party agent.

APPENDIX E - GLOSSARY

Actuarial Valuation: an investigation by an actuary into the ability of the Fund to meet its liabilities. For the LGPS the Fund Actuary will assess the funding level of each participating employer and agree contribution rates with the administering authority to fund the cost of new benefits and make good any existing deficits as set out in the separate Funding Strategy Statement. The asset value is based on market values at the valuation date.

Administering Authority: the council with a statutory responsibility for running the Fund and that is responsible for all aspects of its management and operation.

Admission bodies: A specific type of employer under the Local Government Pension Scheme (the “LGPS”) who do not automatically qualify for participation in the Fund but are allowed to join if they satisfy the relevant criteria set out in the Regulations.

Benchmark: a measure against which fund performance is to be judged.

Best Estimate Assumption: an assumption where the outcome has a 50/50 chance of being achieved.

Bonds: loans made to an issuer (often a government or a company) which undertakes to repay the loan at an agreed later date. The term refers generically to corporate bonds or government bonds (gilts).

Career Average Revalued Earnings Scheme (CARE): with effect from 1 April 2015, benefits accrued by members in the LGPS take the form of CARE benefits. Every year members will accrue a pension benefit equivalent to 1/49th of their pensionable pay in that year. Each annual pension accrued receives inflationary increases (in line with the annual change in the Consumer Prices Index) over the period to retirement.

Covenant: the assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term or affordability constraints in the short term.

CPI: acronym standing for “Consumer Prices Index”. CPI is a measure of inflation with a basket of goods that is assessed on an annual basis. The reference goods and services differ from those of RPI. These goods are expected to provide lower, less volatile inflation increases. Pension increases in the LGPS are linked to the annual change in CPI.

Deficit: the extent to which the value of the Fund’s past service liabilities exceeds the value of the Fund’s assets. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions).

Deficit recovery period: the target length of time over which the current deficit is intended to be paid off. A shorter period will give rise to a higher annual contribution, and vice versa.

Discount Rate: the rate of interest used to convert a cash amount e.g. future benefit payments occurring in the future to a present value.

Employing bodies: any organisation that participates in the LGPS, including admission bodies and Fund employers.

Employer's Future Service Contribution Rate: the contribution rate payable by an employer, expressed as a % of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses.

Equities: shares in a company which are bought and sold on a stock exchange.

Funding or solvency Level: the ratio of the value of the Fund's assets and the value of the Fund's liabilities expressed as a percentage.

Funding Strategy Statement: this is a key governance document that outlines how the administering authority will manage employer's contributions and risks to the Fund.

Government Actuary's Department (GAD): the GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

Guarantee / guarantor: a formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's covenant to be as strong as its guarantor's.

Investment Strategy: the long-term distribution of assets among various asset classes that takes into account the Fund's objectives and attitude to risk.

Letting employer: an employer that outsources part of its services/workforce to another employer, usually a contractor. The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer.

LGPS: the Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements.

Liabilities: the actuarially calculated present value of all benefit entitlements i.e. Fund cashflows of all members of the Fund, built up to date or in the future. The liabilities in relation to the benefit entitlements earned up to the valuation date are compared with the present market value of Fund assets to derive the deficit and funding/solvency level. Liabilities can be assessed on different set of actuarial assumptions depending on the purpose of the valuation.

Maturity: a general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.

Members: The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).

Minimum risk Basis: an approach where the discount rate used to assess the liabilities is determined based on the market yields of Government bond investments based on the appropriate duration of the liabilities being assessed. This is usually adopted when an employer is exiting the Fund.

Orphan liabilities: liabilities in the Fund for which there is no sponsoring employer within the Fund. Ultimately orphan liabilities must be underwritten by all other employers in the Fund.

Percentiles: relative ranking (in hundredths) of a particular range. For example, in terms of expected returns a percentile ranking of 75 indicates that in 25% of cases, the return achieved would be greater than the figure, and in 75% cases the return would be lower.

Phasing/stepping of contributions: when there is an increase/decrease in an employer's long term contribution requirements, the increase in contributions can be gradually stepped or phased in over an agreed period. The phasing/stepping can be in equal steps or on a bespoke basis for each employer.

Pooling: employers may be grouped together for the purpose of calculating contribution rates, (i.e. a single contribution rate applicable to all employers in the pool). A pool may still require each individual employer to ultimately pay for its own share of deficit, or (if formally agreed) it may allow deficits to be passed from one employer to another.

Prepayment: the payment by employers of contributions to the Fund earlier than that certified by the Actuary. The amount paid will be reduced in monetary terms compared to the certified amount to reflect the early payment.

Present Value: the value of projected benefit payments, discounted back to the valuation date.

Primary rate: the contribution rate required to meet the cost of future accrual of benefits, ignoring any past service surplus or deficit but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer's covenant.

Profile: the profile of an employer's membership or liability reflects various measurements of that employer's members, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc.

Prudent Assumption: an assumption where the outcome has a greater than 50/50 chance of being achieved i.e. the outcome is more likely to be overstated than understated. Legislation and Guidance requires the assumptions adopted for an actuarial valuation to be prudent.

Rates and Adjustments Certificate: a formal document required by the LGPS (Scotland) Regulations, which must be updated at least every three years at the conclusion of the formal valuation. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.

Real Return or Real Discount Rate: a rate of return or discount rate net of (CPI) inflation.

Recovery Plan: a strategy by which an employer will make up a funding deficit or run off surplus over a specified period of time ("the recovery period"), as set out in the Funding Strategy Statement.

Scheduled bodies: types of employer explicitly defined in the LGPS (Scotland) Regulations, whose employees must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, police and fire authorities etc., other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers).

Scheme Employers: employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2014 Regulations) would not need to designate eligibility, unlike the Part 2 Scheme Employers.

Secondary rate: the adjustment to the Primary rate to arrive at the total contribution each employer is required to pay. It is essentially the additional contribution (or reduction in contributions) resulting from any deficit (or surplus) attributable to the employer within the Fund.

Section 13 Valuation: in accordance with Section 13 of the Public Service Pensions Act 2014, the Government Actuary's Department (GAD) have been commissioned to advise the Department for Communities and Local Government (DCLG) in connection with reviewing the 2017 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

Solvency Funding Target: an assessment of the present value of benefits to be paid in the future. The desired funding target is to achieve a solvency level of a 100% i.e. assets equal to the accrued liabilities at the valuation date assessed on the ongoing concern basis.

Valuation funding basis: the financial and demographic assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is consistent with an expected rate of return of the Fund's investments. This includes an expected out-performance over gilts in the long-term from other asset classes, held by the Fund.

50/50 Scheme: in the LGPS, active members are given the option of accruing a lower personal benefit in the 50/50 Scheme, in return for paying a lower level of contribution.

DRAFT

FUNDING STRATEGY STATEMENT

ABERDEEN CITY COUNCIL TRANSPORT PENSION FUND

FEBRAURY 2017

Aberdeen City Council

This Funding Strategy Statement has been prepared by Aberdeen City Council (the Administering Authority) to set out the funding strategy for the Aberdeen City Council Transport Fund (the "Fund"), in accordance with Regulation 56 of the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

I

EXECUTIVE SUMMARY

Ensuring that the Aberdeen City Council Transport Fund (the "Fund") has sufficient assets to meet its pension liabilities in the long term is the fiduciary responsibility of the Administering Authority (Aberdeen City Council). The Funding Strategy adopted by the Aberdeen City Council Transport Fund will therefore be critical in achieving this.

The purpose of this Funding Strategy Statement ("FSS") is to set out a clear and transparent funding strategy that will identify how each Fund employer's pension liabilities are to be met going forward.

The details contained in this Funding Strategy Statement will have a financial and operational impact on the participating employer in the Aberdeen City Council Transport Fund (First Aberdeen Limited).

It is imperative therefore that First Aberdeen is aware of the details contained in this statement.

Given this, and in accordance with governing legislation, all interested parties connected with the Aberdeen City Council Transport Fund have been consulted and given opportunity to comment prior to this Funding Strategy Statement being finalised and adopted.   This statement takes into consideration all comments and feedback received.

THE FUND'S OBJECTIVE

The Administering Authority's long term objective is for the Fund to achieve and maintain a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due.

The general principle adopted by the Fund is that the assumptions used, taken as a whole, will be chosen sufficiently prudently for pensions already in payment to continue to be paid, and to reflect the commitments that will arise from members' accrued pension rights.

The funding strategy set out in this document has been developed alongside the Fund's investment strategy on an integrated basis taking into account the overall financial and demographic risks inherent in the Fund. The funding strategy includes appropriate margins to allow for the possibility of events turning out worse than expected.   Results will also have regard to the covenant strength and the investment strategy of the Fund.

SOLVENCY AND LONG TERM COST EFFICIENCY

The employer's contributions are set at such a level to achieve full solvency in a reasonable timeframe. Solvency is defined as a level where the Fund's liabilities i.e. benefit payments can be reasonably met as they arise.

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time. Equally, the FSS must have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

When formulating the funding strategy, the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure its "solvency" and "long term cost efficiency" of the Local Government Pension Scheme (Scotland) (the "LGPS") so far as relating to the Fund.

DEFICIT RECOVERY PLAN AND CONTRIBUTIONS

As the solvency level of the Fund is 94% at the valuation date i.e. the assets of the Fund are less than the liabilities, a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall, which will increase ongoing contribution requirements.

Deficit contributions paid to the Fund will be expressed as flat £ amounts and it is the Fund's objective that any funding deficit is eliminated as quickly as the participating employer can reasonably afford given other competing cost pressures. The recovery period will be set by the Fund, although the employer will be free to pay above the minimum contribution certified if they wish.

The objective is to achieve 100% solvency over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the total contributions at a similar level from the preceding valuation. Full details are set out in this FSS.

The period for recovering any deficit will vary by employer and this is covered in further detail in Appendix B.

ACTUARIAL ASSUMPTIONS

The actuarial assumptions used for assessing the funding position of the Fund and the employer, the "Primary" contribution rate, and any contribution variations due to underlying surpluses or deficits (i.e. the "Secondary" rate) are set out in an Appendix to this FSS.

The discount rate has been derived based on the current objectives of the Administering Authority based on the long term strategy set out in its Statement of Investment Principles (SIP). When assessing the appropriate prudent discount rate, consideration has been given to the level of expected asset returns based on the assets held but ultimately it has been set in relation to the long term "self-sufficiency" target based on a low risk portfolio of assets. It is proposed at this valuation discount rate for determining the past service liabilities and future service ("Primary") contribution rates is set equal to the return on a gilt yield appropriate for the profile and duration of the Scheme's accrued liabilities.

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Fund's accrued liabilities. A deduction of 0.5% per annum due to revaluation and retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index has been made.

The Administering Authority retains the discretion to apply an adjusted discount rate to reflect the termination assumptions for the employer if it were to exit the Fund, in order to protect the Fund. If required, this will be determined by the Section 95 Officer and reported to the Committee.

The demographic assumptions are based on the Fund Actuary's bespoke analysis for the Fund, also taking into account the experience of the wider LGPS where relevant.

FUND PRACTICES

In addition to the information/approaches required by overarching guidance and Regulation, this statement also summarises the Fund's practice in a number of key areas:

1. Covenant assessment and monitoring

The employer's financial covenant underpins its legal obligation and crucially the ability to meet its financial responsibilities to the Fund now and in the future. The strength of covenant to the Fund effectively underwrites the risks to which the Fund is exposed. These risks include underfunding, longevity, investment and market forces.

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital to the overall risk management and governance of the Fund. The employer's covenant will be assessed and monitored objectively in a proportionate manner, and an employer's ability to meet its obligations in the short and long term will be considered when determining its funding strategy.

After the valuation, the Fund will continue to monitor the employer's covenant in conjunction with the funding position over the inter-valuation period. This will enable the Fund to anticipate and pre-empt any material issues arising and thus adopt a proactive approach in partnership with the employer.

CONTENTS

APPENDICES

1 INTRODUCTION

The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) ("the 2014 Regulations") and the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 ("the 2014 Transitional Regulations") (collectively; "the 2014 Regulations") provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Aberdeen City Council Transport Fund (the "Fund"), the Administering Authority will prepare and publish their funding strategy;
- In preparing the FSS, the Administering Authority must have regard to:
  - the guidance issued by CIPFA for this purpose; and
  - the Statement of Investment Principles (SIP) for the Fund published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy set out in the FSS or the SIP.

BENEFITS

The benefits provided by the Fund are specified in the governing legislation contained in the Regulations referred to above. Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure for members. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time facilitating scrutiny and accountability through improved transparency and disclosure.

The Fund is a defined benefit arrangement with principally final salary related benefits earned by contributing members up to 1 April 2015 and Career Averaged Revalued Earnings ("CARE") benefits earned thereafter. There is also a "50:50 Scheme Option", where members can elect to accrue 50% of the full scheme benefits in relation to the member only and pay 50% of the normal member contribution.

EMPLOYER CONTRIBUTIONS

The required levels of employee contributions are specified in the Regulations. Employer contributions are determined in accordance with the Regulations (which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate specifying the "primary" and "secondary" rate of the employer's contribution).

PRIMARY RATE

The "Primary rate" for the employer and Fund is the contribution rate required to meet the cost of the future accrual of benefits, ignoring any past service surplus or deficit, allowing for the employer's membership profile, the funding strategy adopted, the actuarial method used and/or the employer's covenant.

SECONDARY RATE

The "Secondary rate" is an adjustment to the Primary rate to arrive at the total rate of contribution the employer is required to pay. The Secondary rate may be expressed as a percentage adjustment to the Primary rate and a cash adjustment in each of the three years beginning 1 April in the year following the actuarial valuation.

The secondary rate for the Fund in each of the three years shall also be disclosed.

2
PURPOSE OF FSS IN POLICY TERMS

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

The Administering Authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due.

