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To: **Pensions Committee**:- Councillor M. Tauqeer Malik, Convener; Councillor Reynolds, Vice Convener; Councillor Barney Crockett, the Lord Provost; and Councillors Bell, Cooke, Delaney, Henrickson, MacGregor and Wheeler.

Pension Board:- Councillor McKelvie, Chair; Mr N Stirling, Vice Chair; Councillors Allan and Cowe; and Mr I Hodgson, Mr L Knox, Mrs M Lawrence and Mr A Walker.

Town House,
ABERDEEN, 3 December 2020

PENSIONS COMMITTEE AND PENSION BOARD

The Members of the **PENSIONS COMMITTEE AND PENSION BOARD** are requested to meet in the **Council Chamber - Town House** on **FRIDAY, 11 DECEMBER 2020 at 10.30 am.**

FRASER BELL
CHIEF OFFICER - GOVERNANCE

B U S I N E S S

NOTIFICATION OF URGENT BUSINESS

1.1 There are no items of urgent business at this time

DETERMINATION OF EXEMPT BUSINESS

2.1 Members are requested to determine that any exempt business be considered with the press and public excluded

DECLARATIONS OF INTEREST

3.1 Members are requested to intimate any declarations of interest (Pages 3 - 4)

MINUTES OF PREVIOUS MEETINGS

4.1 Minute of Previous Meeting of 29 September 2020 (Pages 5 - 14)

COMMITTEE BUSINESS PLANNER

5.1 Business Planner (Pages 15 - 16)

NOTICES OF MOTION

6.1 There are currently no motions to the Pensions Committee

FINANCE & RISK MANAGEMENT

7.1 Budget/Forecast & Projected Spend 2020/21 - PC/DEC20/BUD (Pages 17 - 24)

7.2 Triennial Valuation and Funding Strategy Statement - PC/DEC20/VAL (Pages 25 - 92)

7.3 Strategic Infrastructure Partnership with Aberdeen City Council - PC/DEC/INFRA (Pages 93 - 96)

SCRUTINY

8.1 Strategy - PC/DEC20/STRAT (Pages 97 - 130)

EXEMPT BUSINESS - NOT FOR PUBLICATION

9.1 Asset and Investment Manager Performance Report - PC/DEC/AIMPR (Pages 131 - 160)

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

DECLARATIONS OF INTEREST

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.

PENSIONS COMMITTEE AND PENSION BOARD

ABERDEEN, 29 September 2020. Minute of Meeting of the PENSIONS COMMITTEE AND PENSION BOARD. Present:- Councillor Malik, Convener; Councillor Reynolds, Vice-Convener; Councillor Barney Crockett, the Lord Provost; and Councillors Bell, Cooke, Delaney, Henrickson, MacGregor and Wheeler (Pensions Committee); and Councillor McKelvie, Chairperson; Mr N Stirling, Vice Chairperson; Councillors Allan and Cowe; Mr L Knox, Mrs M Lawrence and Mr A Walker (Pension Board).

Also in attendance:- Laura Colliss, Pensions Manager; Graham Buntain, Investment Manager; Colin Harvey, Senior Auditor, Internal Audit; and Gillian Woolman, Assistant Director, Audit Scotland.

The agenda and reports associated with this minute can be found here.

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.

BOARD MEMBERSHIP

1. The Convener advised that Mr Ian Black, Pension Board member, had unfortunately had to step down from the Board due to work commitments, however Mr Ian Hodgson, FirstGroup, would be replacing him. Mr Hodgson had hoped to participate in the meeting, but due to a pre-existing appointment had not been able to join. The Convener added that he looked forward to working with Mr Hodgson at future meetings.

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 11.1 (Procurement of Investment Management Consultancy Services) and 11.2 (Asset and Investment Manager Performance Report).

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 the above-mentioned item so as to avoid disclosure of exempt information of the class described in paragraph 8 (Item 11.1) and 6 (Item 11.2).

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

PENSIONS COMMITTEE AND PENSION BOARD
29 September 2020

DECLARATIONS OF INTEREST

3. There were no declarations of interest.

MINUTE OF PREVIOUS MEETING OF 20 MARCH 2020

4. The Committee had before it the minute of its previous meeting of 20 March 2020.

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

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

BUSINESS PLANNER

5. The Committee had before it the committee business planner as prepared by the Chief Officer – Governance.

The Committee resolved:-
(i) to note the update from the Chief Officer – Finance in respect of item 5 (Strategic Infrastructure Priorities and the Scottish Local Government Pension Scheme) that discussions were underway with colleagues from City Growth in respect of the matter but had been delayed due to prioritisation of other work as a result of COVID-19, and that it was hoped to present a report to the December meeting; and
(ii) to otherwise note the planner.

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

INTERNAL AUDIT ANNUAL REPORT 2019/20 - IA/20/010

6. The Committee had before it a report by Internal Audit which provided the Committee with the Internal Audit Annual Report for the North East Scotland Pension Fund for 2019/20.

The report recommended:-
that Committee note –
(a) the Annual Report for 2019/20;

(b) that the Chief Internal Auditor had confirmed the organisational independence of Internal Audit;
(c) that there had been no limitation to the scope of Internal Audit work during 2019/20; and
(d) the progress that management had made with implementing recommendations agreed in Internal Audit reports.

The Committee resolved:-
to approve the recommendations.

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

PENSIONS INVESTMENT STRATEGY & PERFORMANCE - IA/AC2015

7. The Committee had before it a report by Internal Audit which presented the planned Internal Audit report on Pensions Investment Strategy & Investment Performance Management. The report advised that the objective of the audit was to provide assurance over compliance with the pension fund investment strategy and arrangements in place to monitor the performance of investment managers. This had involved review of procedures and documented practice in respect of management by the Service of a sample of investments.

The audit had made a number of recommendations all of which had been agreed with the Service with the exception of a recommendation that the Service should set out performance monitoring procedures. The Service considered that resource constraints were such that assurance on performance monitoring came from the task being assigned to the Investment Manager and team and that being a requirement of the job profiles. Reporting requirements were informed by the discussions and information provided by Fund Managers and an understanding that each Fund Manager mandate was different such that it might require a different set of performance data.

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.

PENSIONS COMMITTEE AND PENSION BOARD
29 September 2020

EXTERNAL AUDIT ANNUAL REPORT 2019/20

8. The Committee had before it a report by the External Auditor on the 2019/20 Annual Audit of the North East Scotland Pension Fund. The report noted that auditors were required to report on specific matters arising from the audit of the financial statements to those charged with governance of a body, prior to the financial statements being approved and certified.

The key messages from the audit were that in the opinion of External Audit, the North East Scotland Pension Fund's financial statements gave a true and fair view and were properly prepared. The management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and had been properly prepared. The report noted that the North East Scotland Pension Fund had valued its Level 2 property assets on an appropriate basis using information provided by professional valuers, and drew attention to the impact of COVID-19 on the level of uncertainty over property valuations. The audit opinion had not been modified in respect of that matter.

The annual performance of the Fund was significantly impacted by Covid-19 19. At 31 December 2019 the value of the main fund's net assets exceeded £4.8 billion but by the end of March the value fell to £4.383 billion, as a result of COVID-19. However the report noted that the Fund had appropriate and effective arrangements in place for financial management and systems of internal control had operated appropriately and effectively in 2019/20. Standards of conduct and arrangements for prevention and detection of fraud and error were appropriate.

There had been negative cash flows from member activity in 2019/20 and the ratio of active fund members to pensioners had fallen. While this trend was expected to continue, the Fund had appropriate and effective financial planning arrangements in place. The report further noted that the Fund's three year funding and investment strategy would be reviewed following the next full triennial valuation, due to be completed by 31 March 2021, and this would determine the level of employer and employee contribution rates from 2021/22 onwards.

It was considered that the Fund had effective governance arrangements that supported scrutiny of decisions made by the Pensions Committee. Governance arrangements had changed in March 2020 as a result of the COVID-19 pandemic. Committees were suspended and virtual meetings of the Urgent Business Committee had been held instead to consider items of an urgent nature. External Audit had concluded that these changes were appropriate and properly disclosed in the Annual Governance Statement.

The impact of COVID-19 on global markets reduced annual returns significantly but investment performance continued to outperform medium and longer term benchmarks. The Fund had adequate arrangements for monitoring investment performance and scrutinising investment management. The Fund's investment performance was also subject to regular review and scrutiny by the Pensions Committee.

The Committee heard in detail from Ms Woolman in respect of the report.

The Committee resolved:-
(i) to thank Ms Woolman and her team for both the clear and informative presentation and report and the work undertaken to ensure the annual report was presented to Committee as expected; and
(ii) to note the audit report.

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

CONSIDERATION AND SIGNING OF AUDITED ANNUAL REPORT AND ACCOUNTS - PC/SEPT20/ARA

9. With reference to article 6 of the minute of the meeting of the Urgent Business Committee of 30 June 2020, the Committee had before it a report by the Chief Officer – Finance which attached the Audited Annual Report and Accounts for the North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF) for consideration and signing.

The report recommended:-
that Committee –
(a) consider and approve the Audited Annual Report and Accounts for the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund; and
(b) instruct the Chief Officer – Finance, as the Local Government (Scotland) Act 1973 – Section 95 Officer, to sign the accounts on behalf of the Funds.

The Committee resolved:-
(i) to thank the Chief Officer – Finance and his team, and the External Auditors for the work undertaken to ensure that the Audited Annual Report and Accounts were presented to Committee as expected, given the ongoing pressures as a result of COVID-19; and
(ii) to approve the recommendations.

PENSIONS COMMITTEE ANNUAL EFFECTIVENESS REPORT - COM/20/117

10. The Committee had before it a report by the Chief Officer – Governance which presented the annual effectiveness report of the Pensions Committee to enable Members to provide comment on the data contained within. It was noted that the data contained in the annual report related solely to the Pensions Committee, as the Pension Board received its own annual report.

The report recommended:-
that Committee –
(a) provide comments and observations on the data contained within the annual report; and
(b) note the annual effectiveness report of the Pensions Committee.

The Committee resolved:-
to note the report.

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

BUDGET/FORECAST 2020/21 - PC/SEPT20/BUD

11. The Committee had before it a report by the Chief Officer – Finance which provided details of the Management Expenses Budget/Forecast 2020/21 for the North East Scotland Pension Fund (NESPF).

The report recommended:-
that the Committee approve the NESPF Management Expenses Budget/Forecast 2020/21, shown in Appendix I.

The Committee resolved:-
to approve the recommendation.

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

STRATEGY - PC/SEPT20/STRAT

12. The Committee had before it a report by the Director of Resources which provided an update on any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies.

The report provided an update on the Scottish Public Pensions Agency (SPPA) Consultation which sought views on changes to the Local Government Pension Scheme (LGPS) in Scotland in respect of the LGPS statutory underpin protection to remove unlawful discrimination found by the Courts in relation to public service pension scheme 'transitional protection' arrangements; the request from Visit Scotland to consolidate its liabilities with the application for a SPPA direction to transfer assets and liabilities to Lothian Pension Fund; the position in relation to Pension Fund Annual Benefit Statements; information on 27 new breaches of law recorded in the NESPF Breaches Register during 19/20, the majority of which had been scheme employers failing to meet their statutory obligations e.g. late payment of pension contributions; the latest position in respect of staff training; that the Pension Board had approved its annual report and agreed that Councillor McKelvie would act as Chair for the year with Mr Neil Stirling as Vice Chair; the latest information on Pensions Committee and Board training; the employer relationship year end process; the data quality improvement plan; and information on the triennial valuation due in March 2021.

The report also noted that the following policy documents had been updated:-

- Statement of Investment Principles
- Breaches of Law Policy
- Conflicts of Interest Policy
- Communications Policy
- Corporate Governance & SRI Policy
- Data Protection Policy
- Employer Engagement Policy
- Nomination and Appointment Process
- Record Keeping Policy

The report recommended:-
that Committee note the work undertaken to review and update the scheme policy documents to ensure continuing compliance with LGPS regulations (as per item 3.9.7 in the report)

The Committee resolved:-
to note the report.

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

TRAINING - PC/SEPT20/TRA

13. The Committee had before it a report by the Chief Officer – Finance which provided details of the training plan (2020/21) for the Pensions Committee and Pension Board of the North East Scotland Pension Fund.

The report recommended:-
that Committee –

(a) agree the proposed training schedule (as set out in items 3.3-8 in the report), subject to latest Scottish Government travel advice and
- approve the travel of members to the training session in London;
- approve the travel of members to attend external training opportunities; and
- approve the travel of members to attend LAPFF meetings;

(b) note the updated Training Policy for Pensions Committee and Board members (as set out in Appendix I to the report); and
(c) note the requirement to have completed the Pensions Regulator online training in line with the Training Policy (as set out in item 3.9 in the report).

The Convener, seconded by the Vice Convener, moved:-

That Committee agree the recommendations contained in the report.

Councillor Cooke, seconded by Councillor Delaney, moved as an amendment:-

That Committee:-
(i) agree the proposed training schedule (as set out in items 3.3-8), subject to latest Scottish Government travel advice, and instruct the Pensions Manager to make preliminary arrangements for participation in training opportunities; and
(ii) approve recommendations (b) and (c) as set out in the report.

On a division, there voted:- <u>for the motion</u> (5) – the Convener; the Vice Convener; and Councillors Bell, Crockett and Wheeler; <u>for the amendment</u> (4) – Councillors Cooke, Delaney, Henrickson and MacGregor.

<u>The Committee resolved</u>:-
to approve the recommendations.

<u>The Board resolved</u>:-
to note the decision of the Committee.

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

PROCUREMENT OF INVESTMENT MANAGEMENT CONSULTANCY SERVICES - PC/SEPT20/CONS

14. The Committee had before it a report by the Chief Officer – Finance which sought approval to use the National LGPS Framework to let investment management consultancy services for the North East Scotland Pension Fund.

The report recommended:-
that Committee –
(a) approve the award of a call-off contract under the National LGPS Framework agreement set up by Norfolk County Council to appoint investment consultants to provide investment management consultancy services to the Fund from 1 April 2021 for a term of 5 years, with the option to extend for a further 2 years; and
(b) approve the potential expenditure for the above as set out in items 4.1 and 4.2 of the report.

