

# FUNDING STRATEGY STATEMENT



## North East Scotland Pension Fund

The information enclosed in this statement and the accompanying policies have a financial and operational impact on all participating employers in the North East Scotland Pension Fund. It is imperative that all existing and potential employers are aware of the details set out herein.

May 2025

***A glossary of the key terms used throughout is available at the end of this document***

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 2018 (as amended) and guidance issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

# 1. Contents and Guide to the Funding Strategy Statement (FSS) and Policies

The information required by overarching guidance and Regulations is included in [Section 2](#) and [Section 3](#). This document also sets out the Fund's policies in the following key areas:

## 1. Actuarial Method and Assumptions (Appendix A)

The actuarial assumptions used for assessing the funding position of the Fund and the individual employers, known as the “Primary” contribution rate, and any contribution variations due to underlying surpluses or deficits, known as the “Secondary” rate, together with other factors that may impact an employer's contribution outcomes, are set out [here](#).

## 2. Deficit Recovery and Surplus Spread Periods (Appendix B)

The key principles when considering deficit recovery and surplus spread periods as part of the valuation are set out [here](#).

## 3. Employer Types and Admission Policy, (Appendix C)

Various types of employers are permitted to join the LGPS under certain conditions. The conditions upon which their entry to the Fund is based/the approach taken is set out [here](#).

## 4. Termination Policy, Flexibility for Exit Payments and Deferred Debt Agreements (Appendix D)

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 former employees along with a termination contribution certificate showing any exit debt or exit credit, due from or to the exiting employer. In some circumstances an employer and the Fund can enter a Deferred Debt Agreement. The termination policy can be found [here](#).

## 5. Review of Employer Contributions between Valuations (Appendix E)

In line with the Regulations, the Administering Authority has the discretion to review employer contributions between valuations in prescribed circumstances. The Fund's policy on how the Administering Authority will exercise its discretion is set out [here](#).

## 6. Covenant Assessment and Monitoring Policy (Appendix F)

The Fund has implemented a policy to regularly monitor the covenant of certain employers in the Fund to ensure they are able to meet their financial responsibilities to the Fund now and in the future. More details are set out [here](#).

## 7. Glossary (Appendix G)

A glossary of the key terms used throughout is available at the end of this document [here](#).

## 2. Background

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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 Fund will therefore be critical in achieving this. The Administering Authority has taken advice from the Actuary in preparing this Statement.

The purpose of this 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.

The details contained in this FSS will have a financial and operational impact on all participating employers in the Fund.

It is therefore imperative 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 Fund have been consulted and given opportunity to comment prior to this FSS being finalised and adopted. This statement takes into consideration all comments and feedback received.

### **Integrated Risk Management Strategy**

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, climate crisis) leading to a worsening of the funding position which would result in greater 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 and long term cost efficiency objectives. Individual employer results will also have regard to their covenant strength, where deemed appropriate by the Administering Authority.

### **The Regulations**

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 FSS.

### **The Solvency Objective**

The Administering Authority's long-term objective is for the Fund to achieve 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 in order to meet the Fund's objective. This in turn means that contributions will be subject to change from one valuation to another. This objective translates to 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 with sufficient prudence for this objective to be reasonably achieved in the long term at each valuation.

### **Long Term Cost Efficiency**

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 and surplus spread periods) must have regard to this requirement which will underpin the decision-making process. 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 the "solvency" of the pension Fund and "long term cost efficiency" of the Local Government Pension Scheme (the "LGPS") so far as relating to the Fund.

### **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.

# 3. Key Funding Principles

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## Purpose of the FSS

Funding is making advance provision to meet the cost of pension and other benefit promises. Decisions taken on the funding approach therefore determine the 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 purpose of this FSS 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.

The aims of the Fund are to:	The purpose of the Fund is to:
<ul style="list-style-type: none"><li>• manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due</li><li>• 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</li><li>• maximise the returns from investments within reasonable risk parameters taking into account the above aims.</li></ul>	<ul style="list-style-type: none"><li>• receive monies in respect of contributions, transfer values and investment income, and</li><li>• pay out monies in respect of Fund benefits, transfer values, costs, charges and expenses as defined in the Regulations.</li></ul>

## Responsibilities of the key parties

The efficient and effective management of the Fund can only be achieved if all parties (including pensions committee, investment managers, auditors and legal advisors, investment advisors, pension board etc) exercise their statutory duties and responsibilities

conscientiously and diligently. The key parties and their roles for the purposes of the FSS are set out below:

## Key parties to the FSS

<b>The Administering Authority should:</b>	<b>The Individual Employer should:</b>
<ul style="list-style-type: none"> <li>• operate the pension Fund</li> <li>• collect employer and employee contributions, investment income and other amounts due to the Fund as stipulated in the Regulations</li> <li>• pay from the Fund the relevant entitlements as stipulated in the Regulations</li> <li>• invest surplus monies in accordance the Regulations</li> <li>• ensure that cash is available to meet liabilities as and when they fall due</li> <li>• take measures as set out in the Regulations to safeguard the Fund against the consequences of employer default</li> <li>• manage the valuation process in consultation with the Fund's Actuary</li> <li>• prepare and maintain a FSS and a Statement of Investment Principles ("SIP), both after appropriate consultation with interested parties</li> <li>• monitor all aspects of the Fund's performance and funding, amending the FSS/SIP as necessary</li> <li>• effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and a scheme employer, and</li> <li>• 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.</li> </ul>	<ul style="list-style-type: none"> <li>• deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations), unless they are a Deferred Employer</li> <li>• pay all contributions, including their own, as determined by the Actuary, promptly by the due date (including any exit payment upon ceasing participation where applicable)</li> <li>• provide the Fund with accurate data and understand that the quality of the data provided to the Fund will directly impact on the assessment of their liabilities and their contributions. In particular, any deficiencies in their data may result in the employer paying higher contributions than otherwise would be the case if their data was of high quality.</li> <li>• undertake administration duties in accordance with the Pension Administration Strategy.</li> <li>• develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework</li> <li>• make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain</li> <li>• have regard to the Pensions Regulator's focus on data quality and comply with any requirement set by the Administering Authority in this context</li> <li>• notify the Administering Authority promptly of any changes to membership or their financial covenant to the Fund, which may affect future funding and comply with any particular Breaches of Law policy specified by the Fund.</li> <li>• understand the pension impacts of any changes to their organisational structure and service delivery model, and</li> <li>• comply with Regulations in the case of a bulk transfer of staff.</li> </ul>

The Fund Actuary should:	A Guarantor should:
<ul style="list-style-type: none"> <li>• 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 its FSS and the Regulations</li> <li>• prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as such as pension strain costs, ill health retirement costs etc.</li> <li>• provide advice and valuations on the termination of admission agreements</li> <li>• provide advice to the Administering Authority on bonds and other forms of security against the financial effect on the Fund of employer default</li> <li>• assist the Administering Authority in assessing whether employer contributions need to be revised between valuations as required by the Regulations</li> <li>• advise the Administering Authority on the funding strategy, the preparation of the FSS and the inter-relationship between the FSS and the SIP, and</li> <li>• 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.</li> </ul>	<ul style="list-style-type: none"> <li>• notify the Administering Authority promptly of any changes to its guarantee status, as this may impact on the treatment of the employer in the valuation process or upon termination.</li> <li>• provide details of the agreement, and any changes to the agreement, between the employer and the guarantor to ensure appropriate treatment is applied to any calculations.</li> <li>• be aware of all guarantees that are currently in place</li> <li>• work with the Fund and the employer in the context of the guarantee</li> <li>• receive relevant information on the employer and their funding position in order to fulfil its obligations as a guarantor.</li> </ul>

## 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.

Each employer's contributions are set at such a level to achieve long-term cost efficiency and full solvency in a reasonable timeframe.



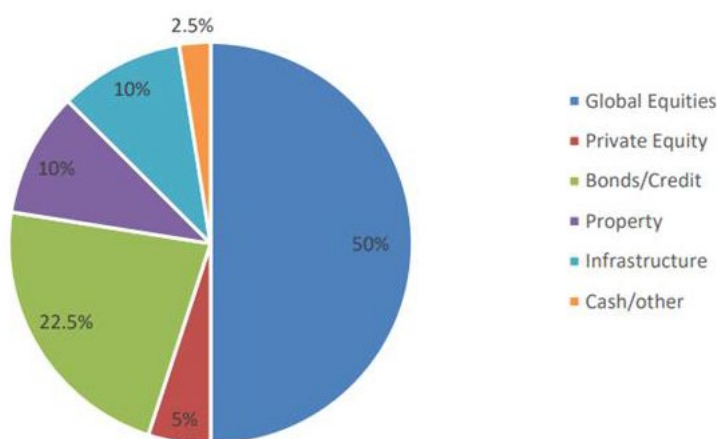
## Link to Investment Policy

The results of the 2023 valuation show the liabilities to be 125% covered by the assets, with a funding surplus of £1.13bn.