The purpose of this Funding Strategy Statement is therefore:

- to establish a clear and transparent fund-specific strategy which will identify how the employer's pension liabilities are best met going forward by taking a prudent longer-term view of funding those liabilities with a view to moving to a self-sufficient position which relies less on the employer covenant
- to establish contributions at a level to "secure the solvency" of the pension fund and the "long term cost efficiency",
- to have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled.

3
AIMS AND PURPOSE OF THE FUND

THE AIMS OF THE FUND ARE TO:

- manage the employer's liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due
- enable the employer contribution rate to be kept at a reasonable and affordable cost to the taxpayers and the employer, while achieving and maintaining Fund solvency and long term cost efficiency, which should be assessed in light of the profile of the Fund now and in the future due to sector changes
- maximise the returns from investments within reasonable risk parameters taking into account the above aims.

THE PURPOSE OF THE FUND IS TO:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of Fund benefits, transfer values, costs, charges and expenses as defined in the 2014 Regulations and the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (as amended).

4
RESPONSIBILITIES OF THE KEY PARTIES

The efficient and effective management of the Fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently. The key parties for the purposes of the FSS are the Administering Authority (and, in particular the Pensions Committee), the employer and the Fund Actuary and details of their roles are set out below. Other parties required to play their part in the fund management process are bankers, custodians, investment managers, auditors and legal, investment and governance advisors, along with the Local Pensions Board created under the Public Service Pensions Act 2013.

KEY PARTIES TO THE FSS

The **Administering Authority** should:

- operate the pension fund
- collect employer and employee contributions, investment income and other amounts due to the pension scheme as stipulated in the Regulations
- pay from the pension fund the relevant entitlements as stipulated in the Regulations
- invest surplus monies in accordance the Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- take measures as set out in the Regulations to safeguard the fund against the consequences of employer default
- manage the valuation process in consultation with the Fund’s actuary
- prepare and maintain a FSS and an SIP, both after proper consultation with interested parties, and
- monitor all aspects of the Fund’s performance and funding, amending the FSS/SIP as necessary
- effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and a fund employer, and
- establish, support and monitor a Local Pension Board (LPB) as required by the Public Service Pensions Act 2013, the Regulations and the Pensions Regulator’s relevant Code of Practice.

The **Individual Employer** should:

- deduct contributions from employees’ pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)
- pay all contributions, including their own as determined by the actuary, 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 Fund benefits, early retirement strain, and
- have regard to the Pensions Regulator’s focus on data quality and comply with any requirement set by the Administering Authority in this context, and
- notify the Administering Authority promptly of any changes to membership which may affect future funding.

The **Fund Actuary** should:

- prepare valuations including the setting of employer contribution rates at a level to ensure fund solvency after agreeing assumptions with the Administering Authority and having regard to their FSS and the Regulations
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill health retirement costs etc.
- provide advice and valuations on the termination of admission agreements
- provide advice to the Administering Authority on bonds and 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 required by the Regulations
- advise on funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the SIP, and
- ensure the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to the Fund Actuary’s role in advising the Fund.

5 SOLVENCY FUNDING TARGET

Securing the "solvency" and "long term cost efficiency" is a regulatory requirement. To meet these requirements the Administering Authority's long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the "funding target") assessed on an ongoing past service basis including allowance for projected final pay where appropriate. In the long term, the employer's total contribution rate would ultimately revert to its Primary rate of contribution.

SOLVENCY AND LONG TERM EFFICIENCY

The employer's contributions are set at such a level to achieve full solvency in a reasonable timeframe. Solvency is defined as a level where the Fund's liabilities i.e. benefit payments can be reasonably met as they arise.

The employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency implies that contributions must not be set at a level that is likely to give rise to additional costs in the future. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the appropriate time.

When formulating the funding strategy the Administering Authority has taken into account these key objectives and also considered the implications of the requirements under Section 13(4)(c) of the Public Service Pensions Act 2013. As part of these requirements the Government Actuary's Department (GAD) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the "solvency" of the pension fund and "long term cost efficiency" of the LGPS so far as relating to the Fund.

DETERMINATION OF THE SOLVENCY FUNDING TARGET AND RECOVERY PLAN

The principal method and assumptions to be used in the calculation of the funding target are set out in **Appendix A**. The employer Recovery Plan is set out in **Appendix B**. This covers the recovery of deficits.

Underlying these assumptions are the following two tenets:

- that the Fund is expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

This allows the Fund to take a longer term view when assessing the contribution requirements for certain employers.

In considering this the Administering Authority, based on the advice of the Fund Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful potentially taking into account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2018 at the latest.

The Administering Authority, following consultation with the participating employer, has adopted the following objectives for setting the individual employer contribution rate arising from the 2017 actuarial valuation:

- The Fund does not believe it appropriate for reductions to the total contributions (primary and secondary rates combined) to apply compared to the existing funding plan where deficits remain unless there is compelling reason to do so.

- Employers will have the freedom to pay above the minimum contributions if they so wish.

- Employer contributions will be expressed and certified as two separate elements:
    - the **Primary rate**: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits
    - the **Secondary rate**: a fixed £ amount adjusted as appropriate to arrive at the required overall contributions over 2018/21 in respect of the employer's deficit

  The total contributions the employer is actually required to pay in any one year is the sum of the Primary and Secondary rates (subject to an overall minimum of zero). Both elements are subject to further review from April 2021 based on the results of the 2020 actuarial valuation.

- On the cessation of the employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment. Any deficit in the Fund in respect of the employer will be due to the Fund as a termination contribution.

- The Administering Authority reserves the right to apply a different approach at its sole discretion, taking into account the risk associated with the employer. Such cases will be determined by the Section 95 Officer and notified to the Committee. The employer will also be notified.

FUNDING FOR NON-ILL HEALTH EARLY RETIREMENT COSTS

Employers are required to meet all costs of early retirement strain by capital payments into the Fund as determined on the advice of the Actuary.

TERMINATION APPROACH

If the employer ceases to participate within the Fund, it becomes an exiting employer under the Regulations. The Fund is then required to obtain an actuarial valuation of the employer's liabilities in respect of the benefits of the exiting employer's current and former employees, along with a termination contribution certificate.

The approach taken will be agreed at the time but is likely to include the option of insuring all or part of the liabilities with an insurance company. Any exit payment will be payable immediately unless agreed otherwise by the Administering Authority. Any deferral of the exit payment would be subject to sufficient contingent security being available from the employer over the period the exit payment would be paid.

6

LINK TO INVESTMENT POLICY AND THE STATEMENT OF INVESTMENT PRINCIPLES (SIP)

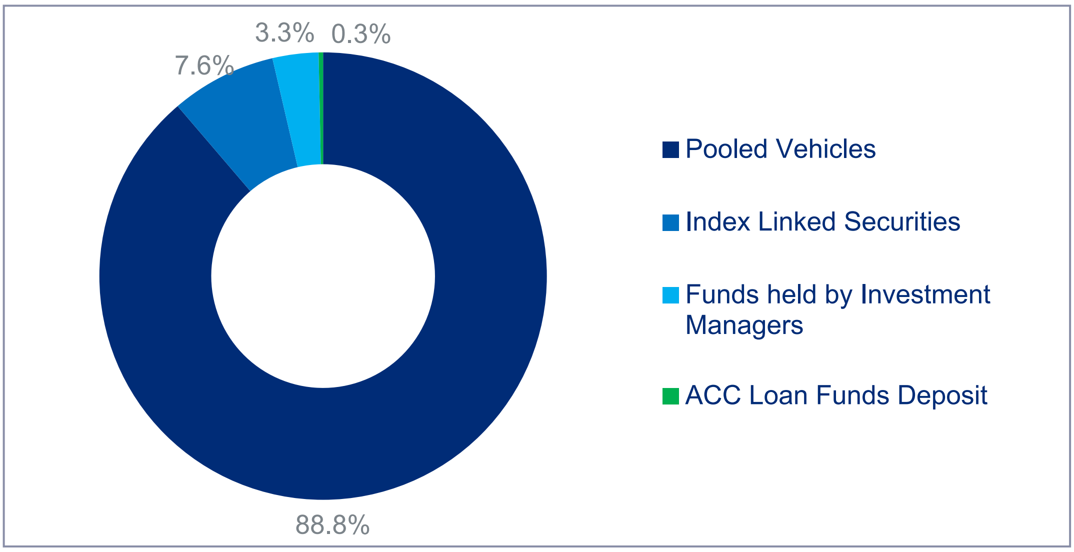
The results of the 2017 valuation show the liabilities to be 93% covered by the current assets.

In assessing the value of the Fund's liabilities in the valuation, allowance has been made for growth asset out-performance as described below, taking into account the investment strategy adopted by the Fund, as set out in the SIP.

Other than by purchasing insurance with a bulk annuity provider, it is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which represents the "minimum risk" investment position which would deliver a very high certainty of returns at or above the return on a gilt yield appropriate for the profile and duration of the Scheme's accrued liabilities. Such a portfolio would consist of UK Government gilt stocks and other instruments of varying durations. Investment of the Fund's assets in line with this portfolio would minimise fluctuations in the Fund's funding position between successive actuarial valuations. It has been agreed at this valuation to set the funding target to be based on such a portfolio of assets.

Currently, the portfolio includes an element of growth assets such as equities, which will give a better prospect that the assets will, over time, deliver returns in excess of gilt yields, reduce the contribution requirements and allow the Fund's assets to be de-risked more quickly than the current de-risking plan. No allowance has been made for this in the assessment of contributions. The target solvency position of having sufficient assets to meet the Fund's pension obligations might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The investment strategy (at 31 March 2017) is:



As documented in the SIP, the investment strategy and return expectations set out above equate to a best estimate average expected return of the return on cash plus 3.1% i.e. 3.35% at the valuation date on the growth portfolio element (although this would reduce over time with any de-risking into other assets). For the purposes of setting funding strategy however, the Administering Authority believes that it is appropriate to recognise a low risk asset portfolio returns only (based on Government bond yields) and let any positive experience emerge.

DE-RISKING OBJECTIVE/FLIGHT PATH FRAMEWORK

The Administering Authority and the employer have agreed a de-risking or "flightpath" strategy for the Fund (this includes reducing interest and inflation risk exposure). The aim of the flightpath is to "lock in" improvements in funding by switching from growth to defensive or matching assets. The de-risking plan is to be reviewed periodically and is structured to keep contributions as stable as possible, i.e. as the asset allocation is only changed following an improvement in funding, the employer contributions (and hence recovery plan) are unaffected.

The de-risking strategy is being implemented alongside the finalisation of the 2017 valuation and details of the current de-risking strategy are shown below:]

Phase	Funding Level	Liability Coverage	Proportion of growth assets	Proportion of matching assets	Return target for growth assets only
1	**<95%**	85%	75%	25%	Cash + 3.1%
2	**<100%**	95%	75%	25%	Cash + 2.4%
3	**>100%**	100%	45%	55%	Cash + 2.0%

7 IDENTIFICATION OF RISKS AND COUNTER-MEASURES

The funding of defined benefits is by its nature uncertain. Funding of the Fund is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the Fund Actuary that the greatest risk to the funding level is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that assumed in the long term.

FINANCIAL

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Market outlook moves at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated

Any increase in the employer's contribution rates (as a result of these risks) may in turn impact on the employer's financial position.

In practice the extent to which these risks can be removed is limited. However, the Fund's asset allocation is kept under constant review and the performance of the investment managers is regularly monitored.

DEMOGRAPHIC

The demographic risks are as follows:-

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)
- Unanticipated acceleration of the maturing of the Fund resulting in further materially negative cashflows and shortening of liability durations

Increasing longevity is something which government policies, both national and local, are designed to promote. It does, however, result in a greater liability for pension funds.

Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, **the employer should be doing everything in their power to minimise the number of ill-health retirements**. Early retirements for reasons of redundancy and efficiency do not materially affect the solvency of the Fund because they are the subject of a direct charge.

With regards to increasing maturity, the Administering Authority regularly monitors the position in terms of cashflow requirements and considers the impact on the investment strategy and liquidity requirements.

INSURANCE OF CERTAIN BENEFITS

The contributions for any employer may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party.

REGULATORY

The key regulatory risks are as follows:-

- Changes to Regulations, e.g. changes to the benefits package, retirement age, potential new entrants to Fund,
- Changes to national pension requirements and/or HMRC Rules

GOVERNANCE

The Fund has done as much as it believes it reasonably can to enable the employer and members to make their views known to the Fund and to participate in the decision-making process.

Governance risks are as follows:-

- The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated
- Administering Authority unaware of structural changes in the employer's membership (e.g. unexpected fall in employee numbers, large number of retirements or redundancy exercises for older members) with the result that contribution rates are set at too low a level
- Changes in the Committee membership.

For these risks to be minimised much depends on information being supplied to the Administering Authority by the employer. Arrangements are strictly controlled and monitored, but the employer bears the risk.

8 MONITORING AND REVIEW

The Administering Authority has taken advice from the actuary in preparing this Statement, and has consulted with the employer participating in the Fund.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of the current economic conditions and will also reflect any legislative changes.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example, if there:

- has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- have been significant changes to the Fund membership, or LGPS benefits
- have been changes to the circumstances of the employer to such an extent that they impact on or warrant a change in the funding strategy
- have been any significant special contributions paid into the Fund.

When monitoring the funding strategy, if the Administering Authority considers that any action is required, the employer will be contacted.

APPENDIX A - ACTUARIAL METHOD AND ASSUMPTIONS

METHOD

The actuarial method to be used in the calculation of the solvency funding target is the Attained Age method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method makes advance allowance for the anticipated future ageing and decline of the current closed membership group potentially over the period of the rates and adjustments certificate.

FINANCIAL ASSUMPTIONS – SOLVENCY FUNDING TARGET AND THE COST OF FUTURE ACCRUAL (OR PRIMARY RATE)

Investment return (discount rate)

The discount rate at the valuation has been derived based on an assumed return equal to the gilt yield derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities. This return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics.

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Fund's accrued liabilities.

A deduction of 0.5% per annum due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index has been made.