The Committee resolved:-
to approve the recommendations.

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

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

15. The Committee had before it a report by the Chief Officer - Finance which provided an overview of the investment activity of both the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund for the three month period ending 30 June 2020.

Appended to the report was information in respect of the NESPF and environmental, social and governance matters and responsible investment.

The Committee and Board heard from Mr Buntain, Investment Manager, in respect of the detail contained within the report. Mr Buntain also provided a verbal update on recent performance following the impact of COVID-19.

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

The Committee resolved:
to note the report.

The Board resolved:-
to note the decision of the Committee.
- **COUNCILLOR M. TAUQEER MALIK, Convener**

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	A	B	C	D	E	F	G	H	I
1	**PENSIONS COMMITTEE BUSINESS PLANNER** The Business Planner details the reports which have been instructed by the Committee as well as reports which the Functions expect to be submitting for the calendar year.								
2	**Report Title**	**Minute Reference/Committee Decision or Purpose of Report**	**Update**	**Report Author**	**Chief Officer**	**Directorate**	**Terms of Reference**	**Delayed or Recommended for removal or transfer, enter either D, R, or T**	**Explanation if delayed, removed or transferred**
3	**11 December 2020**								
4	Strategy	Regular update on any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies		Mairi Suttie	Finance	Resources	1.4		
5	Strategic Infrastructure Priorities and the Scottish Local Government Pensions Scheme	Pensions Committee 15/03/19 - To instruct the Chief Officer Finance to explore the opportunities for a strategic partnership between the Council, other stakeholders and the North East Scotland Pension Fund for the purposes of supporting local infrastructure investment and to report on the feasibility of this within three committee cycles		Jonathan Belford	Finance	Resources	5.1		
6	Valuation Assumptions and Funding Strategy Statement	To provide an update on the valuation assumptions and funding strategy		Claire Mullen	Finance	Resources	1.4		
7	Asset and Investment Manager Performance Report	To provide a review of the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund for the latest three month period		Graham Buntain	Finance	Resources	5.2		
8	Budget Forecast & Projected Spend	Update on budget and annual spend to date		Michael Scroggie	Finance	Resources	1.3		
9	**26 March 2021**								
10	Strategy	Regular update on any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies		Mairi Suttie	Finance	Resources	1.4		
11	Investment Strategy Update	To provide an update on the investment strategy of the NESPF if required		Graham Buntain / Laura Colliss	Finance	Resources	5.2		
12	Asset and Investment Manager Performance Report	To provide a review of the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund for the latest three month period		Graham Buntain	Finance	Resources	5.2		
13	Budget Forecast & Projected Spend	Update on budget and annual spend to date		Michael Scroggie	Finance	Resources	1.3		
14	**25 June 2021**								
15	Strategy	Regular update on any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies		Mairi Suttie	Finance	Resources	1.4		
16	Investment Strategy Update	To provide an update on the investment strategy of the NESPF if required		Graham Buntain / Laura Colliss	Finance	Resources	5.2		
17	Asset and Investment Manager Performance Report	To provide a review of the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund for the latest three month period		Graham Buntain	Finance	Resources	5.2		
18	Budget Forecast & Projected Spend	Update on budget and annual spend to date		Michael Scroggie	Finance	Resources	1.3		

	A	B	C	D	E	F	G	H	I
2	**Report Title**	**Minute Reference/Committee Decision or Purpose of Report**	**Update**	**Report Author**	**Chief Officer**	**Directorate**	**Terms of Reference**	**Delayed or Recommended for removal or transfer, enter either D, R, or T**	**Explanation if delayed, removed or transferred**
19	External Audit Annual Audit Plan	To present the annual audit plan		Rachel Browne	External Audit	External Audit	2.1		
20	Annual Effectiveness Report - Pensions Committee	To present the annual effectiveness report		Stephanie Dunsmuir	Governance	Commissioning	GD 8.5		
21	Internal Audit Annual Report 2020/21	To present the Internal Audit Annual Report for 2020/21		Colin Harvey	Internal Audit	Internal Audit	2.1		
22	Draft NESPF Annual Report & Accounts	To present the draft annual accounts		Laura Colliss	Finance	Resources	3.1		
23	**17 September 2021**								
24	Strategy	Regular update on any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies		Mairi Suttie	Finance	Resources	1.4		
25	Investment Strategy Update	To provide an update on the investment strategy of the NESPF		Graham Buntain / Laura Colliss	Finance	Resources	5.2		
26	Asset and Investment Manager Performance Report	To provide a review of the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund for the latest three month period		Graham Buntain	Finance	Resources	5.2		
27	Budget Forecast & Projected Spend	Update on budget and annual spend to date		Michael Scroggie	Finance	Resources	1.3		
28	NESPF Annual Report & Accounts	To present the audited annual accounts and report on the NESPF		Laura Colliss	Finance	Resources	3.1		
29	External Audit Annual Audit Report 2020/21	To present the External Audit Annual Audit Report 2020/21		Rachel Browne	External Audit	External Audit	2.1		
30	**10 December 2021**								
31	Strategy	Regular update on any changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund strategies		Mairi Suttie	Finance	Resources	1.4		
32	Investment Strategy Update	To provide an update on the investment strategy of the NESPF if required		Graham Buntain / Laura Colliss	Finance	Resources	5.2		
33	Asset and Investment Manager Performance Report	To provide a review of the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund for the latest three month period		Graham Buntain	Finance	Resources	5.2		
34	Budget Forecast & Projected Spend	Update on budget and annual spend to date		Michael Scroggie	Finance	Resources	1.3		

ABERDEEN CITY COUNCIL

COMMITTEE	Pensions Committee
DATE	11 December 2020
EXEMPT	No
CONFIDENTIAL	No
REPORT TITLE	Budget/Forecast & Projected Spend 2020/21
REPORT NUMBER	PC/DEC20/BUD
DIRECTOR	Steven Whyte
CHIEF OFFICER	Jonathan Belford
REPORT AUTHOR	Michael Scroggie
TERMS OF REFERENCE	1.3

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 2020/21 for the North East Scotland Pension Fund (NESPF).

2. RECOMMENDATION

2.1 That the Committee note the update on the NESPF Management Expenses Budget/Forecast and Projected Spend 2020/21, shown in Appendix I.

3. BACKGROUND/MAIN ISSUES

3.1 BUDGET/FORECAST AND PROJECTED SPEND 2020/21

3.1.1 Appendix I shows the NESPF Budget 2020/21. The budget includes a re-alignment of cost headings that follows guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) for Pension Funds. Additional NESPF budget is added for costs outwith the Council's Budget and for those costs directly paid for by the Fund.

3.1.2 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.

3.1.3 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.

3.1.4 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 few 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'.

3.2 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 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 recommendation in this report.

6. MANAGEMENT OF RISK

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

7. OUTCOMES

7.1 This report does not impact the Council Delivery Plan.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Impact Assessment	Not required
Data Protection Impact Assessment	Not required

9. BACKGROUND PAPERS

North East Scotland Pension Fund (NESPF) Annual Report & Accounts (2019/20) and Fund Governance Policy Statement

10. APPENDICES

Appendix I, Budget/Forecast and Projected Spend 2020/21

11. REPORT AUTHOR CONTACT DETAILS

Name	Michael Scroggie
Title	Accounting Manager
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Appendix I – 2020/21 BUDGET/FORECAST AND PROJECTED SPEND

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

	Notes	Full Year Budget 2020/21	Budget to 30/09/20	Actual Spend to 30/09/20	Accrual to 30/09/20	Amended Spend to 30/09/20	Over or (Under) to 30/09/20	Proj Annual Spend 2020/21	Proj Over or (Under) Spend 2020/21
		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Administrative Staff Costs	1	1,567	784	295	329	624	(160)	1,248	(319)
Information Technology		455	227	275	42	317	90	442	(13)
Supplies & Services		129	65	29	38	67	2	126	(3)
Accommodation		251	125	0	89	89	(36)	250	(1)
Printing & Publications		20	10	7	0	7	(3)	20	0
Administration Expenses Total		**2,422**	**1,211**	**606**	**498**	**1,104**	**(107)**	**2,086**	**(336)**

Note (Spend Variance ± 5%):

1. Under spend – Vacancies pending recruitment process

Appendix I – 2020/21 BUDGET/FORECAST AND PROJECTED SPEND (continued)

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

	Notes	Full Year Budget 2020/21	Budget to 30/09/20	Actual Spend to 30/09/20	Accrual to 30/09/20	Amended Spend to 30/09/20	Over or (Under) to 30/09/20	Proj Annual Spend 2020/21	Proj Over or (Under) Spend 2020/21
		£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Investment Staff Costs	1	301	151	53	61	114	(37)	227	(74)
Pension Fund Committee		15	7	0	1	1	(6)	15	0
Pension Board		10	5	0	1	1	(4)	10	0
External Audit Fee		41	21	0	20	20	(1)	40	(1)
Internal Audit Fee		6	3	0	3	3	0	6	0
Actuarial Fees	2	182	91	111	0	111	20	198	16
General Expenses		130	65	38	12	50	(15)	133	3
Oversight & Governance Expenses Total		**685**	**343**	**202**	**98**	**300**	**(43)**	**629**	**(56)**

Note (Spend Variance ± 5%):

1. Under spend – see previous note.
2. Under spend – Actuarial activity slowing down re Project Dallas freeing up resources to re-focus on main fund.

Appendix I – 2020/21 BUDGET/FORECAST AND PROJECTED SPEND (continued)

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

	Notes	Full Year Forecast 2020/21	Forecast to 30/09/20	Actual Spend to 30/09/20	Accrual to 30/09/20	Amended Spend to 30/09/20	Over or (Under) to 30/09/20	Proj Annual Spend 2020/21	Proj Over or (Under) Spend 2020/21
		£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Investment Management	1	10.782	5,391	1,592	4,643	6,235	844	11,887	1,105
Performance Fees		6,335	3,168	0	3,168	3,168	0	6,335	0
Direct Property Expenses	2	774	387	286	0	286	(101)	572	(202)
Transaction Costs	3	475	238	224	309	533	295	1,065	590
Custody Fees		125	62	49	11	60	(2)	129	4
Investment Management Expenses Total		**18,491**	**9,246**	**2,151**	**8,131**	**10,282**	**1,036**	**19,988**	**1,497**

Note (Spend ± 5%):

1. Investment Management costs as at the reporting date are projected for the remaining part of the year. However, costs associated with private equity are not calculated until the year end. Therefore, uncertainty in projecting these costs carries the risk of over/under stating the spend for the year. It is anticipated that there will be an over spend.
2. The Forecast for 2020/21 is based upon the Fund Manager's estimation for the year. Costs as at reporting date are 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 then it is anticipated that there will be an under spend.

3.Transaction Costs are reported by the Custodian (HSBC) 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 then it is anticipated that there will be an over spend.

3(a). Transaction Costs are reported by the Custodian (HSBC).

Analysis of Transaction Costs for the period 1 April 2020 to 30 September 2020:

	Commission (£)	Expenses (£)	Tax (£)	Total (£)
Equities	137,663.82	888.94	355,226.86	493,779.62
Pooled – Unit Trust	0.00	39,058.18	0.00	39,058.18
Grand Total (£)	**137,663.82**	**39,947.12**	**355,226.86**	**532,837.80**

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	11 December 2020
EXEMPT	No
CONFIDENTIAL	No
REPORT TITLE	Tri-ennial Valuation and Funding Strategy Statement
REPORT NUMBER	PC/DEC20/VAL
DIRECTOR	Steven Whyte
CHIEF OFFICER	Jonathan Belford
REPORT AUTHOR	Claire Mullen
TERMS OF REFERENCE	1.1 and 4.1

1. PURPOSE OF REPORT

1.1 To provide details of the 2020 triennial valuation for the North East Scotland Pension Fund including the proposed assumptions outlined in the Draft Funding Strategy Statement.

2. RECOMMENDATIONS

That the Committee:-

2.1 agree the Funding Approach outlined in the 2020 Funding Strategy Statement including the assumptions used in the calculation of the Fund liabilities for the triennial valuation as at 31 March 2020; and

2.2 note the overall whole Fund valuation as at 31 March 2020 (using the proposed assumptions).

3. BACKGROUND

3.1 There is a requirement under the Local Government Pension Scheme (Scotland) Regulations 2018 that the Fund instructs a Scheme actuary to carry out a valuation of the liabilities every three years based on the data held on the administrative system at the date of valuation. Mercer, the appointed Scheme Actuary for the North East Scotland Pension Fund, have therefore provided indicative results on a whole Fund basis as at 30 March 2020.

Funding Strategy Statement (FSS)

3.2 The Draft FSS outlines the approach used by the Scheme actuary to calculate the liabilities held. The assumptions used in these calculations are introduced in page 5 of the draft document, with further detail provided under pages 1 – 7 of appendix A – Actuarial Method and Assumptions.

3.3 Both the financial and demographic assumptions determine the outcome of the valuation and are subject to the discretion and approval of the Fund and the guidance and agreement of the Scheme actuary.

3.4 The results are particularly sensitive to the assumptions on the discount rate. The discount rate reflects the assumed level of investment return on the assets held by the Fund. This assumption has been determined using real returns since the 2017 valuation which better reflects the actual experience of the Fund rather than using the previous method of measuring against the value of guilt yields.

3.5 For the purpose of the 2020 valuation the proposed discount rate is Consumer Price Index (CPI) plus 1.25% for determining past service liabilities and CPI plus 1.5% for future liabilities. This is a reduction in the discount rate from the 2017 valuation which was CPI plus 1.75% for both.

3.6 Other notable assumptions are made around inflation, future salary increases for members, mortality rates and expected member movements.

Employer Consultation

3.7 The regulations require the Fund to consult with all participating employers around the draft FSS. The consultation has now been issued to all employers along with their proposed employer contribution rate requirements for the three year inter-valuation period. The consultation period will run from 4 November 2020 with all responses to be received by the Employer Relationship Team by 4 December 2020.