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 Statement of Investment Principles (SIP).

The overall strategic asset allocation is set out in the SIP. The current strategy is included below.

Growth Assets 55% (+/- 5%), Income/Protection Assets 45% (+/- 5%)



The investment strategy set out above and individual return expectations on those asset classes equate to an overall best estimate average expected return of 4.7% per annum in excess of CPI inflation as at 31 March 2023 i.e. a 50/50 chance of achieving this real return. For the purposes of setting a funding strategy however, the Administering Authority believes that it is appropriate to take a margin for prudence on these return expectations (see further comment in **Appendix A**).

## Risk Management Strategy

A key systematic risk relating to assets and liabilities of the Fund is the impact of climate change. The Actuary will separately quantify and report on this risk. Details will be set out in the final actuarial valuation report in March 2024.

The Fund would consider implementing a bespoke choice of investment strategy for employers on request and in consultation with the employer, based on advice from the Fund Actuary. Such a strategy may exhibit a different risk/return profile 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).

If implemented, the strategy will be reflected in the relevant employer's asset share, funding basis and contribution requirements. However, in the normal course of events, the contribution requirements for employers will not be reviewed until the following actuarial valuation of the Fund. However, the Fund reserves the right to review contributions in the interim period.



If, based on the assessments carried out by the Administering Authority, an employer is deemed to have a weaker covenant than other employers in the Fund or alternatively is expected to exit in the near future, the Administering Authority reserves the right to move an employer (typically following discussions with the employer) into a lower risk investment strategy to help protect against a deterioration in the funding position and protect the Fund as a whole.

## First Aberdeen Limited

One employer currently has a bespoke strategy (including an annuity contract) and specific termination basis, relating to the previous Fund merger with the Aberdeen City Council Transport Fund. This employer terminated with effect from 31 October 2023 so is no longer an active employer within the Fund.

## Identification of Risks and Counter-Measures

The funding of defined benefits is by its nature uncertain. When actual experience is not in line with the financial and demographic 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 quantification of some of the major risk factors.

Financial	Demographic
<p>The financial risks are as follows:-</p> <ul style="list-style-type: none"> <li>• Investment markets fail to perform in line with expectations</li> <li>• Protection and risk management policies fail to perform in line with expectations</li> <li>• Market outlook moves at variance with assumptions</li> <li>• Investment Fund Managers fail to achieve performance targets over the longer term</li> <li>• Asset re-allocations in volatile markets may lock in past losses</li> <li>• Pay and price inflation significantly more than anticipated</li> <li>• Future underperformance arising as a result of participating in the larger asset pooling vehicle therefore restricting investment decisions</li> <li>• An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.</li> </ul>	<p>The demographic risks are as follows:-</p> <ul style="list-style-type: none"> <li>• Future changes in life expectancy (longevity) that cannot be predicted with any certainty. Increasing longevity is something which government policies, both national and local, are designed to promote. It does, however, potentially result in a greater liability for pension funds.</li> <li>• Potential strains from ill health retirements, over and above what is allowed for in the valuation assumptions for employers</li> <li>• Unanticipated acceleration of the maturing of the Fund resulting in materially negative cashflows and shortening of liability durations. The Administering Authority regularly monitors the position in terms of cashflow requirements and considers the impact on the investment strategy</li> </ul> <p>Early retirements for reasons of redundancy and efficiency do not affect the solvency of the</p>

<b>Financial</b>	<b>Demographic</b>
<p>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.</p> <p>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.</p>	<p>Fund because they are the subject of a direct charge.</p>

<b>Governance</b>	<b>Regulatory</b>
<p>Governance risks are as follows:-</p> <ul style="list-style-type: none"> <li>• The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated</li> <li>• 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</li> <li>• Administering Authority not advised of an employer closing to new entrants, something which would normally require an increase in contribution rates</li> <li>• An employer ceasing to exist with insufficient funding or adequacy of a bond.</li> <li>• Changes in the Committee membership.</li> </ul> <p>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.</p>	<p>The key regulatory risks are as follows:-</p> <ul style="list-style-type: none"> <li>• Changes to Regulations, e.g. changes to the benefits package, retirement age, potential new entrants to the Fund,</li> <li>• Changes to national pension requirements and/or HMRC Rules</li> </ul> <p>Membership of the Local Government Pension Scheme 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.</p>

## **Monitoring and Review**

A full review of this Statement will occur no less frequently than every 3 years, to coincide with completion of a full statutory actuarial valuation and every review of employer rates or

interim 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 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 Scheme 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
- if there have been material changes in the SIP

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

# Appendix A – Actuarial method and assumptions

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The key whole Fund assumptions used for calculating the funding target and the cost of future accrual for the 2023 actuarial valuation are set out below.