Salary increases

In relation to benefits earned prior to 1 April 2015, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 0.5% p.a. over the inflation (CPI) assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint as budgeted in the employer's financial plan. The allowance for short term pay restraint, is a salary increase assumption of CPI, equal to 2.9% for the year to 2018.

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions where the LGPS is not required to provide full indexation).

DEMOGRAPHIC ASSUMPTIONS

Mortality/Life Expectancy

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the Fund. The mortality tables used are set out below, with a loading reflecting Fund specific experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. Current members who retire on the grounds of ill health are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 4 years older whereas for existing ill health retirees we assume this is at an age 3 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a level of longevity 'improvement' year on year in the future in line with the CMI projections with a long-term improvement trend of 1.75% per annum for males and females.

The mortality before retirement has also been adjusted based on LGPS wide experience.

Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up.

Other Demographics

Following an analysis of Fund experience carried out by the Actuary, withdrawal rates and the proportions married/civil partnership assumption have been modified from the last valuation. The assumption in relation to the incidence of ill health retirements is unchanged. In addition, no allowance will be made for the future take-up of the 50:50 option (this is the same assumption as at the last valuation). Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate for the next 3 years. Other assumptions are as per the last valuation.

Expenses

Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by including an agreed amount to the contributions as required from the employer. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

The costs of any discretion exercised by the employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation.

SUMMARY OF KEY WHOLE FUND ASSUMPTIONS USED FOR CALCULATING FUNDING TARGET AND COST OF FUTURE ACCRUAL (THE “PRIMARY RATE”) FOR THE 2017 ACTUARIAL VALUATION

Long-term yields	
Market implied RPI inflation	3.4% p.a.
Investment return/Discount Rate	1.6% p.a.
CPI price inflation	2.9% p.a.
Long Term Salary increases	2.9% p.a.
Short Term Salary increases	2.9% for the year to 31 March 2018
Pension increases/indexation of CARE benefits	2.9% p.a.

Life expectancy assumptions

The post retirement mortality tables adopted for this valuation, along with sample life expectancies, are set out below:

	Base Table	**Improvements**	**Adjustment (M / F)**
Current pensioners:			
Normal health	S2PA	CMI_2015 [1.75%]	109% / 87%
Ill-health	S2PA	CMI_2015 [1.75%]	Normal health +3 years
Dependants	S2PMA / S2DFA	CMI_2015 [1.75%]	136% / 118%
Future dependants	S2PMA / S2DFA	CMI_2015 [1.75%]	128% / 100%
Current active / deferred:			
Active normal health	S2PA	CMI_2015 [1.75%]	99% / 109%
Active ill-health	S2PA	CMI_2015 [1.75%]	Normal health +4 years
Deferred	S2PA	CMI_2015 [1.75%]	135% / 97%
Future dependants	S2PMA / S2DFA	CMI_2015 [1.75%]	128% / 100%

	Male life expectancy	Female life expectancy
Actives	25.6	27.0
Deferreds	22.9	28.0
Pensioners	22.2	26.2

All life expectancies are normal health “cohort” expectancies from age 65 in 2017 and non-pensioners’ current age assumed to be 45

Other demographic assumptions are set out in the Actuary’s formal report.

APPENDIX B – EMPLOYER RECOVERY PLAN

If the assets of the employer are less than the liabilities at the effective date, a deficit recovery plan needs to be adopted such that additional contributions are paid into the Fund to meet the shortfall.

It is the Fund's objective that any funding deficit is eliminated as quickly as the employer can reasonably afford based on the Administering Authority's view of the employer's covenant and risk to the Fund. This will determine the minimum contribution requirement and the employer will be free to select higher contributions if they wish.

The recovery period is determined by ensuring overall contributions are reasonably stable relative to the current funding plan allowing for any affordability constraints.

In determining the actual recovery period to apply for the employer, the Administering Authority may take into account some or all of the following factors:

- The size of the funding shortfall / surplus;
- The business plans of the employer;
- The assessment of the financial covenant of the employer, and security of future income streams;
- Any contingent security available to the Fund or offered by the employer such as guarantor or bond arrangements, charge over assets, etc.

The objective is to recover any deficit (or remove any surplus) over a reasonable timeframe, and this will be periodically reviewed. Subject to affordability considerations a key principle will be to maintain the contributions at the expected levels from the preceding valuation.

Other factors affecting the Employer Recovery Plan

As part of the process of agreeing funding plan with the employer, the Administering Authority will consider the use of contingent assets and other tools such as bonds or guarantees that could assist the employer in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities. All other things equal this could result in lower cash contributions being acceptable to the Administering Authority.

APPENDIX C - GLOSSARY

Actuarial Valuation: an investigation by an actuary into the ability of the Fund to meet its liabilities. For the LGPS the Fund Actuary will assess the funding level of the participating employer and agree contribution rates with the administering authority to fund the cost of new benefits and make good any existing deficits as set out in the separate Funding Strategy Statement. The asset value is based on market values at the valuation date.

Administering Authority: the council with a statutory responsibility for running the Fund and that is responsible for all aspects of its management and operation.

Benchmark: a measure against which fund performance is to be judged.

Best Estimate Assumption: an assumption where the outcome has a 50/50 chance of being achieved.

Bonds: loans made to an issuer (often a government or a company) which undertakes to repay the loan at an agreed later date. The term refers generically to corporate bonds or government bonds (gilts).

Buy-in: A buy-in policy is a bulk annuity policy held as a scheme investment, which serves to provide payments that exactly match those due to the members which it covers. Some schemes seek to remove risk in relation to a certain group of members through this type of policy, usually just the pensioner membership.

Career Average Revalued Earnings Scheme (CARE): with effect from 1 April 2015, benefits accrued by members in the LGPS take the form of CARE benefits. Every year members will accrue a pension benefit equivalent to 1/49th of their pensionable pay in that year. Each annual pension accrued receives inflationary increases (in line with the annual change in the Consumer Prices Index) over the period to retirement.

Covenant: the assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term or affordability constraints in the short term.

CPI: acronym standing for “Consumer Prices Index”. CPI is a measure of inflation with a basket of goods that is assessed on an annual basis. The reference goods and services differ from those of RPI. These goods are expected to provide lower, less volatile inflation increases. Pension increases in the LGPS are linked to the annual change in CPI.

Deficit: the extent to which the value of the Fund’s past service liabilities exceeds the value of the Fund’s assets. This relates to assets and liabilities built up to date, and ignores the future build-up of pension (which in effect is assumed to be met by future contributions).

Deficit recovery period: the target length of time over which the current deficit is intended to be paid off. A shorter period will give rise to a higher annual contribution, and vice versa.

Discount Rate: the rate of interest used to convert a cash amount e.g. future benefit payments occurring in the future to a present value.

Employing bodies: any organisation that participates in the LGPS, including admission bodies and Fund employers.

Employer's Future Service Contribution Rate: the contribution rate payable by the employer, expressed as a % of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses.

Equities: shares in a company which are bought and sold on a stock exchange.

Funding or solvency Level: the ratio of the value of the Fund's assets and the value of the Fund's liabilities expressed as a percentage.

Funding Strategy Statement: this is a key governance document that outlines how the administering authority will manage employer's contributions and risks to the Fund.

Government Actuary's Department (GAD): the GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

Guarantee / guarantor: a formal promise by a third party (the guarantor) that it will meet any pension obligations not met by the employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's covenant to be as strong as its guarantor's.

Hedging: a strategy that aims to reduce funding volatility. This is achieved by investing in assets that capture levels of yields based on agreed trigger levels so the change in assets mimics the change in liabilities.

Investment Strategy: the long-term distribution of assets among various asset classes that takes into account the Fund's objectives and attitude to risk.

LGPS: the Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements.

Liabilities: the actuarially calculated present value of all benefit entitlements i.e. Fund cashflows of all members of the Fund, built up to date or in the future. The liabilities in relation to the benefit entitlements earned up to the valuation date are compared with the present market value of Fund assets to derive the deficit and funding/solvency level. Liabilities can be assessed on different set of actuarial assumptions depending on the purpose of the valuation.

Maturity: a general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.

Members: The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).

Minimum Risk Basis: an approach where the discount rate used to assess the liabilities is determined based on the market yields of Government bond investments based on the appropriate duration of the liabilities being assessed.

Percentiles: relative ranking (in hundredths) of a particular range. For example, in terms of expected returns a percentile ranking of 75 indicates that in 25% of cases, the return achieved would be greater than the figure, and in 75% cases the return would be lower.

Present Value: the value of projected benefit payments, discounted back to the valuation date.

Primary rate: the contribution rate required to meet the cost of future accrual of benefits, ignoring any past service surplus or deficit but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer’s covenant.

Profile: the profile of an employer’s membership or liability reflects various measurements of that employer’s members, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc.

Prudent Assumption: an assumption where the outcome has a greater than 50/50 chance of being achieved i.e. the outcome is more likely to be overstated than understated. Legislation and Guidance requires the assumptions adopted for an actuarial valuation to be prudent.

Rates and Adjustments Certificate: a formal document required by the LGPS (Scotland) Regulations, which must be updated at least every three years at the conclusion of the formal valuation. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.

Recovery Plan: a strategy by which an employer will make up a funding deficit or run off surplus over a specified period of time (“the recovery period”), as set out in the Funding Strategy Statement.

Secondary rate: the adjustment to the Primary rate to arrive at the total contribution each employer is required to pay. It is essentially the additional contribution (or reduction in contributions) resulting from any deficit (or surplus) attributable to the employer within the Fund.

Section 13 Valuation: in accordance with Section 13 of the Public Service Pensions Act 2014, the Government Actuary’s Department (GAD) have been commissioned to advise the Department for Communities and Local Government (DCLG) in connection with reviewing the 2017 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

Solvency Funding Target: an assessment of the present value of benefits to be paid in the future. The desired funding target is to achieve a solvency level of a 100% i.e. assets equal to the accrued liabilities at the valuation date assessed on the ongoing concern basis.

Valuation funding basis: the financial and demographic assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is consistent with an expected rate of return of the Fund's investments. This includes an expected out-performance over gilts in the long-term from other asset classes, held by the Fund.

50/50 Scheme: in the LGPS, active members are given the option of accruing a lower personal benefit in the 50/50 Scheme, in return for paying a lower level of contribution.

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ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	1 DECEMBER 2017
REPORT TITLE	2017 ACTUARIAL VALUATION AND FUNDING STRATEGY STATEMENT – INITIAL RESULTS
REPORT NUMBER	PC/DEC17/ACT
DIRECTOR	HEAD OF FINANCE
REPORT AUTHOR	CLAIRE MULLEN

1. PURPOSE OF REPORT:-

1.1 This report provides elected members with details of the initial results of the tri-ennial valuation for the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF) as at 31 March 2017, which has been carried out by the scheme actuary. In addition, it provides a first look at the 2017 Funding Strategy Statement (FSS) for each Fund.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Note the initial valuation results of both Funds as at 31 March 2017;
ii. Note the draft FSS for both the NESPF and ACCTF including the assumptions recommended by the scheme actuary to determine the value placed on the Fund liabilities as at 31 March 2017 and the individual employer contribution rates payable from 2018/19;
iii. Instruct the Head of Finance to carry out a full consultation on the FSS as required by the scheme regulations and provide a report on the consultation outcome to the March Pensions Committee;
iv. Note the intention to disaggregate the remaining employer groupings within the Fund; and
v. Note the remainder of the report.

3. 2017 ACTUARIAL VALUATION AND FUNDING STRATEGY STATEMENT

3.1 In accordance with the Local Government Pension Scheme (Scotland) Regulations 2014, the scheme actuary is required to carry out a valuation of the Funds every 3 years. The results of the tri-ennial valuation provide the funding level which will be published in the Annual Report and Accounts and will set the individual employer contribution rates for the following valuation period.

3.2 The scheme actuary (Mercer) has carried out the initial calculations in relation to both the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF) as at 31 March 2017.

3.3 NESPF

3.3.1 Initial results indicate that the funding level over the whole Fund is 107% as at 31 March 2017. This translates to a surplus of £239 Million when comparing the assets held by the Fund against the calculated value of the liabilities held for members.

3.3.2 The funding level has significantly improved since the 2014 valuation which is predominately due to investment returns but is also as a result of lower than expected pension increases, change in demographic assumptions and member movements within the Fund.

3.3.3 Another factor which has positively affected the valuation results is the change in methodology in setting the discount rate which is the main driver in determining the valuation of the liabilities. Where the discount rate was set using the gilt yields in the 2014 valuation the scheme actuary has advised a shift towards setting the discount rate in relation to real asset returns is now more appropriate (given the low value of gilt yields in relation to asset performance within the Fund). Although this change of methodology has resulted in an improvement in the overall funding position the Fund still wish to adopt a prudent approach with regards to setting the valuation assumptions and determining the value of the liabilities.

3.4 ACCTF

3.4.1 Initial results indicate that the funding level for the Transport Fund is 92.7% as at 31 March 2017. This translates to a deficit of £7.9 Million when comparing the assets of £100 Million against the calculated liabilities of £107.9 Million.

3.4.2 Although the published funding level will drop from 93% in 2014 to 92.7% as at 2017, the methodology used to establish this has changed over the inter-valuation period to reflect the de-risking approach that is being taken for this rapidly maturing Fund.

3.4.3 The suggested discount rate will be determined using the value of gilt yields +0% allowance for out performance in assets compared to the 2014 discount rate of gilts +0.25% p.a. If the scheme actuary were to use a like for like assumption this would translate to a funding level of 97% (an improvement of 4% from the previous valuation).

3.4.4 As the Transport Fund is a 'closed' Fund with only one participating employer it is essential that a prudent approach is applied to the calculation of the liabilities and that the funding level is monitored closely over the inter-valuation period to ensure that the de-risking 'flight plan' currently being delivered through Schroders can be adhered to.