3.8 Employers have been asked to comment on the actuarial approach, the suggested assumptions and provide any comments that they may have on the policies imbedded within the draft document.

3.9 Consultation responses will be discussed with the scheme actuary to determine any adjustments or action to be taken.

Preliminary Whole Fund Results

3.10 Based on the assumptions laid out in the FSS, the NESPF has a funding level of 103% as at 31 March 2020. This has been determined using a value placed on the liabilities held of £4.256m and a calculated surplus of around £127m when compared against the assets held as at the valuation date.

3.11 Individual employer results can differ significantly from the whole Fund as these are based on their own membership profile, the experience of their membership since the previous valuation and the asset returns based on actual cashflows.

3.12 Employers have received their suggested contribution rate requirements and discussions are ongoing around any requested adjustments that can be made on affordability, risk and future budgets and plans. Any adjustments to rates will be carried out in conjunction with the scheme actuary and any decisions taken by the Fund will based on evidence provided by the participating employer.

Completion of the Valuation

3.13 Following finalisation of the assumptions and discussions with all participating employers around their contribution rates requirements the valuation can be completed and signed off by the scheme actuary in time to meet the deadline of 31 March 2021.

3.14 Following completion of the process the signed valuation report and contribution certificate will be provided by Mercer and made available to all employers as well as the Pensions Committee and Board. A copy will also be provided to the Scottish Government as per their requirements.

4. FINANCIAL IMPLICATIONS

4.1 Meeting the liabilities of the Fund is the responsibility of the participating employers. As part of the valuation process the employer contribution requirements for all individual employers for the years 2021/22 to 2023/24 are determined using the approved assumptions.

4.2 Determining the assumptions with the appropriate level of certainty/prudency will impact on the contribution requirements for each employer based on their own liabilities and funding levels.

5. LEGAL IMPLICATIONS

5.1 The Fund is required under the Local Government Pension Scheme (Scotland) Regulations 2018 to consult with all participating employers and the Pensions Committee around the funding approach for the triennial valuation. The valuation is to be completed and signed off by the scheme actuary by 31 March 2021.

6. MANAGEMENT OF RISK

Category	Risk	Low (L) Medium (M) High (H)	Mitigation
Compliance	Failure to meet the requirements of the LGPS (Scotland) Regulations.	H	Robust procedure in place between the Fund and the scheme actuary to ensure that the target date of March 2021 is achieved.
Operational	Incomplete valuation will mean that employers will not be able to apply the correct contribution rates from April 2020	L	Communication plan in place by the Employer Relationship Team to ensure that employers are contacted and contributions are determined prior to cut off date

Financial	Failure to complete valuation could lead to employers under or overpaying contributions from April 2021.	L	Contributions are to be determined by 31 January 2021 allowing ample time to implement any changes for April payroll rollout.

7. OUTCOMES

The proposals in this report have no impact on the Council Delivery Plan.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Impact Assessment	Not required
Data Protection Impact Assessment	Not required

9. BACKGROUND PAPERS

None

10. APPENDICES

Appendix I, NESPF Funding Strategy Statement 2020

11. REPORT AUTHOR CONTACT DETAILS

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DRAFT

North East Scotland Pension Fund

Funding Strategy Statement

November 2020

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)

welcome to brighter

Contents

Appendices

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.

MEETING THE FUND’S SOLVENCY 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. Contributions are set in relation to this objective which means that once 100% solvency is achieved, if assumptions are borne out in practice, there would be sufficient assets to pay all benefits earned up to the valuation date as they fall due.

However, because financial and market conditions/outlook change between valuations, the assumptions used at one valuation may need to be amended at the next to meet the primary objectives. This in turn means that contributions will be subject to change from one valuation to another. This objective is considered on an employer specific level when setting individual contribution rates so each employer has the same fundamental objective in relation to their liabilities.

The general principle adopted by the Fund is that the assumptions used, taken as a whole, will be chosen sufficiently prudently for this objective to be reasonably achieved in the long term at each valuation.

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 to meet the objective for all employers over different periods. The funding strategy includes appropriate margins to allow for the possibility of adverse events (e.g. material reduction in investment returns, economic downturn and higher inflation outlook) leading to a worsening of the funding position which would normally lead to volatility of contribution rates at future valuations if these margins were not included. This prudence is required by the Regulations and guidance issued by professional bodies and Government agencies to assist the Fund in meeting its primary solvency objective. Individual employer results will also have regard to their covenant strength and the investment strategy applied to the asset shares of those employers.

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 requires that any funding plan must provide equity between different generations of taxpayers. This means that the contributions must not be set at a level that is likely to give rise to additional costs in the future which fall on later generations of taxpayers or put too high a burden on current taxpayers. The funding parameters and assumptions e.g. deficit recovery period must have regard to this requirement which means a level of prudence is needed. Furthermore, 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.

SURPLUS/DEFICIT SPREAD PERIOD AND CONTRIBUTIONS

As the solvency level of the Fund is [103]% 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 and based on the Administering Authority's view of the employer's covenant and risk to the Fund. For employers in deficit, 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 or to select any shorter deficit recovery period 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.

Where a deficit exists, the maximum period that it should be recovered over is [19] years, which in the long term provides equity between different generations of taxpayers whilst ensuring the deficit payments are eliminating a sufficient proportion of the capital element of the deficit, thereby reducing the interest cost. This will be periodically reviewed depending on the maturity profile of the Scheme. Similar principles apply to employers in surplus. However, where an employer is expected to exit the Fund, then in normal circumstances, any surplus/deficit would be spread over the remaining period to exit. 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 Section 5.

Where there is a material increase in contributions required at this valuation the employer will be able to 'phase in' their contributions over a period of 3 years in a pattern agreed with the Administering Authority and depending on the affordability of contributions as assessed considering the covenant of an employer, with effect from 1 April 2021.

The government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. A consultation was issued in July 2020, which confirms that the remedy will have the effect of removing the current age criteria applied to the underpin implemented in 2015 for the LGPS, which would then apply to all members who were active as at 1 April 2012. The relevant estimated costs of the remedy have been quantified and notified to employers on this basis. The final funding position and certified contributions for each employer include the estimated costs of the McCloud remedy.

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 from 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 is 1.25% per annum and 1.50% per annum for determining the future service ("Primary") contribution rates. This compares to 1.75% per annum (past and future) at the last valuation.

The assumption for the long term expected future real returns has fallen since the last valuation. This is principally due to a combination of expectations: the returns on the Fund's assets and the level of inflation in the long term. This is also taken into account by the Actuary when proposing the assumptions and at this valuation means that the level of prudence has been reduced. The assumption has therefore been adjusted so that in the Actuary's opinion, when allowing for the resultant employer contributions emerging from the valuation, the Fund can reasonably be expected to meet the Solvency and Long Term Cost Efficiency objectives.

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.

Within the next valuation cycle, the Fund will consider the merits of implementing a choice of investment strategies to offer to employers, which would exhibit lower investment risk than the current whole fund strategy. This may be appropriate for employers who are deemed to have a weaker covenant than others in the Fund or those who wish to target a lower risk strategy (e.g. if planning for termination).

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. In addition, the asset shares maybe restated for changes in data or other policies.

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 C 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 B. 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.

The key objective for the Fund is to only admit employers where the risk to the Fund is mitigated as far as possible. 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 a minimum risk basis 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. Any exit credits (surplus assets over liabilities) will be paid from the Fund to the exiting employer following certification by the Actuary. The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it.

Where there is a **guarantor** who would subsume the assets and liabilities of the outgoing employer the policy is that any deficit or surplus would normally be subsumed into the guarantor and taken into account at the following valuation. This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor.

In some instances an exit debt may be payable by an outgoing employer before the assets and liabilities are subsumed by the guarantor. In the case of a service which has been outsourced, this will be determined by the commercial contract and arrangements which exist between the guarantor and the outgoing employer. Where the outgoing employer is not responsible for an exit debt, no exit credit would be payable to the outgoing employer if a surplus of assets over liabilities exists on termination of an admission agreement.

1 Introduction

The Local Government Pension Scheme (Scotland) Regulations 2018 (as amended) ("the 2018 Regulations"), 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, including ancillary death in service and ill health benefits together with administration costs. It is expressed as a percentage of pensionable pay, 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 reflect any past service deficit or surplus, 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.

The Secondary rate is specified in the rates and adjustments certificate.

For any employer, the rate they are actually required to pay is the sum of the Primary and Secondary rates.

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, exit credits, costs, charges and expenses as defined in the Regulations.

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 with 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
- have regard to the Pensions Regulator’s focus on data quality and comply with any requirement set by the Administering Authority in this context
- notify the Administering Authority promptly of any changes to membership which may affect future funding.
- understand the pensions impacts of any changes to their organisational structure and service delivery model, and
- understand that the quality of the data provided to the Fund will directly impact on the assessment of the liabilities and contributions. In particular, any deficiencies in the data would normally result in the employer paying higher contributions than otherwise would be the case if the data was of high quality.

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 including in relation to exit credit payments
- 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 principles underlying the Employer Recovery Plans are set out below. 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 2021 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.

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 and ancillary death in service and ill health benefits
- the **Secondary rate**: a percentage of pensionable payroll over 2021/24 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 2024 based on the results of the 2023 actuarial valuation.

Spreading of Surplus / recovery of Deficit contributions

It is the Fund's objective that, where a deficit exists, it 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.

In the case of a deficit, recovery periods 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 any shorter deficit recovery period and higher contributions if they wish, including the option of prepaying the deficit contributions in one lump sum either on an annual basis or a one-off payment. This will be reflected in the monetary amount requested via a reduction in overall deficit contributions payable. The Administering Authority does retain ultimate discretion in applying these principles for individual employers on grounds of affordability and covenant strength.

The key principles when considering surplus/deficit spreading are as follows:

- 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. This is to maintain (as far as possible) equity between different generations of taxpayers and to protect the Fund against the potential for an unrecoverable deficit. The deficit recovery period will be set to at least cover the expected interest costs (actual interest costs will vary in line with investment performance) on the deficit. Where an employer is expected to exit the Fund then in normal circumstances, any deficit would be recovered over the remaining period to exit. Where an employer is closed to new entrants then, as a general rule, the spread period should be no more than the average expected future working lifetime of the active membership.

- 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. The average recovery period adopted by all employers will be set out within the Actuary's report. Employers will be notified of their individual deficit recovery period as part of the provision of their individual valuation results.

- 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. Where an employer is expected to exit the Fund then in normal circumstances, the surplus would be spread over the remaining period to exit.

- 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.

- Where increases (or decreases) in employer contributions are required from 1 April 2021, following completion of the 2020 actuarial valuation, the increase (or decrease) from the rates of contribution payable in the year 2021/22 may be implemented in steps, over a maximum period of 3 years, depending on affordability of contributions as determined by the administering authority However, where a surplus exists or where there has been a reduction in contributions paid in respect of an employer's deficit at the valuation, the Fund would not consider it appropriate for any increase in contributions paid in respect of future accrual of benefits to be implemented in steps.

- 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.

- 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 2021/2024. Any application of this option is at the ultimate discretion of the Fund officers and 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.

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

Employers Exiting the Fund

- Employers must notify the Fund as soon as they become aware of their planned exit date. Where appropriate, or at the request of the Scheme Employer, the Fund will review their certified contribution in order to target a fully funded position at exit. Consideration will be given to any cap and collar arrangements when reviewing contribution rates.

- 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. In such circumstances:

The policy for employers **who have a guarantor** participating in the Fund:

Where an employer with a guarantor leaves the Fund, the valuation of the termination payment will be calculated using the funding assumptions used for the assessment of the Solvency Funding Target, as set out in Appendix A.

The residual assets and liabilities and hence any surplus or deficit will normally transfer back to the guarantor but in circumstances where an exiting employer is expected to still be responsible for the termination position, an exit payment/exit credit may be payable from/to the exiting employer.

This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor. If all parties do not agree, then the surplus will be paid directly to the exiting employer following cessation (despite any other agreements that may be in place).

Further details are set out in the Termination Policy in Appendix B.

The policy for employers who **do not have a guarantor** participating in the Fund:

Where an employer with no guarantor leaves the Fund and leaves liabilities with the Fund which the Fund must meet without recourse to that employer, the valuation of the termination payment (or Exit credit) will be calculated using a discount rate based on a minimum risk investment strategy and a more prudent life expectancy assumption.

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process.

- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

  The Administering Authority has can vary the treatment on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary. The termination policy is summarised set out in Appendix B

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.

6

Link to Investment Policy and the Statement of Investment Principles (SIP)

The results of the 2020 valuation show the liabilities to be [103]% 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.

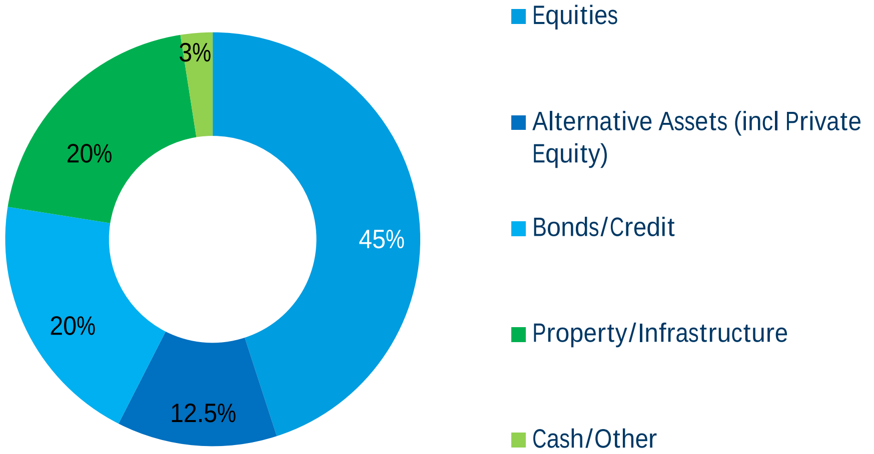
It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which represents the "minimum risk" investment position which would deliver a very high certainty of real returns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

Investment of the Fund's assets in line with the minimum risk portfolio would minimise fluctuations in the Fund's ongoing funding level between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out the valuation it would not be appropriate to make any allowance for out-performance of the Fund investments or any adjustment to market implied inflation assumption due to supply/demand distortions in the bond markets. This would result in real return versus CPI inflation of [minus 1.4]% 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 [62]%. This is a measure of the level of reliance on future investment returns i.e. level of investment risk being taken.