Financial Assumptions	2023 valuation assumption at 31 March 2023	Description
Investment return / discount rate	<p>Ongoing funding basis:</p> <p>4.60% p.a. (past)</p> <p>4.10% p.a. (future)</p>	<p>Derived from the expected return on the Fund assets based on the long term strategy set out in the SIP, including appropriate margins for prudence. For the 2023 valuation, this is based on an assumed return of:</p> <p>2.00% p.a. above CPI inflation (past service) and 1.50% p.a. above CPI inflation (future service).</p> <p>This real return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics.</p> <p>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. Such cases will be determined by the Section 95 Officer and reported to the Committee.</p> <p>The assumed real returns quoted above will be periodically reviewed by the Administering Authority over the period to the next actuarial valuation to ensure that they reflect any significant changes in the Fund's investment strategy or significant changes in market conditions, which impact the appropriate margins for prudence referred to above that were agreed when setting the valuation funding strategy.</p>
	Minimum risk termination basis:	<p>Derived from the yield on conventional UK Government gilts. This assumption will be reviewed on an ongoing basis to allow for changes in market conditions at the relevant employing body's cessation date, along with any other structural or legislative changes.</p> <p>At 31 March 2023 this would be 3.8% p.a.</p>

<b>Financial Assumptions</b>	<b>2023 valuation assumption at 31 March 2023</b>	<b>Description</b>
<b>Inflation (Retail Prices Index)</b>	3.40% p.a.	The investment market's expectation 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 whole Fund's accrued liabilities).
<b>Inflation (Consumer Prices Index)</b>	Ongoing funding basis: 2.60% p.a. (includes an adjustment of 0.80% p.a. from the RPI assumption)	<p>RPI inflation (above) reduced to reflect the expected long-term difference between RPI and CPI measures of inflation (reflecting the profile and duration of the whole Fund's accrued liabilities and 2030 RPI reform) and adjusted to remove the estimated impact of supply/demand distortions as well as Bank of England forecasts. This varies for the ongoing and termination basis, reflecting the degree of inflation hedging inherent in the notional termination basis and will also reflect the duration of an employer's liabilities in the case of a low risk termination calculation.</p> <p>The adjustment to the RPI inflation assumption will be reviewed from time to time to take into account any market factors, which affect the estimate of CPI inflation.</p> <p>The minimum risk termination basis figure at 31 March 2023 would be 3.10%.</p>
<b>Salary increases</b>	Ongoing funding basis: 4.10% p.a.	Pre 1 April 2015 benefits (and 2015 to 2022 McCloud underpin) - the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.50% p.a. over the CPI inflation assumption as described above. This includes allowance for promotional increases.
<b>Pension Increases and Deferred Revaluation</b>	Ongoing funding basis: 2.60% p.a.	Assumed to be in line with the CPI inflation assumption above (noting that pension increases cannot be negative as pensions cannot be reduced). At the 2023 valuation, an adjustment has been made to the liabilities to allow for the known inflation for the period 30 September 2022 to 31 March 2023, and where material, allowance will continue to be made for inflation as it emerges when assessing funding positions between valuations.

<b>Financial Assumptions</b>	<b>2023 valuation assumption at 31 March 2023</b>	<b>Description</b>
<b>Indexation of CARE benefits</b>	Ongoing funding basis: 2.6% p.a.	Assumed to be in line with the CPI inflation assumption above. For members in pensionable employment, indexation of CARE benefits can be less than zero (i.e. a reduction in benefits).
<b>McCloud</b>	A reasonable estimate for the potential cost of McCloud has been included within the 2023 valuation results for each employer. This has been calculated based on the data provided for the 2023 valuation and in line with national guidance.	