3.5 Funding Strategy Statement (FSS)

3.5.1 In accordance with the Local Government Pension Scheme (Scotland) Regulations 2014 a revised Funding Strategy Statement (FSS) for each of the Funds has been drafted as part of the valuation process. The draft FSS's outline the methodology used to determine the valuation outcomes including the suggested assumptions to be applied, the deficit recovery plan and how assets are proportioned throughout the participating employers.

3.5.2 Particular emphasis has been put into the 2017 FSS in relation to the overall Fund solvency and long term cost efficiency. This is a reflection of the change in regulations that require all LGPS (Scotland) Funds to prioritise these values over the desirability to provide contribution rate stability for participating employers.

3.5.3 The FSS has been developed alongside the Funds Statement of Investment Principles (SIPP) and should reflect investment strategy, particularly in relation to allowance made for asset out performance when determining the discount rate assumption.

3.5.4 It is a regulatory requirement that the FSS undergoes a full consultation with all participating employers prior to the valuation being signed off by the scheme actuary in March 2018.

3.6 Individual employer results and rates

3.6.1 The positive valuation results mean that the Local Authorities that make up the vast majority of the active membership within the Fund will be able to maintain the current employer contribution rate that has been applied for the last 3 years (19.3% of pensionable payroll).

3.6.2 However all employers will have their individual funding levels and employer contribution rates determined upon their own membership profiles and experiences throughout the inter-valuation period from 2014 to 2017. This will mean that some employers will have increased contribution requirements from 2018 onwards. This reflects the increased future service costs of providing benefits through the LGPS (Scotland) and the maturing of a lot of the membership profiles of smaller employers.

3.7 Groups

3.7.1 Employer groups were established as part of the 2011 valuation in order to reduce the amount of 'cross subsidy' within the Fund. Prior to this point the Fund was valued as a whole and one employer rate with applied throughout the Fund. The groups were created based on both their characteristics and their date of admission to the Fund. The groups were made up as follows:

- Closed employer group
- Council group
- Colleges group
- Other employers group (admission bodies admitted prior to 2008)

3.7.2 All employers admitted to the Fund after 2008 were given an individual rate.

3.7.3 As part of the 2014 valuation, decisions taken by the employers within the group and changes to the admission agreements between the employers and the Fund meant that both the colleges group and the closed employer group were disaggregated from 1 April 2015.

3.7.4 Due to the positive outcome of the 2017 valuation and the increased emphasis by the Pensions Regulator (tPR) on solvency and long term cost efficiency the Fund proposes to disaggregate the remaining groups with effect from the valuation date. This would mean that from1 April 2018 all participating employers would stand alone and would have their own employer contribution rate based on their individual membership profile, fund experience and funding level. In addition, this will allow the Fund to set rates which take into account the covenant and future plans of each employer and also where appropriate, on an individual basis, to consider affordability.

3.7.5 The final decision will be taken regarding the disaggregation of the remaining groups following consultation with employers. Pension Committee approval for this decision will be required in March 2018.

3.8 Covenant Review

3.8.1 Monitoring of the covenant of each employer in line with the NESPF policy on risk management continues to be a priority of the Employer Relationship Team. Effective monitoring ensures that the risk to the Fund and its participating employers, in relation to the ability of employers to meet the scheme liabilities, is managed and minimised.

3.8.2 Covenant assessment for all admission bodies will be carried out in line with the valuation and will be an important consideration in the setting of the individual employer rates from 2018 onwards.

3.9 Employer Consultation

3.9.1 The regulatory requirement to consult with all employers on the draft Funding Strategy Statement will be carried out in conjunction with the issue and discussion on individual employer contribution rates.

3.9.2 As part of the discussion process an opportunity will be afforded to all employers to discuss the contribution requirements and the suggested assumptions with the scheme actuary at a ‘results event’ to be held in mid-December.

3.9.3 The consultation will be carried out over December and January to ensure that Committee approval can be obtained prior to the valuation being signed off by the scheme actuary in March 2018.

4. FINANCIAL IMPLICATIONS

4.1 The actuarial valuation sets the employer contribution rates for all participating employers within the Funds. It is essential that the underlying assumptions used to determine the contribution requirements are set in such a way that ensures that the Funds remain solvent whilst also taking into consideration the desirability to create stability for employers.

4.2 Whilst the Funds recognise that affordability is a concern with all employers that actively participate within the scheme the regulations require that the emphasis is put on overall solvency of the scheme and minimising risk for the Funds as a whole.

4.3 Failure to set accurate assumptions or set high expectations on the future investment performance will mean that employer rates are not set accurately and will have a detrimental effect on the funding levels for future valuations.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 There are no direct risk implications arising from the recommendation of this report.

7. IMPACT SECTION

7.1 Investment strategy will continue to be a key consideration with regards to funding to ensure that the investment returns meet the requirements of the Fund to achieve the funding target.

8. BACKGROUND PAPERS

8.1 None

9. APPENDICES

9.1 **Appendix I**, North East Scotland Pension Fund Funding Strategy Statement 2017 (draft)
Appendix II, Aberdeen City Council Transport Fund Funding Strategy Statement 2017 (draft)

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ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	16 MARCH 2018
REPORT TITLE	STATEMENT OF ACCOUNTS 2017/18 – ACTION PLAN
REPORT NUMBER	PC/MAR18/ACCOUNTS
DIRECTOR	DIRECTOR OF RESOURCES
REPORT AUTHOR	LAURA COLLISS

1. PURPOSE OF REPORT:-

1.1 The purpose of this report is to provide Elected Members with high level information and key dates in relation to the 2017/18 Statement of Accounts including linkages to the plans and timetables of the Council's External Auditors.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Note the contents of the report

3. BACKGROUND/MAIN ISSUES

3.1 The Statement of Accounts 2017/18 will summarise the Pension Fund's transactions for the period 1 April to 31 March 2018 and its financial position at the year end 31 March 2018. It will be prepared in accordance with the Internal Financial Reporting Standards (IFRS) based Code of Practice on Local Authority Accounting in the United Kingdom (the Code) and the Service Reporting Code of Practice (SeRCOP). There are no changes to either of the codes in 2017/18 which will have any significant impact on the statement of accounts.

3.2 There are a number of key dates and these are summarised as follows:-

31 March 2018	End of Financial Year 2017/18
17 June 2018	Deadline for giving notice to the public of right to inspect and object to Accounts
22 June 2018	Pensions Committee
30 June 2018	Statutory deadline for submission of Draft Statement of Accounts to the Controller of Audit
July 2018	Advertising and Inspection of Accounts
31 July 2018	Deadline for submission of the Whole of Government Accounts (WGA) to the Scottish Government
14 September 2018	Pensions Committee
30 September 2018	Deadline for submission of Audited Statement of Accounts to the Controller of Audit
31 October 2018	Deadline for submission of the Audited WGA to the Scottish Government
30 November 2018	Pensions Committee

3.3 22 June 2018

The Pensions Committee will receive the Draft Statement of Accounts 2017/18, including the Annual Report for overall scrutiny.

3.4 July 2018

This is the period within which the Council must give public notice of the rights of interested parties to inspect and object to its accounts. There are statutory requirement currently under The Local Authority Accounts (Scotland) Regulations 2014 which define the notice period, the inspection period, deadline for submission of an objection and the information which must be made available for inspection.

3.5 14 September 2018

The Pensions Committee will receive Audit Scotland's combined ISA260 and 'Report to those charged with the governance on the 2017/18 audit' for debate and consideration, together with the Audited Statement of Accounts 2017/18 for signing.

4. FINANCIAL IMPLICATIONS

4.1 There are no direct financial implications resulting from this report.

5. LEGAL IMPLICATIONS

5.1 There is a statutory requirement for the Council to produce both a draft and audited Statement of Accounts within certain timescales and to a high standard. This is a major task which requires co-operation and input from a large number of people across all services of the Council. It is only with the commitment of all staff that these high standards and deadlines can be met.

6. MANAGEMENT OF RISK

6.1 There are no direct risk implications arising from the recommendations in this report.

Risk management for the Pension Fund is managed through the Fund's risk register which is reported quarterly to the Pensions Committee.

7. IMPACT SECTION

7.1 The publication of the annual Statement of Accounts demonstrates the Council's proper stewardship and accountability of the public funds with which it is entrusted.

8. BACKGROUND PAPERS

8.1 None

9. APPENDICES

9.1 None

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ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	16 MARCH 2018
REPORT TITLE	INVESTMENT STRATEGY REVIEW 2018
REPORT NUMBER	PC/MAR18/REVIEW
DIRECTOR	DIRECTOR OF RESOURCES
REPORT AUTHOR	LAURA COLLISS

1. PURPOSE OF REPORT:-

1.1 This report details the outcome of the investment strategy review which has been prepared by officers following the outcome of the 2017 Actuarial Valuation. This report sets out the details of the Fund's current investment strategy and makes a number of recommendations on taking the strategy forward over the next 5 to 10 years.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Approve the proposed investment strategy as set out in section 3.5 and Appendix I of the report.

3. BACKGROUND/MAIN ISSUES

3.1 The Fund's established practice is to complete a review of its investment strategy following the outcome of each triennial actuarial valuation.

The aim of the investment strategy is:

- To restore any Fund deficit position through investment returns and agreed contributions to achieve 100% funding but also consider what investment policy the Fund would have when fully funded.

- To provide a framework for identifying changes required over the coming period to continue and maintain the appropriate funding level.

3.2 **Actuarial Valuation 2017 & Funding Strategy Statement**

Valuation Date	31 March 2011 £'s	31 March 2014 £'s	31 March 2017 £'s
Asset Value	2,218	2,834	3,815
Liabilities	2,512	3,025	3,562
Surplus/(Deficit)	(294)	(191)	253
Funding Level	**88%**	**94%**	**107%**

3.2.1 Actuarial Valuation

As shown in the above table, the Fund has continued to increase its funding level, outperforming the target funding level of 100%. Having reached this position it is now very important that the Fund implements an investment strategy that locks in this funding level and protects this position going forward.

3.2.2 Funding Strategy Statement

3.2.2.1The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) (the '2014 Regulations') and the Local Government Pension Scheme (Transitional Provisions and Savings)(Scotland) Regulations 2014 (the '2014 Transitional Regulations') (collectively 'the Regulations') provide the statutory framework from which the administering authority is required to prepare a Funding Strategy Statement ('FSS').

3.2.2.2Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the administering authority, acting on the professional advice provided by the scheme actuary.

3.2.2.3The administering authority's long term objective is for the Fund to achieve a 100% solvency level over a reasonable time period and then maintain sufficient assets in order for it to pay all benefits arising as they fall due.

3.2.2.4The purpose of this Funding Strategy Statement is therefore:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward by taking a prudent longer-term view of funding those liabilities;

- to establish contributions at a level to 'secure the solvency' of the pension fund and the 'long term cost efficiency'; and

- to have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

3.2.2.5 The intention is for this strategy to be both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the administering authority to implement and maintain.

3.2.2.6 Delivery of the Funding Strategy is through a combination of scheme contributions (both member and employer) and the Fund's investment strategy.

3.2.2.7 This report sets out the Fund's current investment strategy and proposal for its development over the next valuation periods.

3.3 Investment Strategy

3.3.1 Despite the time spent by Pension Funds on the appointment, review and selection of fund managers, investment strategy and the development of the strategic benchmark (Alpha) accounts for around 80 - 90% of the performance of a pension fund's assets.

3.3.2 Investment strategy should be determined in order to meet the Fund's particular requirements, with specific reference to the funding position and liability profile, and to the Fund objectives. It need not reflect a standard 'mould' or 'model'; rather it should be based on sound rationale specific to the Fund's own circumstances. In theory every fund should have a different asset allocation policy.

3.3.3 It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which more closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts.

3.3.4 Investment of the Schemes' assets in line with the least risk portfolio would minimise fluctuations in the Schemes' ongoing funding level between successive actuarial valuations.

3.3.5 **However**, if at the last valuation date, the Fund had been invested in this portfolio, then in carrying out the valuation it would not have been appropriate for the actuary to make any allowance for out-performance of the investments. On this basis of assessment, the assessed values of the Funds' liabilities would have been significantly higher, declaring a funding level of 88%.

3.3.6 Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will stabilise the contribution requirements and move towards/maintain the funding target (100%). The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

3.3.7 The current FSS incorporated the following global strategy asset allocation as appropriate to meet the long term objective of achieving/maintaining 100% funding:

<u>Growth Assets 70% (range +/- 5%)</u>
Global Equities 55%
Diversified Growth 10%
Limited Partnerships 5%

<u>Income/Protection Assets 30% (range +/- 5%)</u>
Bonds 10%
Direct Property 10%
Index Linked 5%
Other 5%

3.4 <u>2016 Investment Strategy Review</u>

3.4.1 During the above review a number of topics were considered including:

a) Increased diversified asset allocation
b) Liability Driven Investments
c) Trigger Points
d) Passive Currency Hedge
e) Fund Manager Benchmarks
f) Infrastructure

3.4.2 During the period since this last review the Fund has addressed the above areas by;

a) Diversified its asset allocation, investing in multi Credit, Index Linked bonds, diversified growth funds and infrastructure
b) Taken first steps into liability driven investments with a 5% allocation to Index Linked bonds
c) Continued to work within the risk based framework (Appendix I)
d) Passive Currency Hedge, continues to be under review and will be further addressed once the Global Custodian change has been implemented

e) Fund Manager benchmarks have been reviewed, with some changes being made within the alternative asset allocation
f) The Fund has recently invested £100m in an Infrastructure Fund and continues to look for suitable opportunities.

3.5 **Investment Strategy 2018**

3.5.1 Having taken all the above into consideration which importantly includes the current funding position of 107% the Fund should look to de-risk and lock in recent gains.

3.5.2 To achieve this, the Fund needs to reduce its growth asset allocation and increase its income/protection allocation. This can be done by reducing Global Equities and increasing Bond/Credit assets while introducing an allocation to Infrastructure that will assist in the matching of liabilities.