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 overall strategic asset allocation is set out in the Statement of investment Principles and the current strategy is set out below:



Based on the investment strategy above and the Actuary's assessment of the return expectations for each asset class, this leads to an overall best estimate average expected return of [1.95]% per annum in excess of CPI inflation as at the valuation date. 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. This margin, however, has been reduced to take account of the risk management strategies implemented to reduce the volatility of returns within the investment strategy.

A measure of overall prudence to protect against adverse experience in the future is to consider the funding level if it was assessed on a "best estimate" basis for all the principal assumptions (mainly the investment return and life expectancy). The actuary has assessed this funding level as [115]%. This level of prudence is built in to allow the Fund to address adverse events whilst maintain stability (within reasonable parameters) in employer contributions where appropriate.

Within the next valuation cycle, the Fund will consider the merits of implementing a choice of investment strategies to offer to employers, which would exhibit lower investment risk than the current whole fund strategy. This may be appropriate for employers who are deemed to have a weaker covenant than others in the Fund or those who wish to target a lower risk strategy (e.g. if planning for termination).

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. The Actuary's formal valuation report includes a quantification of the key risks in terms of the effect on the funding position.

Financial

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Any risk management policies 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
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.

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:-

- Future changes in life expectancy (longevity) that cannot be predicted with any certainty
- Potential strains from ill health retirements, over and above what is allowed for in the valuation assumptions for employers
- 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

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.

Ill health retirements can be costly for employers, particularly small employers where one or two costly ill health retirements can take them well above the “average” implied by the valuation assumptions. Increasingly we are seeing employers mitigate the number of ill health retirements by employing HR / occupational health preventative measures. These in conjunction with ensuring the regulatory procedures in place to ensure that ill-health retirements are properly controlled, can help control exposure to this demographic risk.

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. The first draft of this FSS was consulted [tbc].. The revisions to the FSS have been incorporated into this draft and the updated draft was finalised following the Committee meeting on [tbc].

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.
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.
- 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 liabilities to the Fund.

8

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.
- there has been a change in Regulations or Guidance which materially impacts on the policies within the funding strategy.

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 and this will be considered in conjunction with the employer affected and any associated guarantor of the employer's liabilities (if relevant).

Cost Management Process

The cost management process was set up by HMT, with an additional strand set up by the Local Government Pension Scheme (Scotland) Advisory Board (for the Scottish LGPS). The aim of this was to control costs for employers and taxpayers via adjustments to benefits and/or employee contributions.

As part of this, it was agreed that employers should bear the costs/risks of external factors such as the discount rate, investment returns and inflation changes, whereas employees should bear the costs/risks of other factors such as wage growth, life expectancy changes, ill health retirement experience and commutation of pension.

The outcomes of the cost management process were expected to be implemented from 1 April 2019, based on data from the 2016 valuations for the LGPS. This has now been put on hold due to age discrimination cases brought in respect of the firefighters and judges schemes, relating to protections provided when the public sector schemes were changed (which was on 1 April 2014 for the LGPS and 1 April 2015 for other Schemes).

The McCloud judgment

The government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. A consultation was issued in July 2020, which confirms that the remedy will have the effect of removing the current age criteria applied to the underpin implemented in 2015 for the LGPS, which would then apply to all members who were active as at 1 April 2012. The relevant estimated costs of the remedy have been quantified and notified to employers on this basis. The final funding position and certified contributions for each employer include the estimated costs of the McCloud remedy.

As a consequence of McCloud, cost management is expected to remain paused until the remedy is known and therefore no allowance has been made in this valuation. This will be reconsidered once the final outcomes are known.

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

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 date has been derived based on an assumed return of 1.25% per annum above CPI inflation i.e. a real return of 1.25% per annum equating to a total discount rate of [3.35]% 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. The discount rate will be reviewed as a matter of course at the time of a formal valuation or a formal employer rate review.

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) but subject to an adjustment due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index.

The overall average reduction to the assumption to long term RPI inflation to arrive at the CPI inflation assumption at the valuation date is 0.6% per annum. The CPI inflation assumption at the valuation date is 2.1% per annum. This adjustment to the RPI inflation assumption will be reviewed from time to time to take into account any changes in market expectations caused by the reform of the RPI index. Any change will then be implemented for all relevant policies in this Funding Strategy Statement.

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. Depending on the circumstances of the employer, the variants on short term pay that have been applied are either no allowance or allowances based on evidence from the employer of [1%/1.5%/2%] per annum, or alternatively assuming the increase will be in line with the CPI assumption set out above, for each year from the valuation date up to 31 March [2023]. The allowance made has been notified to each employer separately on their individual results schedule.

Application of bespoke salary increase assumptions as put forward by individual employers will be at the ultimate discretion of the Administering Authority but as a minimum must be reasonable and practical. To the extent that experience differs to the assumption adopted, the effects will emerge at the next actuarial valuation.

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). The exception to this is for members who will reach state pension age after 5 April 2021. In line with intended future changes to the regulations, we have allowed for increases on Guaranteed Minimum Pensions to increase in line with the inflation (CPI) assumption described above.

For members in pensionable employment, their CARE benefits are also indexed by CPI although this can be less than zero, i.e. a reduction in benefits, whereas for pension increases this cannot be negative, as pensions cannot be reduced.

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 base 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.

A specific mortality assumption has also been adopted for current members who retire on the grounds of ill health. For all members, it is assumed that the trend in longevity seen over recent time periods (as evidenced in the 2019 CMI analysis) 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 2019 projections and a long term improvement trend of 1.75% per annum.

As an indication of impact, we have set out the life expectancies at age 65 based on the 2020 assumptions:

	Male Life Expectancy at 65		Female Life Expectancy at 65	
	2017	2020	2017	2020
Pensioners	22.6	21.4	24.6	24.0
Actives aged 45 now	25.5	22.9	27.8	26.1
Deferreds aged 45 now	23.4	21.6	26.6	25.1

For example, a male pensioner, currently aged 65, would be expected to live to age 86.4. Whereas a male active member aged 45 would be expected to live until age 87.9. This is a reflection of the expected improvement in life expectancy over the next 20 years in the assumptions above.

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 remain in line with the assumptions adopted for 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

Method and assumptions used in calculating the cost of future accrual (or primary rate)

The future service liabilities are calculated using the same assumptions as the funding target except that a different financial assumption for the discount rate is used. A critical aspect here is that the Regulations state the desirability of keeping the "Primary rate" (which is the future service rate) as stable as possible so this needs to be taken into account when setting the assumptions.

As future service contributions are paid in respect of benefits built up in the future, the Primary rate should take account of the market conditions applying at future dates, not just the date of the valuation, thus it is justifiable to use a slightly higher expected return from the investment strategy. In addition, the future liabilities for which these contributions will be paid have a longer average duration than the past service liabilities as they relate to active members only.

The financial assumptions in relation to future service (i.e. the Primary rate) are based on an overall assumed real discount rate of 1.50% per annum above the long term average assumption for consumer price inflation of 2.10% per annum. This leads to a discount rate of 3.60% per annum.

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 2020 actuarial valuation

Long-term yields		
	Market implied RPI inflation	2.70% p.a.
Solvency Funding Target financial assumptions		
	Investment return/Discount Rate	3.35% p.a.
	CPI price inflation	2.10% p.a.
	Short Term Salary Increases	Varies by employer - 3 year period to 31 March [2023] as noted above
	Long Term Salary increases	3.60% p.a.
	Pension increases/indexation of CARE benefits	2.10% p.a.
Future service accrual financial assumptions		
	Investment return/Discount Rate	3.60% p.a.
	CPI price inflation	2.10% p.a.
	Short Term Salary Increases	Varies by employer - 3 year period to 31 March [2023] as noted above
	Long Term Salary increases	3.60% p.a.
	Pension increases/indexation of CARE benefits	2.10% p.a.

Life expectancy assumptions

The post retirement mortality tables adopted for this valuation are set out below:

Current Status	Retirement Type	Mortality Table
Annuitant	Normal Health	114% S3PMA_CMI_2019 [1.75%] 101% S3PFA_M_CMI_2019 [1.75%]
	Dependant	150% S3PMA_CMI_2019 [1.75%] 104% S3DFA_CMI_2019 [1.75%]
	Ill Health	136% S3IMA_CMI_2019 [1.75%] 144% S3IFA_CMI_2019 [1.75%]
	Future Dependant	146% S3PMA_CMI_2019 [1.75%] 121% S3DFA_CMI_2019 [1.75%]

Active	Normal Health	121% S3PMA_CMI_2019 [1.75%] 101% S3PFA_M_CMI_2019 [1.75%]
	Ill Health	134% S3IMA_CMI_2019 [1.75%] 151% S3IFA_CMI_2019 [1.75%]
Deferred	All	144% S3PMA_CMI_2019 [1.75%] 116% S3PFA_M_CMI_2019 [1.75%]
Future Dependant	Dependant	153% S3PMA_CMI_2019 [1.75%] 128% S3DFA_CMI_2019 [1.75%]

All life expectancies are normal health “cohort” expectancies from age 65 in 2020 and non-pensioners’ current age assumed to be 45.

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

Appendix B – 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 on default. 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.

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 if agreed by the Administering Authority based on the advice of the Actuary. 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.

The NESPF's general 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).

Employers with a Guarantor

If 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 residual assets and liabilities and hence any surplus or deficit will normally transfer back to the guarantor. (For Admission bodies, this process is sometimes known as the "novation" of the admission agreement where a successor body exists to take over the employing body's liabilities; this may (if agreed by the successor body) constitute a complete amalgamation of the assets and liabilities).

In circumstances where an exiting employer is expected to still be responsible for the termination position, an exit payment/exit credit may be payable from/to the exiting employer. This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor. If all parties do not agree, then the surplus will be paid directly to the exiting employer within (despite any other agreements that may be in place).

In some instances, the outgoing employer may only be responsible for part of the residual deficit or surplus as per the separate risk sharing agreement. The default is that any surplus would be retained by the Fund in favour of the outsourcing employer/guarantor unless representation is made by the relevant parties in line with the Regulations as noted above. For the avoidance of doubt, where the outgoing employer is not responsible for any costs under a risk sharing agreement then no exit credit will be paid as per the Regulations unless the Fund is aware of the provisions of the risk sharing agreement in any representation made and determines an exit credit should be paid.

Employers without a Guarantor

A termination assessment will be made based on a minimum risk funding basis. 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).

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process.
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as a lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

The Administering Authority can vary the treatment on a case by case basis of its sole discretion if circumstances warrant it based on the advice of the Actuary and, for example, may adjust any exit payment or exit credit to take into account any risk sharing arrangements which exist between the exiting employer and other Fund employers.

Furthermore, if appropriate, a reasonable allowance for expenses will also be made in relation administration and other expenses. This will be allowed for in the final termination assessment.

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.

Allowing for the McCloud Judgement in Termination Valuations

The government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. A consultation was issued in July 2020, which confirms that the remedy will have the effect of removing the current age criteria applied to the underpin implemented in 2015 for the LGPS, which would then apply to all members who were active as at 1 April 2012.

As part of any termination assessment, a reasonable estimate for the potential cost of McCloud will be included. However, where a surplus or deficit is being subsumed, no allowance will be made for McCloud within the calculations and the impact will be considered at the next contribution rate review.

However, if a representation is made to the Administering Authority in relation to an Exit Credit then a reasonable estimate for the potential cost of McCloud will need to be included. Where a surplus or deficit isn't being subsumed, McCloud will be allowed for as a matter of policy.

The allowance will be calculated in line with the treatment set out in this Funding Strategy Statement for all members of the outgoing employer using the termination assessment assumptions. For the avoidance of doubt, there will be no recourse for an employer with regard to McCloud, once the final termination has been settled and payments have been made. Once the remedy is known, any calculations will be performed in line with the prevailing regulations and guidance in force at the time.

The Administering Authority can vary the treatment on a case-by-case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary based on the representations from the interested parties.

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 2020) 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 2020**
Discount Rate	0.70% p.a.
CPI price inflation	2.10% p.a.
Pension increases/indexation of CARE benefits	2.10% p.a.

The financial assumptions above are as at 31 March 2020. These assumptions will be reviewed on an ongoing basis to allow for changes in market conditions along with any other structural or legislative changes.

In particular, since the valuation date it has been announced that RPI inflation is likely to be reformed with the reform potentially meaning the index is closer to the CPIH inflation measure. This would need to be reflected when deriving an updated market estimate of CPI inflation.

For example, when assessing a termination position (at October 2020) we will adjust the market RPI inflation to arrive at the CPI inflation assumption by deducting 0.6% per annum when assessing an employer's termination position. This adjustment will be kept under review as more details emerge on the reform of RPI

All demographic assumptions will be the same as those adopted for the 2020 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 [2.25]% p.a. from [1.75]% used in the 2020 valuation for ongoing funding and contribution purposes.

Appendix C – 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 centre 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.