## Demographic Assumptions

### Mortality/Life Expectancy

The derivation of the mortality assumption is set out in separate advice as supplied by the Actuary. 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) including a loading reflecting Fund specific experience and will make allowance for future improvements in longevity and the experience of the scheme. 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 2022 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 2022 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 and 2023 assumptions:

<b>Membership Category</b>	<b>Male Life Expectancy at 65 (2020 assumptions)</b>	<b>Female Life Expectancy at 65 (2020 assumptions)</b>
Pensioners	21.4	24.1
Actives aged 45 now	23.0	26.2
Deferreds aged 45 now	21.7	25.2

<b>Membership Category</b>	<b>Male Life Expectancy at 65 (2023 assumptions)</b>	<b>Female Life Expectancy at 65 (2023 assumptions)</b>
Pensioners	21.1	23.4
Actives aged 45 now	22.8	25.5
Deferreds aged 45 now	22.4	25.1

For example, a male pensioner, currently aged 65, would be expected to live to age 86.1. Whereas a female active member aged 45 would be expected to live until age 90.5. The difference reflects the expected increase in life expectancy over the next 20 years in the assumptions above.

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

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_2022 [1.75%]
		108% S3PFA_M_CMI_2022 [1.75%]
	Current Dependant in payment	142% S3PMA_CMI_2022 [1.75%]
		126% S3DFA_CMI_2022 [1.75%]
	Ill health	164% S3IMA_CMI_2022 [1.75%]
		207% S3IFA_CMI_2022 [1.75%]
	Future dependant	142% S3PMA_CMI_2022 [1.75%]
		126% S3DFA_CMI_2022 [1.75%]
Active	Normal health	118% S3PMA_CMI_2022 [1.75%]
		108% S3PFA_M_CMI_2022 [1.75%]
	Ill health	263% S3IMA_CMI_2022 [1.75%]
		349% S3IFA_CMI_2022 [1.75%]
Deferred	All	125% S3PMA_CMI_2022 [1.75%]
		113% S3PFA_M_CMI_2022 [1.75%]
Future Dependant (from current non pensioners)	Future Dependant (from current non pensioners)	134% S3PMA_CMI_2022 [1.75%]
		125% S3DFA_CMI_2022 [1.75%]

\* The life expectancy assumptions use a smoothing parameter of 7 and no short term improvements are allowed for.



<b>Other Demographic Assumptions</b>	
<b>Commutation</b>	Following analysis undertaken by the Actuary, it has been assumed that all retiring members will take 75% of the maximum tax-free cash available at retirement. 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.
<b>Proportions Married / Civil Partnerships assumption</b>	This has been reviewed and updated based on LGPS wide experience.
<b>Other Demographics</b>	Other Demographics - Following an analysis of Fund experience carried out by the Actuary, the incidence of ill health retirements and withdrawal rates 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. 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.
<b>Expenses</b>	Expenses are met out of the Fund, in accordance with the Regulations. This is allowed for by adding 0.4% of pensionable pay to the contributions from participating employers. This is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.
<b>Discretionary Benefits</b>	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.

Further details on the demographic assumptions are set out in the Actuary's formal report.

## 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, alternative methods are adopted, which make 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. Employers who move from open to closed may see an increase in contributions as a result of this change.

The assumptions to be used in the calculation of the funding target are set out above. 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.

There will be a funding plan for each employer. In determining contribution requirements the Administering Authority, based on the advice of the Actuary, will consider whether the funding plan adopted for an employer is reasonably likely to be successful having regard to the particular circumstances of that employer (potentially taking into account any material changes after the valuation date up to 31 March 2024).

As part of each valuation separate employer contribution rates are assessed by the Fund Actuary for each participating employer or group of employers. As indicated above, 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 in the Fund.

### **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 solvency 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.

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. 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. This is taken into account when considering what the appropriate discount rate is and can be higher or lower than the past service discount rate depending on market conditions and outlook and level of smoothing applied.

### **Employer asset shares**

The Fund is a multi-employer Pension Fund 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. In addition, the asset share may be 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.

The Fund's formal policy on the calculation of employer asset shares can be provided as a standalone document upon request.

# Appendix B – Deficit recovery and surplus spread periods

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If the funding level of an employer is above or below 100% at the valuation date (i.e. the assets of the employer are more or less than the liabilities), an adjustment plan needs to be implemented such that the Secondary contributions for each employer can be calculated. This adjustment plan requires a period over which to recover the deficit or run off surplus i.e. the recovery / spread period.

## Contribution Plans – Key Principles

Secondary contributions will be expressed as a percentage of pay. This, when combined with an employer's Primary Rate, will determine the minimum contribution requirement and employers will be free to pay higher contributions if they wish.