3.5.3 The proposed move between Growth and Income/Protection will be phased over time taking into account trigger points and market conditions. In the first instance Officers recommend the following change:

Current Strategic Benchmark	**Proposed Strategic Benchmark**
Growth Assets 70% (+/- 5%)	**Growth Assets 57.5% (+/- 5%)**
Global Equites 55%	Global Equities 45%
Diversified Growth Funds 10%	Diversified Growth Funds 7.5%
Limited Partnerships 5%	Limited Partnerships 5%
Income/Protection Assets 30% (+/- 5%)	**Income/Protection Assets 42.5% (+/- 5%)**
Bonds/Credit 10%	Bonds/Credit 15%
Property 10%	Property 10%
Index Linked 5%	Infrastructure 10%
Other 5%	Index Linked 5%
	Other 2.5%

3.5.4 Further reductions in Growth assets will be implemented as per Appendix I if and when Funding levels and market conditions allow. Any further changes will be brought to Committee for approval.

4. FINANCIAL IMPLICATIONS

4.1 All Pension Fund costs are paid for by the Fund.

5. LEGAL IMPLICATIONS

5.1 As noted in section 3. 2 the strategy is in line with the legal requirements stipulated in the Regulations.

6. MANAGEMENT OF RISK

6.1 The Pension Fund regularly updates its Risk Register in line with change and is reported quarterly to the Pensions Committee.

7. IMPACT SECTION

7.1 The Pensions Committee has a fiduciary duty to monitor the Pension Fund Strategies across all areas and timelines to deliver a timely, accurate and compliant service to all stakeholders.

8. BACKGROUND PAPERS

8.1 None

9. APPENDICES

9.1 **Appendix I**, Strategic Benchmark Allocation

10. REPORT AUTHOR DETAILS

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Appendix I

MOVEMENT IN STRATEGIC BENCHMARK 2018 TO 2027

Current Strategic Benchmark as per SIP 2017	**Growth Assets** **70% (+/- 5%)** *Global Equities 55%* *Diversified Growth Funds 10%* *Limited Partnerships 5%*	**Income/Protection Assets** **30% (+/- 5%)** *Bonds 10%* *Property 10%* *Index Linked 5%* *Other 5%*
Proposed Strategic Benchmark as at 1 April 2018	**Growth Assets** **57.5% (+/- 5%)** *Global Equities 45%* *Diversified Growth Funds 7.5%* *Limited Partnerships 5%*	**Income/Protection Assets** **42.5% (+/- 5%)** *Bonds / Credit 15%* *Property 10%* *Infrastructure 10%* *Index Linked 5%* *Other 2.5%*
Proposed Strategic Benchmark as at 1 April 2021	**Growth Assets** **50% (+/- 5%)** *Global Equities 40%* *Diversified Growth 5%* *Limited Partnerships 5%*	**Income/Protection Assets** **50% (+/-5%)** *Bonds / Credit 20%* *Property 10%* *Infrastructure 10%* *Index Linked 5%* *Other 5%*
Proposed Strategic Benchmark as at 1 April 2024	**Growth Assets** **45% (+/- 5%)** *Global Equities 40%* *Limited Partnerships 5%*	**Income/Protection Assets** **55% (+/-5%)** *Bonds / Credit 20%* *Property 10%* *Infrastructure 10%* *Index Linked 10%* *Other 5%*
Proposed Strategic Benchmark as at 1 April 2027	**Growth Assets** **40% (+/- 5%)** *Global Equities 35%* *Limited Partnerships 5%*	**Income Assets** **60% (+/-5%)** *Bonds / Credit 20%* *Property 10%* *Infrastructure 10%* *Index Linked 10%* *Other 10%*

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ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	16 MARCH 2018
REPORT TITLE	REVIEW OF NESPF COMPLIANCE WITH THE PUBLIC SERVICE PENSIONS ACT 2013 (PSPA 2013) AND PENSION REGULATOR REQUIREMENTS
REPORT NUMBER	PC/MAR18/GOV
DIRECTOR	DIRECTOR OF RESOURCES
REPORT AUTHOR	MAIRI SUTTIE

1. PURPOSE OF REPORT:-

1.1 To provide members with a review of the North East Scotland Pension Fund's (the 'Fund') compliance with the Public Service Pensions Act 2013 and the Pension Regulator ('tPR') requirements relating to the Fund during the financial year 2017/18.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Note the report

3. BACKGROUND/MAIN ISSUES

3.1 GOVERNANCE FRAMEWORK REVIEW

3.1.1 A review of the Fund's governance framework is conducted on an annual basis. The purpose of the review is to assess current practices and procedures; ensuring the Fund has in place a robust governance framework and complies with legislation and best practice guidance.

3.1.2 In terms of Scheme compliance with legislation such as the Local Government Pension Scheme (Scotland) Regulations and the PSPA 2013 and tPR requirements (as set out in *Code of Practice 14 Governance and Administration of Public Sector Pension Schemes*) a review is carried out on a six monthly basis by Fund officers with annual reporting to the Committee.

3.1.3 To assist public service pension schemes in reviewing their Scheme, a self-assessment tool has been developed by tPR. The Fund has utilized this tool to assist in reviewing our current governance, risk and administration practices.

3.2 Pension Board

3.2.1 The NESPF Pension Board is made up of equal numbers of trade union (4) and employer representatives (4) as follows:

- *1 x Aberdeen City Council*
- *1 x Aberdeenshire Council*
- *1 x The Moray Council*
- *1 x Scheduled/Admitted bodies*
- *1 x Unison*
- *1 x Unite*
- *1 x GMB*
- *1 x UCATT*

3.2.2 The role of the local pension board is to assist the administering authority (Aberdeen City Council) to:

- ensure effective and efficient governance and administration of the Local Government Pension Scheme (LGPS), and
- ensure compliance with LGPS scheme regulations and other relevant legislation together with any requirements imposed by tPR.

3.2.3 The Pension Board has a monitoring, assisting and reviewing purpose rather than being a decision making body. In so doing, the Pension Board is helping to manage the reputational risk of the Fund, and of the administering authority, which responds to the Pension Regulator's expanded regulatory role.

3.2.4 Meeting Attendance for 2017/18

During 2017/18 the Pension Board met formally (and concurrently with the Pensions Committee) on:

12 June 2017 (Pension Board only)
23 June 2017
15 September 2017
1 December 2017
16 March 2018

3.2.5 During 2017/18 there was a 90% (up to December 2017) turnout of Pension Board members at meetings. Active participation during meetings and a willingness to undertake training, indicate the strong commitment of Board members to the continuing effectiveness of the NESPF Pension Board.

The table below details meeting attendance during 2017/18 to date.

Name	**12 June '17**	**23 June '17**	**15 Sept ' 17**	**1 Dec '17**
Cllr Alan Donnelly *			✓	**X**
Cllr Freddie John*	✓	✓		
Cllr Alistair McKelvie	✓	✓	✓	✓
Cllr John Cowe	✓	✓	✓	✓
Marie Hart	✓	✓	✓	**X**
Morag Lawrence	✓	✓	✓	✓
Alan Walker	✓	✓	✓	✓
Kevin Masson	✓	✓	✓	✓

** Councillor Donnelly replaced Councillor John on the Pension Board from September 2017*

3.2.6 Pension Board costs of operation 2017/18

The costs and expenses of the Pension Board are met as part of the administration costs of the Fund. The costs are principally travel related expenses to attend meetings and training events. The Pension Board carries out its role in a cost effective manner, mindful of delivering value for money.

The table below details costs of operation for 2017/18 **to date**.

Travel Costs/Expenses	2418.32
Catering	£567.10
Training Room	£500.00
Total	**£3485.42**

3.2.7 Pension Board Training Attendance for 2017/18

It is a statutory requirement under Schedule 4 of the Public Service Pensions Act 2013 that members of Pensions Board have 'knowledge and understanding' of pensions law and be 'conversant' with Scheme regulations and Fund documents. The issue of training is approached carefully by both the administering authority and individual Board members.

3.2.8 The Board meets annually in June to review their annual report and agree a training plan for the forthcoming year. This provides the opportunity for any issues around attendance to be addressed and gaps in training knowledge identified.

3.2.9 During 2017/18 Pension Board members have continued to demonstrate a commitment to developing their 'knowledge and understanding' by attending various training events covering investments, governance, stewardship and the valuation process. Fund Officers maintain a training log to allow attendance to be monitored on an ongoing basis.

The table below details training attendance for 2017/18 **to date**.

Name	**11 Aug '17**	**31 Oct – 1 Nov '17**	**21 Nov '17**	**11-12 Jan '18**
Cllr Alan Donnelly*	✓	X	✓	✓
Cllr Freddie John*	✓			
Cllr Alistair McKelvie	✓	X	X	X
Cllr John Cowe	✓	X	X	✓
Marie Hart	X	✓	✓	X
Morag Lawrence	✓	X	✓	✓
Alan Walker	✓	✓	✓	✓
Kevin Masson	X	X	X	X

3.3 COMPLIANCE REVIEW

3.3.1 A compliance review is carried out by the Fund on a six monthly basis, with annual reporting to the Pensions Committee.

3.3.2 Summary of main findings:

3.3.3 Overall the review found that the key controls for monitoring the ongoing compliance with legislation and tPR requirements are in place and working effectively, with the latest compliance review taking place in December 2017. A review using the tPR Scheme Assessment Tool confirmed there were no areas of concern.

3.3.4 Work continues to take place within the Fund to ensure we are meeting our legislative and tPR requirements.

3.3.5 Officers are in the process of reviewing Pension Fund processes and policies in preparation for the introduction of the General Data Protection Regulation (GDPR) from May 2018. The GDPR requires Officers to be able to evidence compliance with its principles.

3.3.6 For example, one area in which we identified the need for improvement was in relation to subject access requests. It is anticipated that these will become much more frequent once the GDPR comes into play (given the removal of the right to charge a fee) and therefore it is vital that Pension Fund staff are firstly able to identify such requests and secondly are familiar with handling procedures; otherwise there is an increased risk of non-compliance with the GDPR provisions covering subject access requests. The Governance Team have implemented and will maintain a register to record all incoming subject access requests. This will allow us to monitor the handling of such requests and ensure we are meeting our requirements under the GDPR i.e. responding within the shorter one month timeframe. In addition, a procedure manual is being finalised and will be circulated to assist staff, in addition to training by the Benefit Administration Manager.

3.3.6 Officers have recently carried out an interim tracing exercise, focusing on the 'gone away' members identified during the 16/17 benefit statement exercise (i.e. members we do not hold an up to date address for) to ensure we are complying with our record keeping requirements under tPR *Code of Practice no. 14 and* under the Local Government Pension Scheme (Scotland) Regulations 2014.

3.3.7 The Fund is also monitoring progress on a new Norfolk LGPS Framework for Member Data Services (address tracing/mortality screening) which we plan to procure when it goes 'live' later this year. Use of this framework will assist us in meeting requirements under the GDPR in respect of the personal data we hold on our members.

3.3.8 Staff training has been scheduled for March/April to ensure all staff fully understand what their responsibilities are in regard to data protection under the GDPR and to explain new policies and procedures in advance of its introduction.

3.4 <u>GOING FORWARD</u>

3.4.1 The Governance Review commissioned by the Scottish Ministers was completed by KPMG in early 2017. There were 18 recommendations made based on the research carried out. The Scottish Ministers have agreed the recommendations subject to two caveats and further work will be needed to implement these recommendations during 2018/19 (see Appendix I).

3.4.2 The Pension Board will continue to assist and constructively challenge officers to deliver effective management and administration of the Fund.

4. FINANCIAL IMPLICATIONS

4.1 Good governance is a crucial element of effective public services. It leads to good management, good performance and good stewardship of public money.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 The are no direct risk implications arising from the recommendations of this report.

7. IMPACT SECTION

7.1 The Fund will continue to review its governance arrangements, taking on board any recommendations issued from the Scheme Advisory Board following its review.

8. BACKGROUND PAPERS

8.1 Training Policy (for Committee and Board)
Terms of Reference – Pensions Committee
Terms of Reference – Pension Board

9. APPENDICES

9.1 **Appendix I**, SPPA Governance Review Implementation timetable

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SCOTTISH PUBLIC SERVICE PENSIONS GOVERNANCE REVIEW
KPMG RECOMMENDATIONS

This paper sets out the SPPA's proposed next steps to implement the recommendations made by KPMG in their report. Scottish Ministers have agreed the recommendations, subject to two caveats in relation to recommendations 6 (dedicated staff) and 11 (three year terms). These are covered below under the relevant proposals.

Roles and Responsibilities

1. Scottish Government to consider tasking the LGPS Scheme Advisory Board to demonstrate that the local LGPS Pension Boards have achieved a reasonable working balance between the oversight of the local pension funds and the good governance and administration of the schemes, as required by the Public Service Pensions Act 2013 ('the 2013 Act') and the Pensions Regulator's Code of Practice 14.

This is one of several strands which fall to the LGPS. These will be discussed between SPPA and the LGPSAB Secretariat at a meeting in **late August** and will be discussed at the SAB meeting in **late September**. The aim would be to agree a timetable for the work at the September meeting.

2. On behalf of the Scottish Government, SPPA should consult with the Pensions Regulator and other relevant bodies to develop appropriate guidance for all Pension Board and Scheme Advisory Board members on what is expected of them, citing examples of best practice as appropriate. For example, this guidance should include what 'assisting the Scheme Manager' means in practice.

The Pensions Regulator (TPR) has updated its high level guidance. SPPA will be meeting TPR in **late August/early September** to discuss the possible shape of more specific guidance and that will inform discussion with stakeholders, including Boards. The aim would be to issue more detailed advice for the Scottish schemes **by end November**.

Training

3. SPPA, in its role as Scheme Manager, together with Local Authorities filling the same role for the LGPS, should ensure an annual training plan is in place for all Board members. This should cover those subjects common to all Boards as well as addressing issues specific to the challenges faced by different Boards.