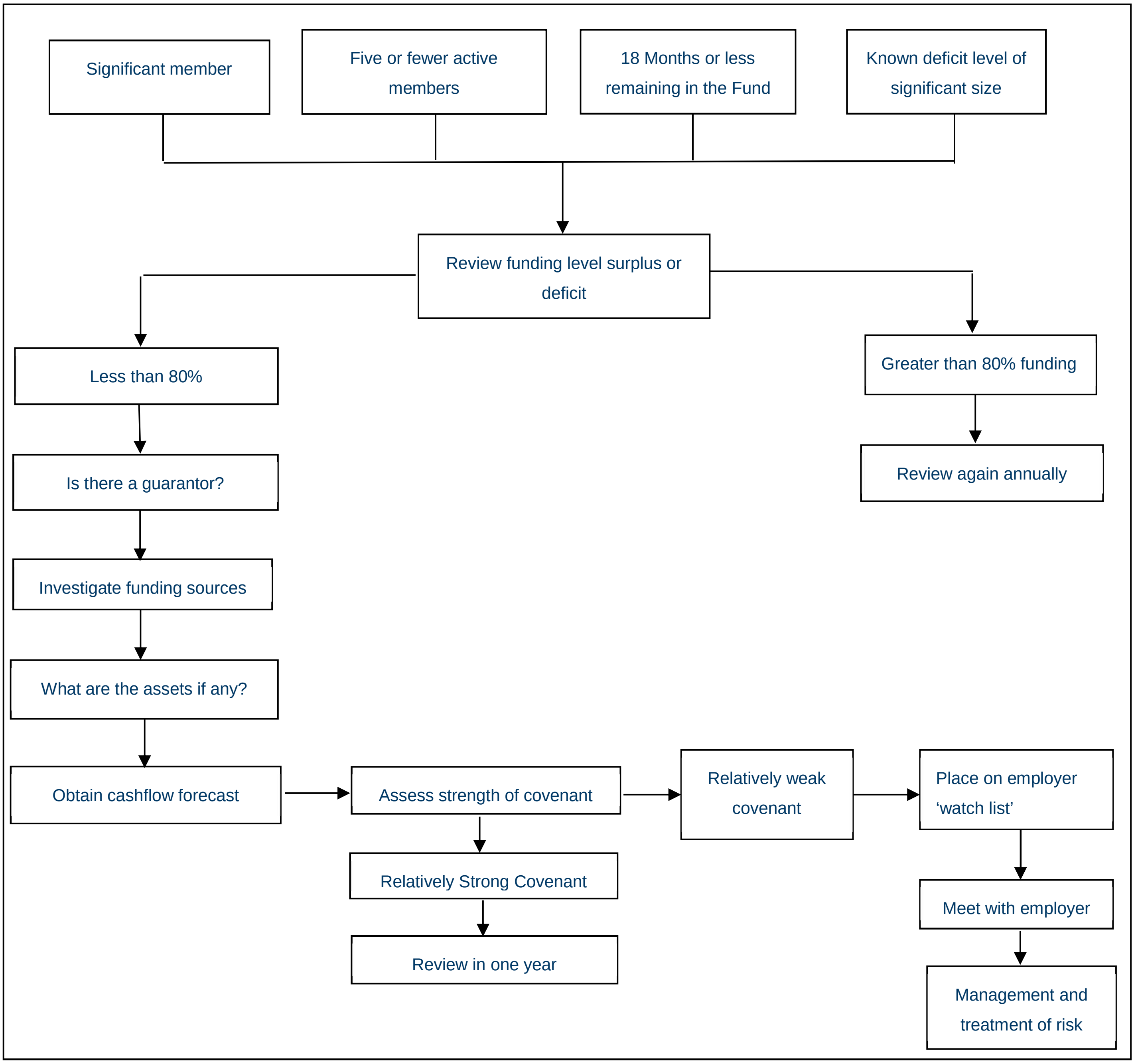
4.3 EMPLOYER MEETINGS

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 or residual surplus would then be dealt with as per Appendix C.

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/, a proportion of those liabilities (or equally receive all surplus or proportion of surplus), arising upon termination (the contingent event). This can take place through the absorption of the assets and liabilities by the guarantor to form part of its own position 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 the position upon termination; however, in certain circumstances where an exit payment is required, it may not be possible for an organisation to pay the total termination deficit 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 for an employer in deficit, 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 centred 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 D – 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.

Contingent Assets: assets held by employers in the Fund that can be called upon by the Fund in the event of the employer not being able to cover the debt due upon termination. The terms will be set out in a separate agreement between the Fund and employer.

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.

CPIH: An alternative measure of CPI which includes owner occupiers’ housing costs and Council Tax (which are excluded from 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).

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 (Primary 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.

Equity Protection: an insurance contract which provides protection against falls in equity markets. Depending on the pricing structure, this may be financed by giving up some of the upside potential in equity market gains.

Exit Credit: the amount payable from the Fund to an exiting employer in the case where the exiting employer is determined to be in surplus at the point of cessation based on a termination assessment by the Fund Actuary.

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, 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.

McCloud Judgment: This refers to the linked legal cases of Sargeant and McCloud, and which found that the transitional protections (which were afforded to older members when the public service pension schemes were reformed in 2014/15) constituted unlawful age discrimination.

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. At the valuation date this was equivalent to a discount rate of CPI less 1.4% p.a.

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 period: the target length of time over which the current deficit is intended to be paid off or the current surplus is intended to be refunded.

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 Scottish Public Pensions Agency (SPPA) in connection with reviewing the 2020 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.

SWAPS: a generic term for contracts put in place with financial institutions such as banks to limit the Fund’s investment and other financial risks.

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	Pension Committee
DATE	11 December 2020
REPORT TITLE	Strategic Infrastructure Partnership with Aberdeen City Council
EXEMPT	No
CONFIDENTIAL	No
REPORT NUMBER	PC/DEC20/INFRA
DIRECTOR	Steve Whyte
CHIEF OFFICER	Jonathan Belford
REPORT AUTHOR	Jonathan Belford
TERMS OF REFERENCE	5.1

1. PURPOSE OF REPORT

1.1 At its meeting of 15 March 2019, the Committee agreed to instruct the Chief Officer – Finance to explore the opportunities for a strategic partnership between the Council and the North East Scotland Pension Fund (NESPF) for the purposes of supporting local infrastructure investment, and report back on the feasibility. The purpose of the report is to address that instruction.

2. RECOMMENDATIONS

2.1 That the Committee note the content of the report and agree that the Pension Manager maintain a watching brief on the development of investor ready opportunities in the City Region area.

3. BACKGROUND

3.1 In investment terms 'infrastructure' is a broad asset class.

The definition of Infrastructure

'The basic facilities, services and installations needed for the functioning of a community or society, such as transportation and communications systems, water and power lines and public institutions including schools, post offices and prisons'

Infrastructure Sectors;

Transport	– roads, airports and ports.
Utilities	– water, electricity and gas grids
Telecommunications	– fibre and broadcast towers
Oil & Gas	– oil storage and pipelines
Social	– hospitals, schools and prisons
Renewable Energy	– wind, solar, hydro and biomass

3.2 In general the Government is responsible for providing infrastructure services to the community, Government however may discharge its responsibility directly or outsource to the private sector. In addition, the private sector may provide infrastructure services if market conditions are right.

3.3 While responsibility rests with Government, infrastructure services can be paid for in different ways, for example from general tax revenues or under 'user pay' arrangements.

3.4 With ageing infrastructure, increasing demand and new innovations investment in infrastructure throughout the UK is in high demand, with public and private sector joining forces to deliver on expectations across national and local plans.

3.5 Locally investment is sought for Aberdeen's strategic infrastructure priorities identified in the Regional Economic Strategy, City Region Deal and the City Centre Masterplan. Most recently, in May 2020, the Council's Urgent Business Committee approved the Net Zero City Vision for Aberdeen and a Strategic Infrastructure Plan – Energy Transition to support delivery of the vision.

3.6 The Committee was advised in the Strategic Infrastructure Priorities and the Scottish Local Government Pension Scheme report (PC/MAR19/INFRA) that there are some legal restrictions for the NESPF investing directly in Aberdeen City Council capital investments. This followed NESPF having reviewed the option to invest in the Aberdeen City Council Bond, when due diligence and legal advice was clear that the Pension Fund was prevented from participating due to the Pensions Act 1995 Section 40 which restricts employer-related investments.

3.7. Employer-related investments relate to *(a) shares or other securities issued by the employer or by any person who is connected with, or an associate of, the employer, (b) land which is occupied or used by, or subject to a lease in favour of, the employer or any such person, (c) property (other than land) which is used for the purposes of any business carried on by the employer or any such person, (d) loans to the employer or any such person, and (e) other prescribed investments,*

3.8 The ambition set out in the Regional Economic Strategy and the Net Zero City Vision for example goes much further than simply a Council being the funder of infrastructure. Both recognise the role of the UK Government and the Scottish Government in developing a mix of opportunities for a range of stakeholders, either in the public or private sector. This is not without its challenges.

The challenges of infrastructure investment

3.9 Infrastructure's economic characteristics can lead to attractive investment opportunities but not all display the same characteristics.

3.10 Providing essential services by infrastructure assets requires government / community involvement and as such;

- Incorporates an explicit or implied cap on returns, resulting in greater emphasis on initial investment assessment, robust valuation and ongoing management.
- Requires responsible and informed long term investing and effective governance.

3.11 Whilst infrastructure investments can display lower volatility they are not immune to economic cycles.

3.12 Private investment in infrastructure assets is relatively immature and as such there is no readily available access route for non-specialist investors. Also, the regulatory and/or contractual complexity that tend to accompany such investments also act as a high barrier to entry for non-specialist investors.

3.13 Mitigating some of the challenges can be achieved by taking significant care and judgement to match opportunities to risk/return requirements. Selecting an access route that delivers an outcome in line with expectations, delivering on not only return but governance.

Infrastructure Asset Allocation

3.14 The Strategic Asset Allocation for NESPF remains underweight in relation to Infrastructure, despite new investments in the past 12 to 18 months. The Pension Fund requires investor ready projects, that have a clear business case and fully prepared offer to the market for any investment to be considered.

3.15 Work with Council officers has concluded that with all of the ambition and expectation for development to be taken forward, there is still a great deal of work to be carried out to move local investment opportunities to be investment ready and for a pipeline to be created.

3.16 There is therefore no further work on investment appraisal to be carried out at this time.

3.17 That said it is obvious there is clear intent included in, for example, the Regional Economic Strategy and Strategic Infrastructure Plan – Energy Transition that will need investment. Over time it is expected that the proposals will become more developed and therefore in the meantime it is recommended the Pension Fund watch developments and consider suitable proposals that are aligned to the Investment Policy, as they arise.

4. FINANCIAL IMPLICATIONS

4.1 There are no financial implications arising directly from this report.

5. LEGAL IMPLICATIONS

5.1 Legal advice was sought in relation to the NESPF investing in the Aberdeen City Council bond issue as mentioned in the report. There are no legal implications arising directly from this report.

6. MANAGEMENT OF RISK

6.1 There are no issues arising directly from this report, however the management of risk is a vital component of the governance and due diligence in relation to actual investment decisions.

7. OUTCOMES

COUNCIL DELIVERY PLAN	
Regional and City Strategies	The proposals in this report support the Regional Economic Strategy and Net Zero City Vision by remaining interested in the investment opportunities arising from locally.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Impact Assessment	Full impact assessment not required
Data Protection Impact Assessment	Not required

9. BACKGROUND PAPERS

None

10. APPENDICES

None

11. REPORT AUTHOR CONTACT DETAILS

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ABERDEEN CITY COUNCIL

COMMITTEE	Pensions Committee
DATE	11 December 2020
EXEMPT	No
CONFIDENTIAL	No
REPORT TITLE	Strategy
REPORT NUMBER	PC/DEC20/STRAT
DIRECTOR	Steven Whyte
CHIEF OFFICER	Jonathan Belford
REPORT AUTHOR	Laura Colliss and Mairi Suttie
TERMS OF REFERENCE	1-5

1. PURPOSE OF REPORT

1.1 To inform the Committee and provide recommendations (if applicable) to changes to the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund.

2. RECOMMENDATION

2.1 That the Committee note the final outcome of the annual benefit statement project, which was completed successfully, for reassurance (3.9.2 of the report refers).

3. BACKGROUND

3.1 In line with the structural review of the Pension Fund, six specific areas were identified to fully address the strategic management of the Fund;

- Investment
- Accounting
- Benefit Administration
- Systems
- Governance
- Employer Relations

3.2 The roles and responsibilities within these areas have been very clearly defined to ensure accountability across the Pension Fund.

3.3 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/fundgovernance.aspx).

3.4 Also available on the Pension Fund website are all the policy documents that govern the Pension Fund including its various strategies.

3.5 **INVESTMENT**

3.5.1 *Asset & Investment Manager Performance Report*

Separate Report, provided

3.5.3 **Local Authority Pension Fund Forum (LAPFF)**

Copies of the latest e-bulletins, quarterly engagement and annual reports are available at http://www.lapfforum.org

3.6 **ACCOUNTING**

3.6.1 Budget/Forecast and Projected Spend 2020/21 Report

Separate Report, provided

3.7 **BENEFIT ADMINISTRATION**

3.7.1 **Scottish Public Pensions Agency Consultation (SPPA)**

3.7.1.1 Pension Fund officers have prepared and submitted a response to the SPPA consultation on addressing discrimination – amendments to the statutory underpin as reported previously (item 3.7.1 of PC/SEPT20/STRAT). This consultation proposes changes to address age discrimination brought about by changes to the Scheme in 2015.

Appendix I, Consultation Response

3.8 **SYSTEMS**

3.8.1 Performance reporting is provided on a quarterly basis.

Appendix II, Pensions Administration Strategy Update

3.9 **GOVERNANCE**

3.9.1 **Scheme Advisory Board**

Copies of the latest bulletins and meetings are available at http://lgpsab.scot

3.9.2 **Pension Fund Annual Benefit Statements (ABS)**

3.9.2.1 Following on from the update to Committee in September (PC/SEPT20/STRAT), the annual benefit statement project has now been successfully completed.

3.9.2.2 Active benefit statements were issued electronically to members through My Pension (MSS) by the statutory deadline of 31 August. Letters and emails were issued in advance to active members advising them that their statements were available to be viewed online and activation keys were issued to those members not already registered for MSS.

3.9.2.3 The Fund recorded 99.74% compliance for all benefit statements in 19/20 (active, deferred and councillors). This is a slight decrease from the reported figure of 99.86% in 18/19. This slight decrease is understandable given both employers and NESPF staff are working under very challenging circumstances due to COVID-19.

3.9.2.4 In line with our Breaches Policy, this will be recorded on the Breaches Register but not reported to the Pensions Regulator. Due to the ongoing COVID-19 situation the Pensions Regulator have chosen to adopt a more flexible approach, however we do not deem the breach to be of material significance. Officers have already investigated the member records which did not generate an annual benefit statement.111 errors were identified in total out of 42,853 records, the identified errors were for members that had not paid any pension contributions in 19/20 and therefore had no data on which to produce a statement i.e. employees who are taken onto the payroll in March but didn't receive their first pay until April, and for a very small minority the appropriate data was not received from the employer. Where applicable, the employer relationship team will work with employers to resolve any data issues going forward.