This work is **continuing.** Training plans already exist and form part of Board work plans. They are tailored to the needs of the respective Boards. SPPA provides support and training on issues which are common to all Boards. For instance, training on valuations is being delivered to all SABs between **August and October 2017**. SPPA will continue to monitor the implementation of the plans. For LGPS this will form part of the discussions in **August/September**.

4. All Pension Board and Scheme Advisory Board members should be required to undertake the Pensions Regulator on-line training as part of their induction training.

Board members do undertake this training. SPPA will ask all Boards to confirm that all members have completed the on-line training **by end September** and will maintain a requirement to complete the training as part of member induction in future.

5. Training logs from all Boards should be submitted on a regular basis to SPPA (for unfunded Scheme Pension Boards and Scheme Advisory Boards and the LGPS Scheme Advisory Board) or the LGPS Scheme Advisory Board (for LGPS Pension Boards).

This will be subsumed within the work on Training Plans (rec. 3)

Support for Boards

6. Scheme Manager to ensure a consistently high standard of support is provided to the Boards it supports, preferably from dedicated staff to enable a consistency in approach. All Boards should issue papers and agendas and publish minutes within agreed timescales, thus allowing members sufficient time to prepare themselves for meetings.

7. SPPA should establish and set out clearly what level of support for Boards is appropriate within the available resources.

8. SPPA to consider appointing four dedicated pension managers, one for each of the four unfunded schemes, to act as the focal point for all SPPA interaction with the Scheme Advisory Boards and Pension Boards. The pension manager would attend all relevant Scheme Advisory and Pension Board meetings on behalf of SPPA

SPPA accepts the need to ensure a consistently high standard of support to all Boards and is considering the best way for staff to deliver this. This may include the use of dedicated staff. The management of the schemes and the way in which the respective Boards are supported will be taken into account in designing the new Target Operating Model. As part of that work, SPPA is considering the dedicated manager model but has concerns that it may not represent the most efficient management of the schemes and that it would not deliver the level and consistency of service which the Boards expect. The expectation is that SPPA will put a model to Boards by **the cycle of meetings towards the end of 2017**.

9. All relevant information concerning public service pension Boards, including the LGPS Boards, should be published in one central location (for example the SPPA website). This website should include the Terms of Reference for each Board, meeting minutes, annual reports and details of all Board members. It would also be helpful if references to each of the LGPS Pension Boards used a common naming convention. Such a depository of information will enable members of pension schemes and the general public to easily find relevant information and facilitate comparison where appropriate.

Much of the information is already available and work is being done on ensuring consistency. The aim is to have the information brigaded as recommended **by end October 2017**

Board Composition

10. Scottish Government may wish to seek assurances that the two largest Boards require a membership of 14 and 24, when the majority appear to be able to discharge their duties with an average of fewer than 10 members.

SPPA will discuss with the two Teachers' Scheme Boards the extent to which the numbers are necessary to discharge their respective duties. This will be on the agendas for the Boards' **September** meetings.

11. In consultation with Board members, and in particular Board Chairs, a succession plan is put in place for each Board to ensure a balance is struck between ensuring sufficient experience is retained whilst also introducing new blood to the Boards. In the absence of an alternative suggestion, tenures of three years are proposed, with the opportunity to serve an additional term if agreed.

There is a need to maintain expertise and plan for succession. Boards made clear the need to avoid a cliff edge where all members' terms of office expire simultaneously. When the current terms expire, SPPA would therefore propose to use a mixture of 3 and 4 year appointments to ensure that not all members' terms would expire at the same time. Once that staggering is in place, the term could revert to 3 years for all.

12. The current practice of appointing independent Chairs for the four unfunded scheme Pension Boards has worked well and should continue. The value of using independent Vice-Chairs is less clear and after the next round of member appointments/extensions, SPPA in consultation with the relevant Boards should review the need for these posts.

As recommended, SPPA will explore this with the Boards **after the next round of member appointments/extensions**.

13. The current practice of SPPA, on behalf of Scottish Government, providing the Chair for the Firefighters' Scheme Advisory Board and the Police Scheme Advisory Board should cease. A new Chair for each of these two Boards should be appointed as soon as possible and consideration should be given to the post being given to an independent candidate. Furthermore, consideration should be given to future Chairs of all the Scheme Advisory Boards being independent appointments.

SPPA will cease chairing the Fire and Police SABs. SPPA will consider, with the relevant Boards, the issue of independent chairs as **part of the forthcoming (re)appointment cycle.**

14. Cease the practice of independent Chairs attending the SPPA Corporate Board as a matter of course. They should be invited as observers, when appropriate.

This has been implemented.

15. It is recommended that the Scottish Government takes steps to ensure that its Boards reflect the diversity of the members that they represent. In particular, pensioners should be represented on Boards as member representatives.

SPPA will explore with Boards and stakeholders how to improve the diversity of the membership and how best to ensure that pensioners are represented on Boards. This will be done **as part of the forthcoming (re)appointment cycle**.

Board Interaction

16. Consideration should be given to establishing a formal distribution of minutes between Pension Boards and their respective Scheme Advisory Boards.

This is being implemented.

17. All Pension Board members and Scheme Advisory Board members should be encouraged to attend other Pension and Scheme Advisory Board meetings wherever this is practicable and at least once during their tenure.

Boards may wish to discuss how they go about this, possibly coordinating exchange visits between Boards. This could start immediately and would be a **continuing** part of Board member development.

18. An annual public service pensions conference should be organised for all Board members to attend. SPPA is probably best placed to take on this task.

SPPA will organize a conference and would propose holding it in **autumn 2018**. As a first step, SPPA will seek views of Board members on what they would wish a conference to achieve.

ABERDEEN CITY COUNCIL

COMMITTEE	PENSIONS COMMITTEE
DATE	16 MARCH 2018
REPORT TITLE	STRATEGY
REPORT NUMBER	PC/MAR18/STRATEGY
DIRECTOR	DIRECTOR OF RESOURCES
REPORT AUTHOR	LAURA COLLISS

1. PURPOSE OF REPORT:-

1.1 To inform the Committee and provide recommendations to any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee:

i. Approve the Pension Fund Signatory List as noted in Appendix II (for implementation as at 1 April 2018. (item 3.6.1)
ii. Review and approve the policy document changes (item 3.6.2).
iii. Note the remainder of the report

3. BACKGROUND/MAIN ISSUES

3.1 In line with the structural review of the Pension Fund, six specific areas have been identified which fully address the strategic management of the Fund;

- Investment
- Accounting
- Benefit Administration
- Technical
- Governance
- Employer Relations

The roles and responsibilities within these areas have been very clearly defined to ensure accountability across the Pension Fund.

The Pensions Committee will be comprehensively informed via this report as to the current position and any variances to the Funds strategy and recommendations. To support this report service updates covering the six strategic areas will also be available via the secure website (http://www.nespf.org.uk/TheFund/Governance/Committee.aspx) and email.

Also available on the Pension Fund Website are all the Policy documents that govern the Pension Fund including its various strategies.

3.2 **INVESTMENT**

3.2.1 *Asset & Investment Manager Performance Report*
Investment Strategy Update Report
Investment Strategy Review 2018 Report

Separate Reports, provided.

3.2.2 **Local Authority Pension Fund Forum (LAPFF)**

Copies of the latest e-bulletins, quarterly engagement and annual reports are available at http://www.lapfforum.org/

3.3 **ACCOUNTING**

Budget/Forecast Report

Statement of Accounts 2017/18 – Action Plan

Separate Reports, provided.

3.4 **BENEFIT ADMINISTRATION**

3.4.1 **LGPS (Scotland) Regulations 2018**

Officers submitted a response on the draft regulations on 11th January 2018 prior to the end of the consultation period which was extended to15th January 2018. The draft regulations propose a number of key changes around AVCs and 'Freedom & Choice' as well as greater flexibilities to assist fund authorities and employers to address funding liabilities when a body ceases to be a scheme employer.

3.4.2 **GMP Equalisation & Indexation Update**

The Government has published a response to its consultation on the indexation and equalisation of Guaranteed Minimum Pension (GMP) which ran between 28th November and 20th February 2017. The consultation was about how the Government should continue to meet its obligations to index (price protect) and equalize (make equal payments to men and women) the pension entitlements of Scheme members with a GMP element to their pension.

The Government has been implementing an 'interim solution' since April 2016 and has decided to further extend this solution for an additional two years and four months, covering members who reach State Pension Age before 6th April 2021. In the interim period, the Government plans to continue to investigate an alternative long-term solution, with 'conversion' (converting GMP into scheme benefit; equating £1 of GMP to £1 of scheme benefit) seeming the favoured option at present.

3.5 TECHNICAL

3.5.1 Appendix I, Pensions Administration Strategy Update

3.5.2 Testing Working Party

NESPF signed up to the Altair 8.1 Testing Working Party with officers attending an introductory day in Manchester on 5th December 2017. The testing period ran from 8th January to the beginning of February 2018, with officers from across Pensions assisting in testing a number of improvements and changes to the administration system e.g. legislative updates, calculations, reporting etc. The testing went well with only minor issues identified and these were resolved quickly.

3.6 GOVERNANCE

3.6.1 Signatory List

A revised signatory list is attached at Appendix II for approval, to take effect from 1 April 2018.

The signatory list has been updated to include current team leaders and officers within both Legal & Democratic Services and Commercial & Procurement Services.

3.6.2 Document Review

The Fund undertakes an annual review of all major Scheme policies and statements. Revisions as at February 2018 have been made to the following policies:

- Employer Engagement Policy
- Governance Compliance Statement

- Statement of Investment Principles

Details of the revisions to each policy are provided in Appendix III. Copies of the revised policies are available on request from the Governance Team or can be accessed in the secure area of the NESPF website (www.nespf.org.uk).

3.6.3 **Scheme Advisory Board**

Copies of the latest bulletins and meeting minutes available at http://lgpsab.scot

3.6.4 **Annual Governance Review**

Review of NESPF Compliance with the Public Service Pensions Act 2013 and Pension Regulator Requirements

Separate report, provided

3.6.6 **Fraud, Whistleblowing & Breaches of Bribery Act**

There have been no cases during the year 2017/18.

3.6.7 **Internal & External Audit**

NESPF Annual Audit Plan 2017/18 Draft
Internal Audit Plan 2018/19

Separate reports, provided

3.7 **EMPLOYER RELATIONSHIP**

3.7.1 **Funding Update**

Update on the Draft Funding Strategy Statement & presentation

Separate report, provided

3.7.2 Appendix IV, Report on Valuation Data Quality for the Main Fund

4. FINANCIAL IMPLICATIONS

4.1 The performance of the Fund over the long term can impact on the Fund's funding level and therefore the ability to meet its long term liabilities.

5. LEGAL IMPLICATIONS

5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

6.1 The Pension Fund regularly updates its Risk Register in line with change and is reported quarterly to the Pensions Committee.

Appendix X, Copy of Risk Register (February 2018)

7. IMPACT SECTION

7.1 The Pensions Committee has a fiduciary duty to monitor the Pension Fund Strategies across all areas and timelines to deliver a timely, accurate and compliant service to all stakeholders.

8. BACKGROUND PAPERS

8.1 None

9. APPENDICES

9.1 Appendix I, Pension Administration Strategy Update
Appendix II, Signatory List
Appendix III, Document Review
Appendix IV, Report on Valuation Data Quality for the Main Fund
Appendix X, Copy of Risk Register

10. REPORT AUTHOR DETAILS

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North East Scotland
PENSION FUND

Pension Administration Strategy

Quarterly Reporting |December 2017

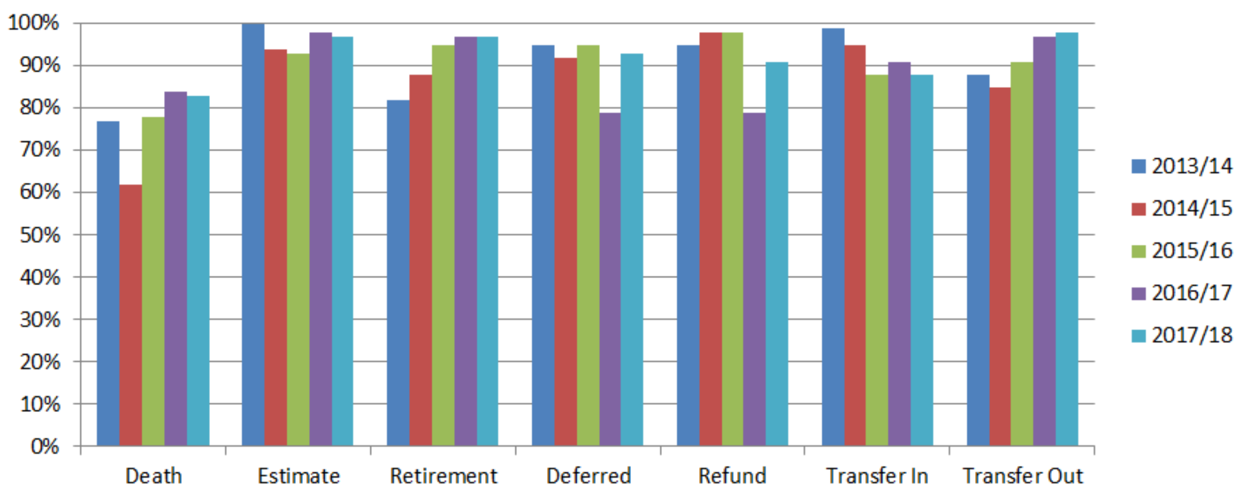
1. NESPF performance to 31 December

1.1 Key administration tasks

Measuring performance is essential to evidence the efforts made by both the Pension Fund and Scheme employers to comply with statutory requirements and deliver a high quality pension administration service. The Pension Fund aims to provide the information below within the agreed timescales shown.