3.9.2.5 Costs for the ABS project this year were slightly up from 2019 due to email set up costs, however this was a one off expenditure to enable the Fund to utilise Adare's email facility and it covered both active/deferred mailings as well as any other email broadcasts issued in future years. Overall the move to online benefit statements has delivered a cost saving for Fund, we anticipate costs to continue to reduce as the process is streamlined and more members register for MSS.

3.9.2.6 At present, 731 (+96 from 18/19) active and 431 (+13 from 18/19) deferred members have opted in to receive traditional paper statements and letters will still be sent to members not registered for MSS.

3.9.2.7 In terms of online usage following the mailing, we saw respectively an increase of 14.3% in deferred members registering for MSS and a 13.4% increase for active members. In addition to viewing benefit statements, MSS is a useful tool for members to view up to date pensions data, keep the Fund informed of changes to personal data and help plan for their retirement using the online calculator. Officers continue to participate in the MSS working group to help future development and further work will be undertaken to grow MSS registration and interaction amongst members.

3.9.3 **Accommodation**

The fit out of Marischal Square was completed on the 19th November, on time. A report will be presented to the March 2021 Committee meeting providing full details.

3.10 **<u>EMPLOYER RELATIONSHIP</u>**

3.10.1 **Tri-ennial Valuation Update**

An update on the tri-ennial valuation focussing on the assumptions and Funding Strategy Statement.

Separate report, provided

3.10.2 **Financial Forum**

3.10.2.1 Given the ongoing COVID-19 situation, the decision was taken to host the annual Financial Forum online. As 2020 is a valuation year, it was important that employers were given the opportunity to be provided with as much information as possible.

3.10.2.2 Presentations were provided by the Scheme Actuary, Mercer and Fund Officers. In addition, a virtual Q & A session was held which gave employers the opportunity to question the Actuary, Investment Manager, Operations Manager and Pensions Manager from a whole Fund perspective. Employers were also given an opportunity for further 1-2-1 sessions to discuss their individual positions.

3.10.3 **Aberdeen City Council Transport – Buy in**

The buy in was completed on the 19th November, on time. A report will be presented to the March 2021 Committee meeting providing full details.

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 a number of legal implications arising from implementation of the strategy which have been identified and addressed as set out in this report.

6. MANAGEMENT OF RISK

6.1 The Pension Fund maintains its own Risk Management Policy and regularly updates its Risk Register in line with change. This is reported quarterly to the Pensions Committee.

Appendix III, Copy of Risk Register (November 2020)

7. OUTCOMES

7.1 The proposals in this report have no impact on the Council Delivery Plan.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Impact Assessment	Not required
Data Protection Impact Assessment	Not required

9. BACKGROUND PAPERS

None

10. APPENDICES

Appendix I, Consultation response
Appendix II, PAS update
Appendix III, Copy of Risk Register (November 2020)

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Scottish Public Pensions Agency
Buidheann Peinnseanan Poblach na h-Alba

Annex D – Consultation Response Form

The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2020

RESPONDENT INFORMATION FORM

Please Note this form **must** be returned with your response to ensure that we handle your response appropriately

1. Name/Organisation

Organisation Name

North East Scotland Pension Fund

Title **Mr** ☐ **Ms** ☐ **Mrs** ☐ **Miss** ☒ **Dr** ☐ ***Please tick as appropriate***

Surname

Suttie

Forename

Mairi

2. Postal Address

Resources, Business Hub 16
3rd Floor-West, Marischal College
Broad Street
Aberdeen

Postcode AB10 1AB	**Phone** 01224264264	**Email** Pensions@nespf.org.uk

3. Permissions - I am responding as…

Individual ☐ / **Group/Organisation** ☒

Please tick as appropriate

(a) Do you agree to your response being made available to the public (in Scottish Government library and/or on the Scottish Government web site)?

Please tick as appropriate ☐ **Yes** ☐ **No**

(b) Where confidentiality is not requested, we will make your responses available to the public on the following basis

Please tick ONE of the following boxes

Yes, make my response, name and address all available ☐

or

Yes, make my response available, but not my name and address ☐

or

Yes, make my response and name available, but not my address ☐

(c) The name and address of your organisation ***will be*** made available to the public (in the Scottish Government library and/or on the Scottish Government web site).

Are you content for your ***response*** to be made available?

Please tick as appropriate ☐ **Yes** ☒ **No**

(d) We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Please tick as appropriate ☒ **Yes** ☐ **No**

Comments

Question 1

Do you agree with our proposal to remove the discrimination found in the McCloud and Sargeant cases by extending the statutory underpin to younger scheme members?

Yes, to an extent. See answers to subsequent questions for explanation.

Question 2

Do you agree that the underpin period should end in March 2022?

Yes, otherwise it could go on indefinitely which wasn't the intention of the pension reforms changing to career average schemes.

Question 3

Do you agree that the revised regulations should apply retrospectively to 1st April 2015?

They should apply from at least 1 April 2015, otherwise more inconsistencies will be created. However, there may be potential for members who joined between 1 April 2012 and 31 March 2015 to challenge the regulations in the future. Should the amendments apply to all members who joined from 1 April 2012 onwards and who were active in the CARE scheme? We don't believe it is realistic to expect members who joined from 2012 to have been engaged enough to know the scheme was going to change and what impact it would have for them. It is important any possible future challenges are avoided, so we don't have to repeat this process.

Question 4

Do the draft regulations implement the revised underpin which we describe in this paper?

Yes, overall they implement the revised underpin as described, although please see Question 6 for specific comments on the regulations.

Question 5

Do the draft regulations provide for a framework of protection which would work effectively for members, employers and administrators?

They do provide a framework of protection for the members, by addressing the discrimination (subject to our response to question 3). However, due to the publicity generated from other public sector scheme challenges, there is potential that members may have a high expectation for these amendments, when it is unlikely many will actually have the new underpin apply. The short timescale will also detrimentally affect members as business as usual work won't be able to get done while implementing the new regulations.

The timescale of April 2021 is far too tight for scheme employers and administrators to be able to communicate and implement the regulations effectively. For administrators to be able to implement this effectively, software providers need to have enough time to provide a workable solution so that thousands of manual calculations aren't required. The work involved in order to implement these regulations is excessive in comparison to the number of members who will benefit.

There needs to be clear and consistent guidance for employers and administrators on how to implement and how to prioritise work, including business as usual. This needs to be provided from SAB or SPPA well in advance of the regulations being in force, which is unachievable in the proposed timescale.

Question 6

Do you have other comments on technical matters related to the draft regulations?

Amendment of the LGPS (Scotland) Regulations 2018		
Draft Reg No.	Reg to be Amended	Comment/Suggestion
3	84	Propose Regulation 3 is removed so it won't be a requirement to provide underpin info in ABS If not removed: • Inserted paragraph (5) refers to the 2008 Scheme, but this should be the 2009 Scheme. • The closing quotation marks at the end of the inserted paragraph (6) should actually be at the end of the inserted paragraph (10). • Paragraphs (8), (9) and (10) are indented too far right.
Amendment of the LGPS (Transitional Provisions & Savings) (Scotland) Regulations 2014		
Draft Reg No.	Reg to be Amended	Suggestion
6	4	There are multiple references to "the 2014 Regulations" in this regulation. Should we take the opportunity to update it to say "the 2018 Regulations"?
6 (b)	4(1)(b)	Spacing/lines are muddled. I think this should be set out as: (b) for paragraph (1)(b) substitute- "(b) is or has been an active member of the 2015 Scheme; and"
6 (c)	4(1)(c)	Spacing/lines are muddled. I think this should be set out as: (c) in paragraph (1)(c) substitute "; and" with ".";
6 (e)	4	Inserted paragraph (1B)(a) refers to Regs 16 and 17. These are for Contributions during reserve forces service leave and trade dispute absence respectively. Should this actually refer to Regs 13 (Re-employed and rejoining deferred members) and 14 (and Concurrent employments) instead?
6 (h)	4	• There is already a paragraph (2)(c). Reword as "for paragraph (2)(c) substitute-" • Reg 29(6) is for voluntary retirement before NPA, so don't see why that Reg is being singled out. Should it be 29(7) for flexible retirement, or 29(8) for redundancy?
6 (i)	4	• Needs brackets i.e. should be "after paragraph (2) insert-" instead of “after paragraph 2 insert-” • In the inserted paragraph (2A), also add "or (2)(c)" at the end. Unless there is a reason it shouldn't be included?
6 (n)	4	The paragraph amending paragraph (5)(b) seems to have been missed from the lettered list. It is for a new paragraph, so should really be under list point (o) and subsequent points will need to be re-lettered
6 (s)	4	• Agree with the wording for new paragraph (6A), however I'd expect it to be added as (6B) and for (6A) to cover the active ill-health retirement. This would mirror inserted paragraphs (5A) and (5B) which are added to cover IH and DiS for the provisional assumed benefits. I would expect we'd need the equivalent to confirm IH enhancement should be included in the provisional underpin amount. Or is it not needed because the IH enhancement should be calculated using the 2009 Regs enhancements? • Inserted paragraph (7)(a) refers to “29(10), 29(5) or 29(6) of the 2018 Regulations”. These cover early, late and normal retirement respectively. Should 29(14) also be referenced (payment from deferred) to cover all voluntary

		retirements? • Inserted paragraph (7)(b) refers to "29(7) of the 2018 Regulations". This covers flexible retirement. Should 29(4) and 29(8) also be referenced (payment at 75 and redundancy/efficiency) to cover all other non-voluntary payments? • Inserted paragraph (7)(f) confirms the underpin crystallisation date for deaths. For all retirements, the underpin crystallisation date is from date of payment, not retirement. To be consistent I would expect it to be the day after date of death i.e. the date any survivor benefits are payable • Inserted paragraph (10) refers to "30(6) of the 2018 Regulations" and "29(6)". There is no regulation 30(6) and as this refers to flexible retirement, I think both references should be to 29(7).

Question 7

Do you agree that members should not have to have an immediate entitlement to a pension at the date they leave the scheme for underpin protection to apply?

Yes. It will be easier to administer if the check is done on leaving, then it can be ensured all required info is in place, rather than potentially having to request information from employers years after someone has left. It also makes sense to have it calculated so it is there if required for transfers out and aggregation. However, communication with members will be key to ensure they understand the underpin on leaving isn't guaranteed and may not apply at crystallisation.

Question 8

Are there any other comments regarding the proposed underpin qualifying criteria you would like to make?

Only reiterating the previously mentioned comments in Q3, whether the amendments should apply to all members who joined from 1 April 2012 onwards and who were active in the CARE scheme, to avoid any future member challenges.

Question 9

Do you agree that for underpin protection to apply, members should meet the underpin qualifying criteria in a single scheme membership?

Yes, otherwise it is far too administratively complex. Also, this is consistent with everything in the Regs being post specific e.g. contribution rate, accrual rate etc.

Question 10

Do you agree with our proposal that certain active and deferred members should have an additional 12 month period to decide to aggregate previous LGPS benefits as a consequence of the proposed changes?

Only if absolutely necessary. While the Regs weren't clear, it appears it wasn't the intention for the underpin to apply across unaggregated employments. Considering scheme administrators weren't aware of this, it is unlikely members were.

Practically it would be fraught with problems as to how we identify the members, how to communicate the member options in a clear way and the 12 month timescale is too tight on top of all the other amendments and business as usual. While this timescale is too tight, it is recognised that a time limit does need to be put upon it to tie in with normal aggregation rules. It wouldn't be practical to allow members a final chance to decide whether to aggregate before leaving, as that doesn't tie in with current aggregation rules, and would allow members to benefit from hindsight or could possibly cost employers more by members simply choosing to aggregate as they are getting other benefits paid on ill-health or redundancy. A longer timescale would therefore be a better option or being able to give 12 months from the time information is sent to the member as a deadline, rather than a set date.

Question 11

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Do you consider that the proposals outlined in paragraphs 50 to 52 would have 'significant adverse effects' in relation to the pension payable to or in respect of affected members? (as described in section 23 of the Public Service Pensions Act 2013, 'Achieving a fair and consistent underpin')
Not if an additional 12 month period is being proposed. However, it could also be argued that any adverse effects wouldn't be 'significant' anyway, based on the number of members who will benefit from the underpin and the amount of underpin that may be applied.

Question 12
Do you have any comments on the proposed amendments described in paragraphs 56 to 58?
No

Question 13
Do you agree with the two-stage underpin process proposed?
Yes in principle, but will need to be careful how we advise members of the underpin at the initial underpin date i.e. that it's not guaranteed and may not be applied at crystallisation. There is a real potential for members to misunderstand.

Question 14
Do you have any comments regarding the proposed approaches outlined above?
The only comment is how complicated various scenarios, such as ill-health and transfers, are becoming due to the various layers of regulations and considering the underpin will impact such a small number of members. Clear and concise guidance will be needed on how to implement all the different proposals for various scenarios, as well as what to do if no contact is available e.g. in death cases. Transfers are becoming especially complicated and it is unclear how much members will understand when given the different options available to them.

Question 15
Do you consider there to be any notable omissions in our proposals on the changes to the underpin?
Clear in-depth guidance is required for all changes and should be available as a priority to allow software providers to refer to when amending systems and to allow administrators to get procedures in place.

Clarification will be needed on how the following will work:

- Transfers Out – What should be done where a transfer out has already been paid and the new scheme is not willing to accept a balancing payment. What happens if the administrators of the receiving scheme charge an administration fee in excess of the additional CETV? How to manage payments following rectification of interfunds
- Whether Divorce CETV calculations will need to be revisited
- Members with a pension debit following divorce
- Scheme Pays Offsets
- Recalculation of a pension which produced Strain on Fund costs – will the employer be required to pay the additional cost arising as a result of underpin applying?
- Trivial Commutation – how will this work as all benefits should have been extinguished & commutation period will have finished. What should be done if benefits would've exceeded the trivial commutation limit with revised underpin included.
- Employer waiving reductions under 2015 scheme, that wouldn't have been allowed under the 2009 scheme – should the reductions be waived in calculating the final underpin amount as well to give a true comparison?
- The order of applying PI and reductions/increases

Question 16
Do you agree that annual benefit statements should include information about a member's underpin protection?

Definitely not for active members under 2009 Scheme NPA. It will be useful to provide general information and an explanation of the underpin, but there isn't a need to provide the figures. In order to keep members interested and engaged in the ABS it is important the information is clear and concise. Giving information about something that may not apply when they leave or take payment seems contradictory to this. It will lead to a lot more questions, especially if a provisional guarantee amount is shown on the ABS, but doesn't apply when a member leaves. Even though we call it provisional, a lot of members will take it as entitlement. We don't show figures for members with a Certificate of Protection, as that is dealt with on leaving, so this falls into the same situation.

Similarly for other scenarios (over 2009 scheme NPA, deferred members) while there may be a provisional guarantee amount present, we don't know if it'll actually be applied until the benefits are crystallised, so are we just giving the member a false expectation if they are included?

Question 17

Do you have any comments regarding how the underpin should be presented on annual benefit statements?

If it must be presented, it should be under an explanation of the underpin, making it clear that the amount is only applicable based on the figures in this statement and may not apply when payment is taken. Standard wording should be used across the Scottish funds.

We have been moving to simplify these as much as possible, so adding a provisional figure will just open us up to more confusion and questions from members.

Question 18

Do you have any comments on the potential issue identified in paragraph 109?

No

Question 19

Do the proposals contained in this consultation adequately address the discrimination found in the McCloud and Sargeant cases?

Don't believe this is a question for administrators to answer. Whilst the mechanics of the proposals do appear to address the McCloud and Sargeant cases we are not legal experts so cannot confirm if there is further discrimination (directly or indirectly) in the proposed remedy.

Question 20

Do you agree with our equalities impact assessment?

Don't believe we are in a position to comment on this.

Question 21

Are you aware of additional data sets that would help assess the potential impacts of the proposed changes on the LGPS membership, in particular for the protected characteristics not covered by the GAD analysis (age and sex)?

Don't believe we are in a position to comment on this.

Question 22

Are there other comments or observations on equalities impacts you would wish to make?

No

Question 23

What principles should be adopted to help members understand the implications of the proposals outlined in this paper?

It needs to be ensured all administrators are delivering the same message, clearly and concisely.

Communication materials need to be provided for administrators to use (and issue to employers/members) well in advance of the implementation timescale, whether from LGA, SPPA or SAB.

Materials should include up to date FAQs, sample responses to employers, a means where LGPS funds can continually ask questions and benefit from updated information, guidance and examples. It is critical that this information is kept up to date and evolves as new issues arise.

We have serious concerns as to whether members are going to engage and understand communications provided.

Question 24

Do you have any comments to make on the administrative impacts of the proposals outlined in this paper?

This is going to have a major impact on resources to get all the required information. A worry is that, after a huge amount of information is required to be collated and processed, will there actually be many members who benefit from the revised underpin? NESPF have only had a handful of cases since 2015 of the statutory underpin applying, so can't envisage the revised underpin applying to many.

Administration resources are low across the funds anyway, so this will put a major strain on work and, as already mentioned, will impact all members due to business as usual suffering. Outsourcing to private companies is a potential, but costly option, that will need to be considered due to lack of resource.

Guidance should be provided by SPPA/SAB in relation to reasonable timescales for the various stages of the project including:

- encouraging employers to provide data as soon as is reasonably practical and no later than a defined date. It should be noted that a deadline of or around 31st March is not helpful due to year end pressures for both employers and pension funds
- provision of updated software from the software suppliers
- expected final dates for all funds to have reviewed and rectified benefits back to 2015.

The timescale given, of implementation from April 2021, is just not workable.

Question 25

What principles should be adopted in determining how to prioritise cases?

After dealing with cases coming into payment on an ongoing basis, pensions in payment should be prioritised first, followed by deaths and transfers.

Question 26

Are there material ways in which the proposals could be simplified to ease the impacts on employers, software systems and scheme administrators?

Clear guidance (perhaps statutory) clarifying how cases should be dealt with where data is not available from employers and how this can be reasonably ascertained, would assist with the administrative burden.

Furthermore nationally agreed tolerances that identify minimum thresholds before retrospective changes/updates are made (again balancing cost and benefit of updates) could simplify the proposals, introducing efficiencies for funds and employers.

A minimum threshold amount before changes/updates are made should be considered, for those members that don't request a recalculation. This could avoid large administrative costs for very small member benefits.

Question 27

What issues should be covered in administrative guidance issued by the Scheme Advisory Board, in

particular regarding the potential additional data requirements that would apply to employers?
Technical, detailed guidance on each of the scenarios that will need to be revisited and how to apply for each scenario going forward, including those items listed in our Q15 response, while also providing examples.

Guidance on what to do for cases that employers can't provide the required information.

Clear guidance for employers on what data is required going forward and why.

<u>Question 28</u>

On what matters should there be a consistent approach to implementation of the changes proposed?

- Communication wording for members and employers
- Prioritisation of cases
- What to do for cases that employers can't provide the required information
- What to do when there is no next of kin to contact, for survivor benefits or if the original recipient has now died

<u>Question 29</u>

Do you have any comments regarding the potential costs of McCloud remedy?
The estimated impact of the remedy was calculated for all employers and included in the 2020 actuarial results. Our FSS and termination policies will ensure that an estimate of any costs associated with the remedy are included in the exit assessment for an outgoing employer.

The administrative burden is a significant one and therefore the costs relating to administration could be significant. Short-term costs for Funds will be material, including system upgrades and functionality, additional resources, external advisor support and communication activities. The costs for employers may also be significant in terms of their own resources and changes to and extracting data from payroll systems.

If additional resource cannot be secured, then the prospect of having to outsource part or all of the remedy will be an expensive option that many Funds will have no option but to consider.

Our software supplier has declared that development effort will be comparable with the introduction of career average schemes in 2014/2015 and the development costs across all public-sector schemes are expected to run into millions of pounds.

In the longer term, there is likely to be additional costs due to ongoing system functionality and the increased complexity of the regulations.

Pension Administration Strategy

Quarterly Reporting September 2020

1. NESPF performance from 1st April to 30th September

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.

		Completed cases during reporting period			Additional targets for completed cases during reporting period				Uncompleted cases during reporting period	
Administration Task	Target	Cases	Achieved	Percentage	+ 5 days	+ 10 days	+ 20 days	> + 20 days	Cases	Revised %
Notification of death in service	5 days	12	12	**100.0%**					7	**63.2%**
Notification of retirement estimate	10 days	192	191	**99.5%**	99.5%	99.5%	99.5%	1	4	**97.4%**
Notification of retirement benefits	10 days	786	659	**83.8%**	88.8%	94.3%	96.9%	17	124	**72.4%**
Notification of deferred benefits	10 days	1220	1137	**93.2%**	94.4%	95.4%	95.6%	55	249	**77.4%**
Notification of refund	10 days	709	687	**96.9%**	98.3%	99.6%	99.9%	1	11	**95.4%**
Notification of transfer in value	10 days	25	23	**92.0%**	92.0%	92.0%	96.0%	1	6	**74.2%**
Notification of transfer out value	10 days	131	78	**59.5%**	67.7%	69.2%	73.1%	35	15	**53.4%**
		3075	2787	90.6%				110	416	79.8%

Completed cases during reporting period - reporting output is based on 5 and 10 day targets built into workflow cases for processing administration tasks as declared in the pension administration strategy:

- *Overall percentage achieved has remained the same at 91% with a slight increase in the revised percentage from 78% to 80%*
- *A significant improvement for retirement processing with 10% increases for both percentages.*

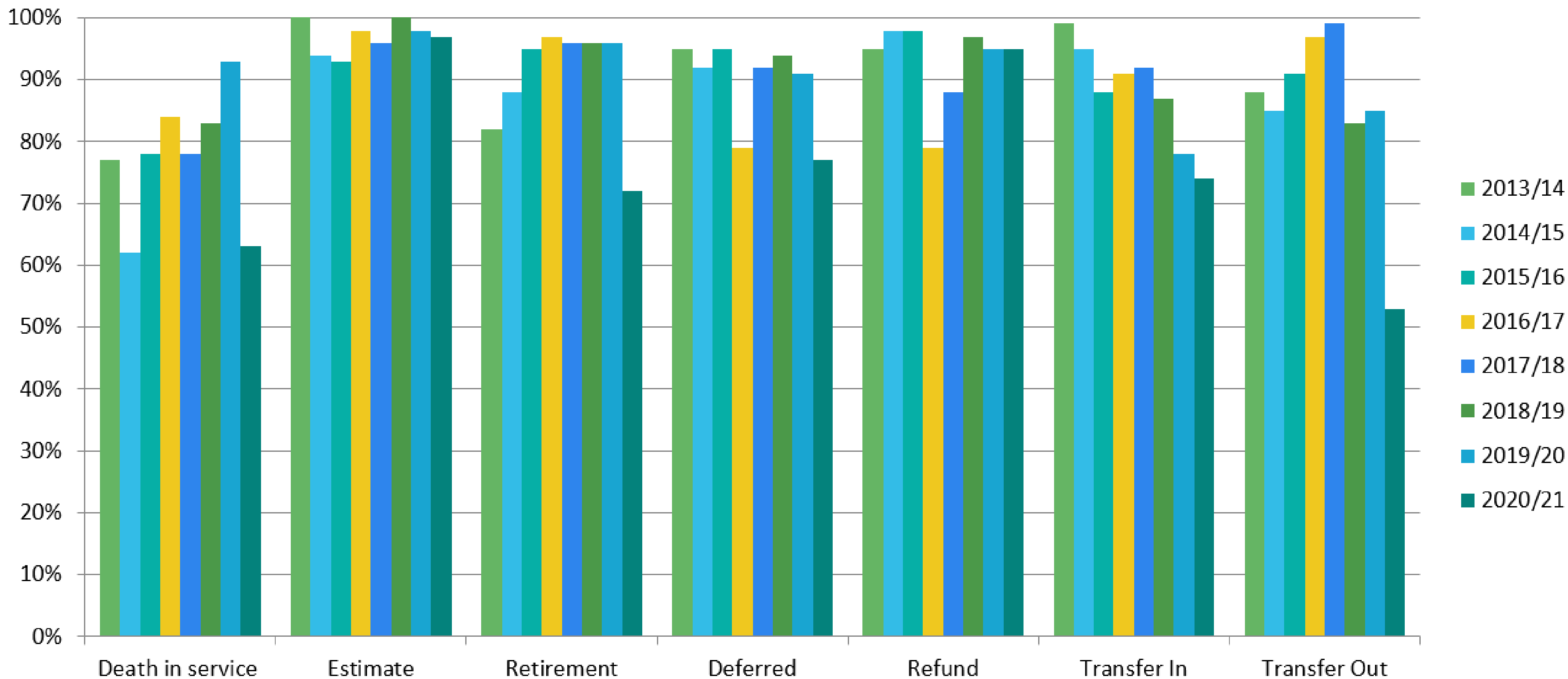
Additional targets for completed cases during reporting period - reporting output is based on adding 5/10/20 days to the 5 and 10 day targets built into workflow cases for processing administration tasks:

- *110 cases taking more than +20 days shows it is still taking longer to complete cases, this time last year 22 were reported.*

Uncompleted cases during reporting period - cases identified that were due to be completed and do not have a Reply Due date set in advance of the end of the reporting period:

- *416 cases were identified and contributed to the revised percentages, this time last year 101 were reported*
- *The impact of Covid-19 and home working remains significant.*

1.2 Previous years comparison



2. Employer performance from 1st April to 30th September

2.1 Policy on discretions received (85%)

Each Scheme emloyer is required under regulation 58 of the Local Government Pension Scheme (Scotland) Regulations 2018 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	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 Scotland	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 regarding 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
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 (470,030)

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)	1,445
Amendments (address, personal details, hours and absence)	8,981
Leavers (exit and opt out)	1,397
Contributions (employee, employer and additional)	155,397
Salary	153,276
Cumulative CARE Pay	149,417
Works Address	2,117

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.

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 2020)

* Moved to another LGPS for administrating

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												
North East Scotland College	Extract File												
Scottish Water	Extract File												
Scottish Fire and Rescue Service	Extract File												
Sport Aberdeen	Extract File												
ID Verde	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												
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												
Inspire	Online Return												
Mental Health Aberdeen	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 Scotland	Online Return												
SCARF	Online Return												
Scotlands Lighthouse Museum	Online Return												
St Machar Parent Support Project	Online Return												
Station House Media Unit	Online Return												
Visit Scotland	Online Return						*	*	*	*	*	*	*
Xerox	Online Return												

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Risk Register

Pensions Dashboard

In line with best practice and the Pensions Regulator (tPR) 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.

This Risk Register is reviewed and updated quarterly, with reporting to the Pensions Committee.

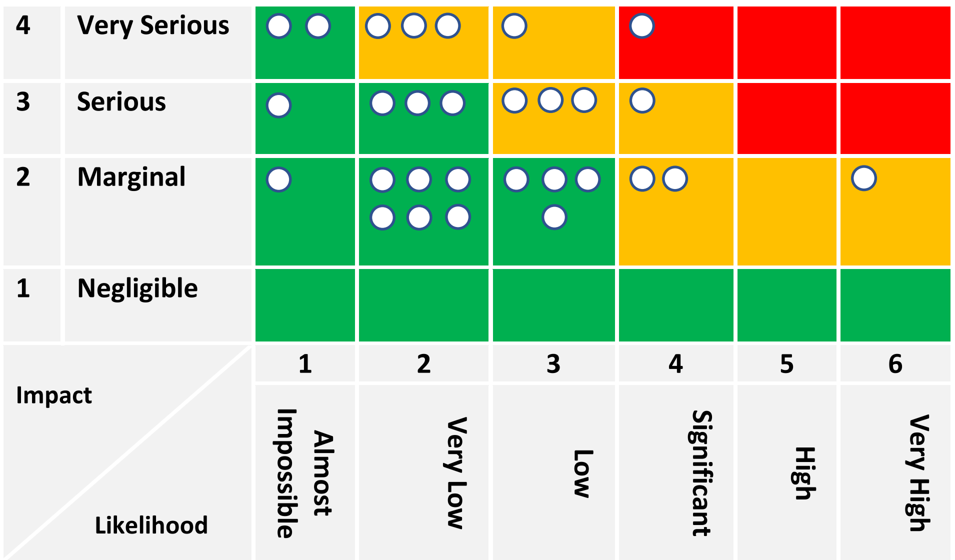
The Pensions Committee is responsible for receiving assurance on the effectiveness of NESPF risk management arrangements as per their Terms of Refence.