Administration Task	Target	Amount	Achieved	Percentage
Notification of death in service	5 days	36	30	83%
Notification of retirement estimate	10 days	663	644	97%
Notification of retirement benefits	10 days	1260	1223	97%
Notification of deferred benefits	10 days	797	744	93%
Notification of refund	10 days	1027	935	91%
Notification of transfer in value	10 days	85	75	88%
Notification of transfer out value	10 days	314	308	98%

1.2 Previous years comparison



2. Employer performance to 30 September

2.1 Policy on discretions received (85%)

Each Scheme emloyer is required under regulation 58 of the Local Government Pension Scheme (Scotland) Regulations 2014 to prepare a written statement of its policy on how it will exercise various discretions provided by the Scheme. This 'discretions policy' must be kept under review by employers and revised as necessary.

Employers			
Aberdeen City Council	Aberdeen Cyrenians	Aberdeen Endowments Trust	Aberdeen Foyer
Aberdeen Heat and Power	Aberdeen Performing Arts	Aberdeen Sports Village	AIYF
Aberdeenshire Council	Aberlour	Archway	Bon Accord Care
Bon Accord Support	Outdoor Access Trust for Scotland	Fersands and Fountain	First Aberdeen
Forth & Oban (City)	Fraserburgh Harbour	Grampian Valuation Joint Board	Home Start Aberdeen
Inspire	Mental Health Aberdeen	Middlefield Community Project	Moray College
NESTRANS	North East Scotland College	North East Sensory Services	Osprey Housing
Pathways	Peterhead Port Authority	Printfield Community Project	Robert Gordons College
Robert Gordon University	Sanctuary Housing	Sanctuary Scotland Scottish Fire and Rescue	Scottish Fire and Rescue
Scotland's Lighthouse Museum	Scottish Police Authority	Scottish Water	Sport Aberdeen
St Machar Parent Support Project	Station House Media Unit	The Moray Council	Visit Scotland
Xerox			

2.2 Signed PLO statements received (46%)

Following the revision of the NESPF Pension Administration Strategy in April 2018 each Scheme employer must designate a named individual to act as a Pension Liaison Officer, the main contact with regard to any aspect of administering the Local Government Pension Scheme (LGPS).

Pension Liaison Officers			
Aberdeen City Council	Aberdeen Cyrenians	Aberdeen Endowments Trust	Aberdeen Foyer
Aberdeen Heat and Power	Aberlour Childcare Trust	Alcohol & Drugs Action	Archway
Bon Accord Care	Bon Accord Support	Outdoor Access Trust for Scotland	Fraserburgh Harbour
Middlefield Community Project	Moray College	North East Scotland College	North East Sensory Services
Pathways	Peterhead Port Authority	Printfield Community Project	Robert Gordons College
Scottish Fire and Rescue	Scottish Water	Sport Aberdeen	St Machar Parent Support Project
Visit Aberdeenshire	Xerox		

2.3 Quantity of data received (565,739)

All Scheme employers are now required to provide monthly data using I-Connect, by way of a monthly file extracted from the payroll system or by completing electronic forms for individual members.

I-Connect events processed	Total
Starters (new start and opt in)	3118
Amendments (address, personal details, hours and absence)	19284
Leavers (exit and opt out)	2278
Contributions (employee, employer and additional)	182426
Salary	180334
Cumulative CARE pay	175447
Works address	2852

2.4 Quality of data received

The quality of data received from Scheme employers is assessed and checked by the Employer Relationship Team (ERT). Red, Amber and Green flags will be used to assess the quality of the data. The Pension Fund will seek, at the earliest opportunity, to work closely with Scheme employers in identifying areas of unsatisfactory performance, and provide the necessary training and development for improvement.

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Since the introduction of the requirement to provide monthly information in this format the quality of the data received through i-Connect has been of a very high standard. This allows the Fund to provide accurate and up to date information to members, meet the requirements of The Pension Regulator and improved the accuracy of the financial information held for the valuation of the Fund.

Green	I-Connect events processed and validated by ERT
Amber	I-Connect events processed however missing or incorrect data identified by ERT
Red	I-Connect events not processed
Blank	Data not provided (as at 31 December 2017)

Employer	Submission	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Aberdeen City Council	Extract File												
Aberdeenshire Council	Extract File												
Bon Accord Care	Extract File												
Bon Accord Support	Extract File												
Grampian Valuation Joint Board	Extract File												
Moray Council	Extract File												
NESTRANS	Extract File												
Police Scotland (Aberdeen)	Extract File												
Robert Gordon University	Extract File												
Moray College*	Extract File												
Scottish Water	Extract File												
Sport Aberdeen	Extract File												
Aberdeen Endowments Trust	Online Return												
Aberdeen Cyrenians	Online Return												
Aberdeen Foyer	Online Return												
Aberdeen Heat and Power	Online Return												
Aberdeen Performing Arts	Online Return												
Aberdeen Sports Village	Online Return												
Aberlour Child Care Trust	Online Return												
Aberdeen International Youth Festival	Online Return												
Archway	Online Return												
City Moves Dance Agency	Online Return												
Alcohol & Drugs Action	Online Return												

Fersands and Fountain	Online Return												
First Aberdeen	Online Return												
Forth and Oban (City)	Online Return												
Forth and Oban (Shire)	Online Return												
Fraserburgh Harbour	Online Return												
Homestart Aberdeen	Online Return												
Homestart NEA	Online Return												
ID Verde	Online Return												
Inspire	Online Return												
Mental Health Aberdeen	Online Return												
Middlefield Community Project	Online Return												
North East Sensory Services	Online Return												
Osprey Housing	Online Return												
Outdoor Access Trust Scotland	Online Return												
Pathways	Online Return												
Peterhead Port Authority	Online Return												
Printfield Community Project	Online Return												
Police Scotland (Glasgow)	Online Return												
Robert Gordon College	Online Return												
Robertson FM City	Online Return												
Robertson FM Shire	Online Return												
Sanctuary Housing	Online Return												
Sanctuary Scotland	Online Return												
SCARF	Online Return												
Scotlands Lighthouse Museum	Online Return												
Scottish Fire and Rescue	Online Return												
St Machar Parent Support Project	Online Return												
Station House Media Unit	Online Return												
Visit Scotland	Online Return												
Xerox	Online Return												
North East Scotland College	ALCARE												

*Currently receiving test files for main file extract submissions

Authorised Signatory List for the Aberdeen City Council Pensions Fund
(known as the North East Scotland Pension Fund and including the Aberdeen City Council Transport Fund)

The Pensions Committee for the Aberdeen City Council Pensions Fund authorised the following named officers of Aberdeen City Council to sign documents in respect of the Fund, with effect from 1st April 2018.

Signing Instructions – Any <u>one</u> of the undernoted signatories.

OFFICERS AUTHORISED TO SIGN ALL DOCUMENTS IN RESPECT OF THE ABOVE FUND	
NAME AND POSITION	**SIGNATURE**
TBC Chief Officer - Finance	
Sandra Buthlay Accounting Manager	
Fraser Bell Chief Officer - Governance	
Jackie Buchanan Service Manager - Legal Services	
Jess Anderson Team Leader - Governance	
Steven Inglis Team Leader - Governance	
Elaine Falconer Team Leader - Litigation	
Elene Carlisle Team Leader - Planning and Environment	
Jenni Wilson Team Leader - Licensing	
Craig Veitch Team Leader - Property	
Craig Innes Head of Commercial and Procurement Services	
Alison Watson Team Leader - Legal Team, Commercial and Procurement Services	

OFFICERS AUTHORISED TO SIGN IN RESPECT OF DAY TO DAY ADMINISTRATION OF THE PENSION FUND	
NAME AND POSITION	**SIGNATURE**
Laura Colliss Pensions Manager	
Gary Gray Benefit, Administration & Technical Manager	
Michael Scroggie Accounting Manager	
Caroline Mann Senior Pensions Officer Investments	
Graham Buntain Investment Manager	

Appendix II

Document Name		Revisions
1.	Employer Engagement Strategy	• New format to bring in line with other policy documents • Minor amendments for consistency with other documents and practice.
2.	Governance Compliance Statement	• New format to bring in line with other policy documents • Amendments made to explain 'partial' compliance
3.	Statement of Investment Principles	• New format to bring in line with other policy documents • To reflect proposed changes following the Fund's tri-ennial valuation as at 31 March 2017 and investment review.

All of the above revised reports are available to view via the Pension Fund website at www.nespf.org.uk

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North East Scotland PENSION FUND

Valuation Data Quality for Main Fund

The scheme actuary (Mercer) provided North East Scotland Pension Fund (NESPF) with a Data Quality Report for the 2017 Valuation and included an analysis tool that measured the quality of data provided using RAG[1] flags. The report analyses Common data items prescribed by The Pension Regulator (TPR) as well as Detailed data tests for active, deferred and pensioner members.

NESPF carefully examined the results provided by the tool to identify further measures that could improve the quality of our data and the valuation process, this report summarises work undertaken as a result of flags raised in the analysis.

1. Common Data

All of the 9 common data tests raised green flags against the standard tolerance used for valuation however TPR guidance for record keeping suggests that postcodes must be present if an address is not identifiable as being overseas, further investigation of missing postcodes revealed:

- 2 members with current record status of active, both now resolved
- 196 members with current record status of deferred, some overseas but majority gone away
- 16 members with current record status of dependant, all overseas
- 142 members with current record status of pensioner, majority living abroad
- 25 have current record status of undecided, mixture of overseas and gone away.

Member data is obtained from employers through an online tool or via a secure file upload facility. The systems used require data to be processed in a valid, prescribed format and therefore all common data will remain of a high standard going forward.

[1] Red, amber and green flags set to standard (Mercer) or user defined (NESPF) tolerance levels

2. Detailed Data Tests – Red Flags

NESPF investigated all red flags raised against the standard tolerances used for valuation.

2.1 Post 15 Pension inconsistent with Actual Pay (82.1%)

Further investigation revealed that more than 99% had a revalued pension output value that was within 1% of total CARE pay divided by accrual rate. A sample check of members showed differences of more than 1% were due to aggregation or transfer in values included in the revalued pension. Mercer advised that a calculation in the test used 3 years which applied to England and Wales rather than 2 which applied to Scotland and recalculation has reduced percentage from 82.1% to 16.3% and changed flag to amber.

2.2 Current pension inconsistent with amount at leaving (56.8%) and **Pre 15 pension inconsistent with pay and service (55.4%)**

Both these flags are as a result of an error with the valuation extract program which was highlighted by Mercer and raised by NESPF. The report commented that *"this appears to be largely due to incorrect historical service figures, rather than the current pension figures themselves being correct"*. PRB005294 is a confirmed system problem where 60th service is incorrectly output for pre 2009 leavers and no 80th service is output for pre 2009 joiners. A sample check of members confirmed that the pension values extracted from the system were correct.

2.3 Inconsistent retirement age (21.2%)

This flag is a result of an error with the valuation extract program where qualifying service provided was blank for some deferred members (Pre 09 leavers and 2016/17 leavers). Mercer confirmed that the Critical Retirement Date as supplied was used so the valuation calculations will not have been affected.

2.4 Spouses pension outside 30% - 50% of members (29.3%)

As expected because of:

- Female members with service prior to 6 April 1988
- Members where GMP only is currently in payment
- Members where pension has been reduced because of re-employment.

2.5 No GMP – some expected based on service dates (11%)

As expected and will be resolved on completion of guaranteed minimum pension reconciliation with HMRC.

3. Detailed Data Tests – Amber Flags

Although Mercer stated in their report they would not be materially significant NESPF investigated all the amber flags raised against the standard tolerances used for valuation.

3.1 Actual pay inconsistent with FT pay and part time hours (16.1%)

Since the introduction of the CARE scheme some employers have struggled to provide accurate FTE pays however the actual pays are checked every month by the Employer Relationship Team. How we have historically recorded casual workers will have an impact on this test as the part time hours held will be 0.01, further investigation identified 1,340 members in the active extract. There are also valid scenarios that will fail such as members who joined in March but did not get paid until April, further investigation identified 43 part time members in the active extract with a FTE pay but no actual pay. The FTE recorded on the system is for a full year so it is likely that members who became part time during the year could fail this test as there does not appear to be anything in the active extract to indicate when part time hours take effect from.

3.2 No GMP – some expected based on service dates (14%)

As expected and will be resolved on completion of guaranteed minimum pension reconciliation with HMRC.

3.3 Inconsistency between member status and exit data (6.4%)

Further investigation revealed that majority of 1,500 members with current record status code of non-active and no exit mode output were undecided leavers. A number of members were identified as having a current record status code of active and an exit mode output however a sample check revealed that majority were members who left on 31/03/2017 and the exit mode output reflects their status from 01/04/2017. PRB005054 is a confirmed system problem where no exit mode is set in the extract for aggregated employments.

3.4 No spouse's pension (17.4%)

As expected because the marital status held on system will determine whether a spouse's pension is calculated. Further investigation of pensioners with no spouse's pension revealed more than 2,800 have a status of single, divorced or widow and 440 have a status of married or partnership albeit at the time their benefits were calculated their status would have been different.

4. Improvements

Mercer acknowledged the quality of data provided by NESPF for the 2017 Valuation was "*very good*" however all of the following will further improve data quality and the valuation process:

4.1 Problem Fixes

Software release 8.1 contains 11 problem fixes for the valuation extract program and will be delivered early in 2018.

4.2 Address Tracing

Address tracing exercise to reduce amount of gone away addresses held on the system to comply with TPR requirements.

4.3 GMP Reconciliation

Ongoing reconciliation of GMP's with HMRC which has to be completed by December 2018.

4.4 Undecided leavers

Given the amount of undecided leavers present on the extract files NESPF will look at ways to better manage and reduce the amount of status 2 records on the system.

4.5 Data Improvement Plan

To coincide with the greater emphasis being put on to data quality from the TPR and to minimise the risk posed by inaccurate data on the triennial valuation results the NESPF will develop and follow a data improvement plan from 1 April 2018.

NESPF Risk Register

1. In line with best practice and the Pension Regulator's Code of Practice, NESPF maintains a risk register to ensure the risks the Fund faces are properly understood and risk mitigation actions are in place.

2. The risk register is updated regularly, with quarterly reporting to the Committee and Board.

3. Summary at November 2017

Key priorities for 2017/18

Catastophic Impact		**1**	**7**			
Critical Impact		**6**				
Marginal Impact		**2, 4**	**5**	**3**		
Negligle Impact						
Consequences	Almost impossible	Very low	Low	Significant	High	Extremely High

Ongoing Assessment with tPR requirements

Catastophic Impact	**17, 22, 23, 24**	**2, 14**	**7**			
Critical Impact		**6, 20**	**15, 18, 19**	**8, 9, 26**		
Marginal Impact	**16**	**3, 4, 25**	**1, 5, 10, 11**	**13,20**		**12**
Negligle Impact						
Consequences	Almost impossible	Very Low	Low	Significant	High	Extremely High

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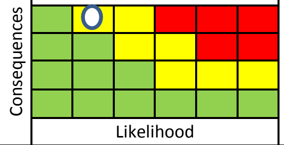
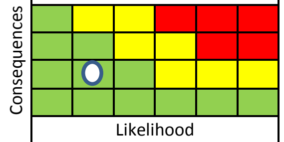
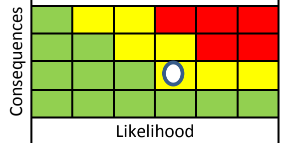
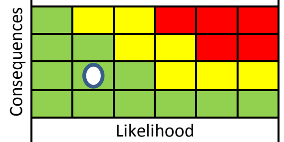
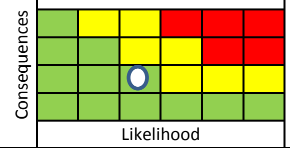
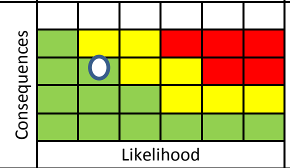
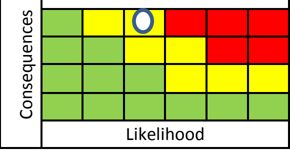
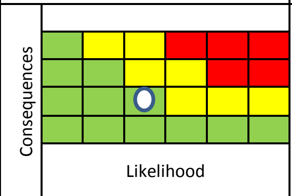
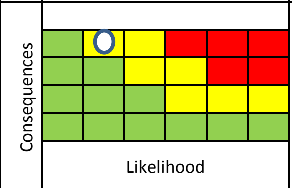
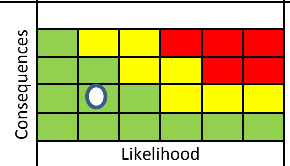
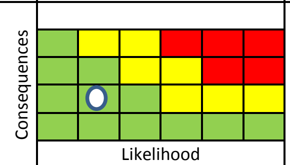
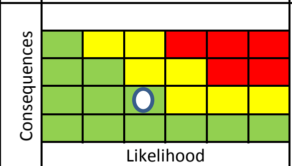
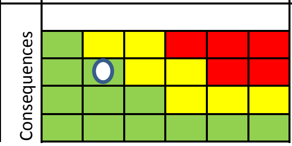
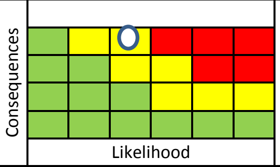
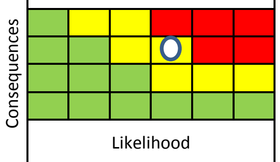
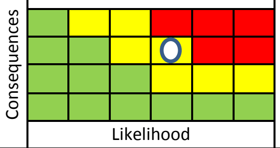
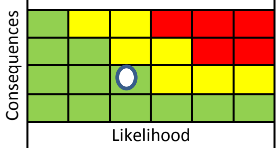
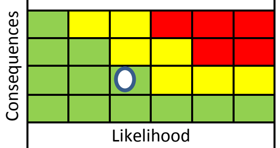
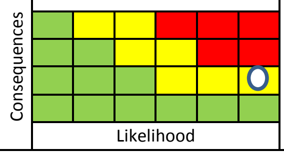
Pension Fund Risk Register **Key Priorities 2017-18**

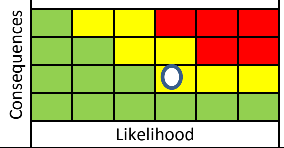
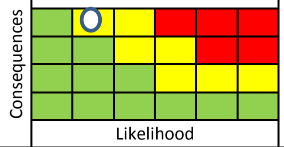
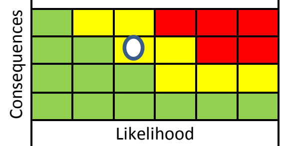
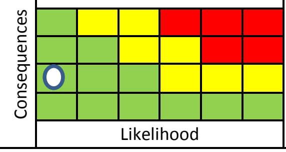
No	Category	Description	Potential Consequence of Risk	Risk mitigation measures	Risk Matrix	Risk Score	Status/Work to be undertaken	Change since last review
1	Corporate	Lack of effective Risk Management	Failure to identify and respond to risks with the potential to impact on our ability to achieve our objectives	Pension Fund risk register reviewed and updated quarterly		8	Ongoing	⟺
2	Corporate	Poor Governance	Failure to ensure the Fund has in place a sound organisational framework, identifies responsibilities, manages its systems and processes and supports the Council's culture and values	Fund has in place an annual review of its governance statement and supporting documents ensuring they comply with both regulation and Council objectives. New governance framework established from April 2015. ACC Governance review is in progress.		4	Ongoing - annual review of policy documents	⟺
3	Corporate	Lack of Performance Measures	Failure to measure how successful we are at delivering the Pension Fund Business Plan priorities and achieving improved outcomes for our scheme members	Fund has in place both statutory and local PI's		8	CIPFA Benchmarking exercise. Also quarterly Investment performance and PAS reporting to Committee.	⟺
4	Funding	Actuarial Valuation - impact of market volatility	Increase in employer contributions to meet unfunded position	Interim actuarial valuation to be undertaken		4	Follow up report to March'18 committee following consultation.	⟺

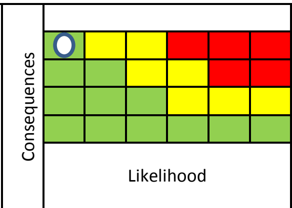
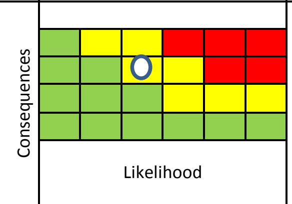
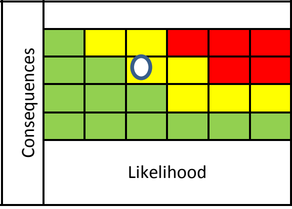
5	Regulatory and Compliance	Requirement to complete GMP Equalisation	Failure to ensure that future member benefits are calculated correctly. Audit critism and financial loss to the Fund	Staff appointed to carry out calculations		6	Ongoing. Report due to June'18 committee meeting.	
6	Governance	Annual Review of workings of Pension Board and Pension Committee	Failure to ensure effective joint working of the Pension Board and Pension Committee, not compliant with Scheme Regs and Pension Regulatore requirements	Review of Penion Committee and Board		6	Report to Committee in March'18. Recommendations of SPPA Governance Review being implemented.	
7	Investment	New Global Custody Services	Failure to manage transition between old and new custodial arrangements. Financial loss through delay in service or errors in data	Working group in place. Regular reporting to Pension Committee		12	Transition to new Global custodian underway. Due to complete by April 2018.	

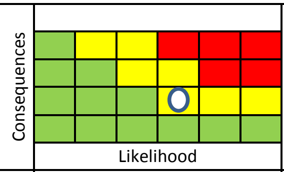
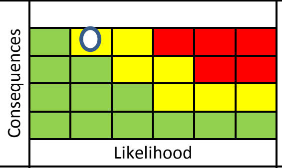
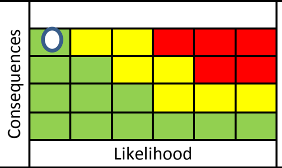
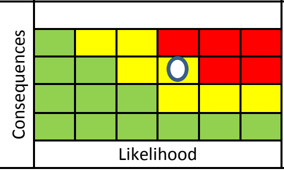
Pension Fund ongoing risk assessment in accordance with Pension Regulator Requirements

No	Category	Description	Potential Consequence of Risk	Risk mitigation measures	Risk Matrix	Risk Score	Status/Work to be undertaken	Change since last review
1	**Operational**	Pension Administration system failure	Staff downtime, loss of service delivery	System is hosted externally with back-up in separate location		6	Report provided to Pensions Manager quarterly on hosted system errors and resolutions	
2	**Operational**	Unable to access workplace	Staff downtime, loss of service delivery	Disaster recovery policy in place which is incorporated within CG overall policy		8	Review to be carried out. Pension Fund Management team to be made fully aware of disaster recovery plan	
3	**Operational**	Overpayment of pension benefits	Audit criticism, legal challenge, reputational risk	All pension payments signed off by a senior pensions officer – segregation of duties for staff processing lump sums		4	Ongoing	
4	**Operational**	Failure to maintain member records and comply with regulations	Incorrect pension payments, incorrect assessment of actuarial liabilities	All employers required to submit monthly data, which is checked		4	PAS reporting quarterly to the Pensions Manager and Committee.	
5	**Operational**	Failure to carry out effective member tracing	Incorrect pension payments, incorrect assessment of actuarial liabilities	Tracing service in place (ATMOS)		6	ATMOS exercise carried out for 'gone away's. Tracing framework available from summer 2018.	
6	**Operational**	Fraud/Negligence	Overpayment, unauthorised payments, system corruption, audit criticism, reputational damage	All pension payments signed off by a senior pensions officer – segregation of duties for staff processing lump sums		6	Ongoing	

					Likelihood			
7	**Operational**	Failure to recruit and develop staff	Reduction in service delivery, poor operation of risk management controls	New structure put in place in 2016 & training plans for all staff completed reviewed annually. On-going review of staffing requirements.		12	Several vacant posts still to be filled.	
8	**Funding**	Fund's investments fail to deliver returns in line with anticipated returns required to meet the valuation of the long term liabilities	Increase in employer contributions	Quarterly assessment of investment performance of fund, triennial actuarial valuation and quarterly funding updates reported to pensions committee. Triennial investment strategy review.		12	Ongoing	
9	**Funding**	Fall in bond yields, leading to risk in value placed on liabilities	Increase in employer contributions	Quarterly funding updates prepared by FSM reported to Pensions Committee		12	Ongoing	
10	**Funding**-	Pay and price inflation valuation assumptions either higher or lower	Increase in employer contributions	Quarterly funding updates reported to Pensions Committee		6	Information to be provided by FSM	
11	**Funding**	Longevity issues	Increase in employer contributions	Actuarial assessment every three years undertake scheme specific analysis		6	Revised Investment Strategy to committee in March'18	
12	**Funding**	Employers leaving scheme/closing to new members due to cost	Residual liabilities could fall to other scheme employers	Monitor scheme employer – seek guarantors for smaller employers		12	Ongoing	

13	**Funding**	Failure to recover unfunded payments from employers, cross subsidy by other employers	Residual liabilities could fall to other scheme employers	Accounting officers will escalate employer payment issues to Employer Relationship Team. Breaches recorded & monitored by Governance Team with reporting to TPR if 'material'		8	Ongoing	
14	**Financial**	Failure of world stock markets	Increase in employer contribution rates	Diversification of scheme assets, investment strategy review following outcome of triennial valuation		8	Revised Investment Strategy to committee in March'18	
15	**Financial**	Early retirement strategies by scheme employers	Pressure on cash flow	On-going discussions with scheme employers of Funding issues. Documentation in place		9	Ongoing	
16	**Financial**	Negligence, fraud, default by investment managers	Loss of value of the Fund, reputational damage	Fund management monitoring, SAS 70 reports and appropriate clauses in all scheme documentation		2	Ongoing	

17	**Financial**	Failure of Global Custodian	Loss of investments or control of investment	Regular meetings with global custodian, receipt of SAS 70 reports and monitoring		4	In process of appointing new custodian.	
18	**Financial**	Failure to monitor investment managers and assets	Audit criticism, legal challenge, reputational risk	Quarterly assessment of investment performance of fund, triennial actuarial valuation and quarterly funding updates reported to Pensions Committee.		9	Ongoing	
19	**Regulatory and Compliance**	Failure to comply with LGPS Regulations, Pensions Act, HMRC and other overriding regulations	Audit criticism, legal challenge, reputational risk, financial loss/financial penalties	Six monthly review of compliance with regulations and annual report to Pensions Committee		9	Six monthly review. Annual report to March'18 committee meeting.	

20	**Governance**	Potential risks and conflicts of interest between ACC and NESPF	Audit criticism, legal challenge, reputational risk	Regular discussions between Chief Officer - Finance and Pensions Managers, areas of risk and conflict reported to Pensions Committee. Register in place to record & monitor conflicts.		8	Ongoing	
21	**Governance**	Data Protection - Failure to secure and manage personal data	Audit criticism, legal challenge, reputational risk	Internal control and procedures for management of data. Project Group set up to look at implications of GDPR and assess current processes.		8	Ongoing - policies and processes to be implemented by May 2018	
22	**Governance**	Failure to comply with FOI requests	Audit criticism, legal challenge, reputational risk	Pensions Manager responsible for all FOI requests and meeting deadline for information requests		4	Ongoing- Governance Team oversee FOI	
23	**Governance**	Failure to monitor employer covenants	Residual liabilities could fall to other scheme employers	On-going discussions with scheme employer of funding issues		12	Ongoing	

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Pensions Committee & Board Meeting Dates 2018-2019

Members, please note that Aberdeen City Council has now approved its diary of meetings from April 2018 to April 2019.

The dates are:-

10.30am, Friday 22 June 2018

10.30am, Friday 14 September 2018

10.30am, Friday 30 November 2018

10.30am, Friday 15 March 2019

Electronic appointments will be sent.

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