Risk Scoring Process

In order to apply an assessment rating (score) to a risk, NESPF implements a 4 x 6 matrix. The 4 scale represents the impact of a risk and the 6 scale represents likelihood of a risk event occurring.

4	Very Serious	4	8	12	16	20	24
3	Serious	3	6	9	12	15	18
2	Marginal	2	4	6	8	10	12
1	Negligible	1	2	3	4	5	6
Impact / Likelihood		1	2	3	4	5	6
		Almost Impossible	Very Low	Low	Significant	High	Very High

Current Heat Map (where risks NESPF001 through 029 fall)



Red = High Priority (urgent action required)
Orange = Medium Priority (assess adequacy of current controls, consider further action required to mitigate risk)
Green = Low Priority (no immediate action subject to exceptions, continue to review)

Last Update: November 2020

Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
Pension Fund Level									
NESPF001	**Risk:** COVID-19 **Causes:** Global virus pandemic **Potential Impact:** Failure to pay pensions, loss of staff due to illness, ability to meet regulatory requirements, financial impact on investment returns, covenant risk for employers	• Government and regulator guidance • NESPF risk policy and register • Updates/Communication between CO-Finance and Pension Manager • Business Continuity plans in place • Homeworking for Pensions Staff • PAS performance reporting • Internal/External audits • Regular staff comms and training	4	4	16	↔	**TREAT**		**Laura Colliss, ongoing**
NESPF002	**Risk:** Lack of effective risk controls **Causes:** Failure to implement risk management framework **Potential Impact:** Operational, financial and reputational issues	• NESPF risk register is reviewed and updated quarterly by senior management team • Consideration by Pensions Committee & Board at quarterly meetings • NESPF specific Risk Management Policy in place	4	1	4	↔	**TREAT**		**Ongoing**
NESPF003	**Risk:** Poor Governance		2	2	4	↔	**TREAT**		**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	Causes: Lack of robust and effective governance framework and supporting policies and procedures **Potential Impact:** Regulatory compliance issues, inability to determine policies and make effective decisions leading to poor service delivery and reputational risk	• Annual review of Funds Governance Compliance Statement and supporting policies and procedures • Adherence to Council's Scheme of Governance • Committee Effectiveness Report to support good governance						Committee Effectiveness Report presented to September 2020 meeting. Temporary governance arrangements in place due to COVID 19 ceased in August.	
NESPF004	**Risk:** Lack of performance measures **Causes:** Failure to develop performance reporting framework **Potential Impact:** Lack of transparency, poor performance could go unaddressed	• Statutory and local KPI's • Pension Administration Strategy published quarterly • Investment performance (against benchmark) reported to Committee quarterly	2	3	6	↔	**TREAT**		**Ongoing**
NESPF005	**Risk:** Failure of Pensions Committee and Pension Board to operate effectively **Causes:** Poor attendance/commitment to role, high turnover of members, lack of training **Potential Impact:** Non-compliance with regulatory requirements, inability to	• Publication of Pension Board Annual Report • Training Policy reviewed annually and training register in place • Nomination & Appointment procedure • Annual Committee Effectiveness Report	3	2	6	↔	**TREAT**	Normal Governance arrangements to recommenced from August 2020.	**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	make decisions or policies, reputational risk								
NESPF006	**Risk:** Operational Disaster; unable to access the workplace **Causes:** Major incident, natural disaster **Potential Impact:** Loss of service delivery, staff downtime	• ACC Disaster Recovery policy in place • NESPF Business Continuity Plan to address loss/disruption to benefit administration system	2	2	4	↔	**TOLERATE**		**Ongoing**
NESPF007	**Risk:** Failure to recruit, retain and develop staff **Causes:** Limited pool of resources/competition with private sector, lack of training/development opportunities, resource drain from wider priorities **Potential Impact:** Loss of service delivery, risk to succession planning	• All staff have individual development plans which are reviewed regularly through CR&D • Training register to monitor • 2 full time training & development staff • Internal 2 year training programme for benefit admin staff • Future-focused staffing structure, subject to ongoing review	4	2	8	↔	**TREAT**	Recruitment underway to fill vacant posts. Staffing update to December Committee meeting. Office relocation is on schedule to be completed by December.	**Laura Colliss, December 2020**
NESPF008	**Risk:** Pay and price inflation valuation assumptions either higher or lower **Causes:** Economic factors	• Quarterly funding updates to Committee (using FSM)	2	2	4	↔	**TOLERATE**	Tri-ennial valuation 2020 in progress	**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	Potential Impact: Potential increase in employer contribution rates and liabilities	• Tri-ennial valuation • Individual employer contribution rates							
Governance									
NESPF009	**Risk:** Failure to adhere to relevant pensions legislation and guidance **Causes:** Political and legislative changes, increased administrative complexity, staff training issue **Potential Impact:** Audit criticism, legal challenge, reputational risk, financial loss and tPR action	• Six monthly compliance review, with annual reporting to Pensions Committee and Board • Active participation at LGPS events, Testing Working Party for administration software updates • Established processes for staff training • Regular benefit admin team meetings to share knowledge	3	3	9	↔	**TREAT**		**Ongoing**
NESPF010	**Risk:** Failure to comply with FOI or SAR requests **Causes:** Missed statutory deadlines due to training or resource issues **Potential Impact:** Audit criticism, legal challenge, reputational risk	• Internal written procedures in place • FOI/SAR log to record & monitor	3	1	3	↔	**TREAT**	New online process through GovServices implemented to manage FOI requests	**Ongoing**
NESPF011	**Risk:** Conflicts of Interest **Causes:** Competing professional and personal interests of staff, Committee and Board members	• Regular discussions between CO-Finance and Pension Fund Manager	2	4	8	↔	**TREAT**		**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	Potential Impact: Audit criticism, legal challenge, reputational risk	• Standing agenda item at meetings • Conflicts policy & register in place, with conflicts declarations issued annually							
Benefit Administration									
NESPF012	**Risk:** Requirement to complete GMP reconciliation **Causes:** End of contracting out due to reforms of state pension **Potential Impact:** Failure to calculate future benefits correctly, audit criticism, financial loss	• Dedicated GMP project team reporting to Operations Manager • Regular updates to Committee and Board	2	2	4	↔	**TREAT**	IPE regulations with effect 1 March 2020. Final file received from HMRC in June 2020, work to be finalised by end of year.	**Gary Gray, December 2020**
NESPF013	**Risk:** Fraud/Negligence **Causes:** Dishonesty or human error by staff, scheme members **Potential Impact:** Overpayment/unauthorised payments, system corruption, audit criticism, legal challenge, reputational risk	• Segregation of duties for benefits staff authorising/submitting lump sum payments • Pension payments signed off by benefits senior • Participation in National Fraud Initiative exercise • Overseas pensioner existence checking • Breaches Policy & register • Internal Audit control reviews	2	3	6	↔	**TREAT**	Enhanced Admin to Pay module to provide secondary calculation checks as system requirement implemented into Live system during October 2020. Procedure testing underway and full review to be completed in New Year.	**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
Investments									
NESPF014	**Risk:** Insufficient assets to meet the Funds long term liabilities **Causes:** Failure of investment strategy or fund managers to produce expected returns **Potential Impact:** Increase in employer contribution rates, investment risk, audit criticism, financial loss	• Quarterly assessment of investment performance and funding updates • Tri-ennial valuation and investment strategy review • Diversification of assets • Due diligence of fund managers • External advisor for specialist guidance on strategy	4	3	12	↔	**TREAT**	Tri-ennial valuation in progress, investment strategy review outcome to follow. Tender underway for new investment management consultancy services.	**Ongoing**
NESPF015	**Risk:** Failure to monitor investment managers and assets **Causes:** Lack of internal procedures **Potential Impact:** Audit criticism, legal challenge, reputational risk	• Quarterly assessment and reporting of asset performance • Regular meetings with investment managers	3	3	9	↔	**TREAT**		**Ongoing**
NESPF016	**Risk:** Failure of world stock markets **Causes:** Systemic **Potential Impact:** Increase in employer contribution rates, financial loss	• Diversification of Scheme assets • Tri-ennial valuation and investment strategy review	4	2	8	↔	**TOLERATE**		**Ongoing**
NESPF017	**Risk:** Negligence/Fraud/Default **Causes:** Dishonesty by fund managers, lack of care or human error	• Due diligence on appointment and appropriate clause in legal agreements	2	1	2	↔	**TOLERATE**		**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	Potential Impact: Financial loss, reputational damage	• Fund management monitoring • SAS 70 reports							
NESPF018	**Risk:** Failure of Global Custodian **Causes:** Financial market crisis, regulatory/political **Potential Impact:** Loss of assets or control of assets	• Regular meeting with custodian • Receipt of SAS 70 reports and monitoring	4	1	4	↔	**TOLERATE**		**Ongoing**
NESPF019	**Risk:** Failure to implement ESG policy **Causes:** Lack of skills/knowledge, lack of transparency on practices or clear policy **Potential Impact:** Reputational damage	• Member training on roles and fiduciary duties • Policy incorporated within SIP • PRI membership	2	3	6	↔	**TREAT**	Annual PRI signatory assessment completed	**Ongoing**
Accounting									
NESPF020	**Risk:** Poor financial reporting **Causes:** Lack of internal policies and procedures, failure to keep up to date with changes in the Code of Practice and other overriding changes, training issues **Potential Impact:** Qualified accounts	• Comprehensive policies and procedures in place and review of *the Code* • Attending CIPFA meeting and reviews • Regular reconciliations e.g. fund managers, custodian • Internal/External Audits	3	2	6	↔	**TREAT**	Audited accounts signed following September's Committee meeting.	**Ongoing**
Technical									
NESPF021	**Risk:** Failure to secure and manage personal data in line		4	2	8	↔	**TREAT**	No data breaches this quarter,	**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	with data protection requirements **Causes:** Cyber-attack, human processing error **Potential Impact:** Audit criticism, legal challenge, reputational risk, financial penalties	• Annual information governance training for staff • Policies and procedures in place and reviewed regularly (Breaches, Data Protection, Systems Access and Retention Schedule) • Secure physical storage measures • Admin system providers implement range of protections against cyber threats including encryption, firewalls, annual 3rd party penetration testing etc						however risk rating left at same level due to ongoing COVID-19 and homeworking situation.	
NESPF022	**Risk:** Failure of the Fund's administration system **Causes:** Outages, hardware and software failures and cyber attacks **Potential Impact:** Staff downtime, loss of service delivery	• Administration system is hosted externally with back up in separate location • Regular software updates • Business continuity and disaster recovery plans in place	3	2	6	↔	**TOLERATE**		**Ongoing**
NESPF023	**Risk** Failure to track member status and trace information **Causes:** Poor record keeping **Potential Impact:** Incorrect pension payments, incorrect	• Tracing service in place (ATMOS) • Use of 'Tell Us Once' service	2	3	6	↔	**TREAT**		**Ongoing**

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Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	assessment of actuarial liabilities, tPR action	• Data quality improvement plan including measures to trace • Existence checking							
Employer Relationship									
NESPF024	**Risk:** Failure to monitor employer covenant **Causes:** Failure of internal procedures **Potential Impact:** Orphaned liabilities could fall on remaining employers	• Continued implementation of Covenant Assessment and Monitoring Policy (within FSS)	3	4	12	↔	**TREAT**		**Ongoing**
NESPF025	**Risk:** Changes in early retirement strategies by employers **Causes:** Public service cuts to funding **Potential Impact:** Pressure on cash flows	• Management through Covenant Assessment and Monitoring Policy (within FSS)	3	3	9	↔	**TREAT**		**Ongoing**
NESPF026	**Risk:** Employers leaving Scheme or closing to new members **Causes:** Public service cuts to funding, increased pension contribution costs **Potential Impact:** Orphaned liabilities could fall to remaining employers	• Management through Covenant Assessment and Monitoring Policy (within FSS) • Cost Cap mechanism introduced in LGPS regulations	2	6	12	↔	**TREAT**		**Ongoing**
NESPF027	**Risk:** Longevity **Causes:** Increasing life expectancy rates	• Tri-ennial valuation undertakes scheme	2	2	4	↔	**TOLERATE**	Tri-ennial valuation in progress	**Ongoing**

Code	Risk Description	Mitigating Controls	Current Risk				Approach	Additional Actions/Latest Notes	Owner & Timescale
			Impact	Likelihood	Score	Movement			
	Potential Impact: Increase in employer contribution rates and liabilities	specific analysis including review of life expectancy/mortality assumptions which are set with some allowance for increases							
NESPF028	**Risk:** Employer contributions not received, collected or recorded accurately **Causes:** Lack of staff resources, training issues **Potential Impact:** Orphaned liabilities could fall to remaining employers	• Internal escalation procedures • Breaches policy and register Monthly data submission reconciled by ERT • Quarterly PAS reporting to Committee & Board • Ongoing training provided by dedicated ERT to Scheme employers • Employer Briefings	2	4	8	↔	**TREAT**		**Ongoing**
NESPF029	**Risk:** Failure to maintain member records; data incomplete or inaccurate **Causes:** Lack of staff resources, training issues **Potential Impact:** Incorrect pension payments, incorrect assessment of actuarial liabilities, reputational damage, tPR action	• Monthly data from employers which is reconciled by ERT • Quarterly PAS reporting to Committee & Board • Data quality improvement plan implemented	2	2	4	↔	**TREAT**		**Ongoing**

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Agenda Item 9.1

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