The Administering Authority retains ultimate discretion in applying these principles for individual employers on grounds of affordability and covenant strength and it may be deemed necessary to deviate under exceptional circumstances. Employers will be notified of their individual spread period as part of the provision of their individual valuation results.

The key principles when considering surplus offsets are as follows:

1. In determining the actual recovery / spread 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 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 remove any surplus over a reasonable timeframe, and this will be periodically reviewed.
2. **For the 2023 valuation the Fund has set a funding buffer.** For those employers assessed to be in surplus at the valuation date, a surplus buffer (expressed as a percentage of the employer's liabilities) will apply meaning surplus offsets will not be available to those with a funding level of less than the buffer. For those with funding levels greater than the buffer (typically [115%]), surplus offsets will be based on the surplus above the buffer only. Surplus below the buffer is to be retained within the Fund as a reserve against future adverse asset and liability experience, to increase the long-term stability of contributions. The size of the buffer will be reviewed at each valuation and may differ between employers for reasons set out above.
3. Where an employer is expected to exit the Fund then consideration of the appropriate contribution rate between now and exit would be given. This may mean that contributions are based on the termination funding assumptions as opposed to the

ongoing assumptions and appropriate consideration will be given to any surplus or deficit recognised when setting contributions.

4. 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.
5. 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.

# Appendix C – Employer types and admission policy

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## Introduction

This appendix details the admissions policy that applies to the Fund, including the methodology for assessing ongoing contribution requirements and the considerations for current and former admission bodies. Admissions to the Fund are generally relatively rare.

- 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 Fund is kept as a live document and will be updated by the Administering Authority as bodies are admitted to, or leave the Fund.

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 termination 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 termination basis 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 Fund. As the Scheme Employer is effectively the ultimate guarantor for these admissions to the Fund, 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 / surplus spread periods for Admitted Bodies will be set in line with the Fund’s general policy as set out in this 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 Fund, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the Fund, the Administering Authority may in this case treat the admission body as pre-funding for termination, with contribution requirements assessed using the termination 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 the termination methodology and assumptions. This will substantially reduce the risk of an uncertain and potentially large exit 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 termination basis or alternative prudent approach based on advice from the Actuary.

For any employing bodies funding for termination, the assets applied will be credited in line with a notional or actual strategy (e.g. if a modified investment strategy has been implemented for the employer) based on the advice of the Actuary to provide less volatility in the termination funding position.



# Appendix D – Termination policy, flexibility for exit payments and Deferred Debt Agreements

## Exiting the Fund

This appendix details the Fund's policy on the methodology for assessment of termination payments in the event of the cessation of an employer's participation in the Fund.

## Aims and objectives

The Administering Authority's aims and objectives related to this policy are as follows:

- To confirm the approach for the treatment and valuation of liabilities under Regulation 61 (2) for employers leaving the Fund.
- To confirm the approach for the treatment and valuation of liabilities for employers who have requested an indicative valuation under Regulation 61 (2A).
- To provide information about how the Fund may apply its discretionary powers when managing employer cessations.
- To outline the responsibilities of (and flexibilities for) exiting employers, the Administering Authority, the Actuary and, where relevant, the original ceding scheme employer (usually a letting authority).

## Background

A scheme employer may become an exiting employer when a cessation event is triggered e.g. when the last active member stops participating in the Fund. On cessation from the Fund, the Administering Authority will instruct the Fund Actuary to carry out a valuation of assets and liabilities for the exiting employer to determine whether a deficit or surplus exists under Regulation 61 (2). The Fund has full discretion over the repayment terms of any deficit, and the extent to which any surplus results in the payment of an exit credit.

A scheme employer may also propose to become an exiting employer at a future date and request an indicative valuation at a specific date under Regulation 61 (2A). If the employer ceases participation in the Fund within a 90- day period of the indicative cessation date, the results of the indicative cessation valuation must be used to determine whether a deficit or surplus exists. As in the case of a cessation valuation under Regulation 61 (2) the Fund has full discretion over the repayment terms of any deficit, however is liable for any surplus through the payment of an exit credit. For more information see section entitled "Approach for Indicative Valuations"

## Policies

On considering an exit from the Fund, an employer may request the Fund to instruct the Actuary to carry out an indicative valuation to determine whether there is a surplus or

deficit at the proposed date of exit. A period of at least 12 months must have elapsed since any such previous request from the employer.

On exit from the Fund and in the event where an indicative valuation has not been carried out, the Administering Authority will instruct the Fund Actuary to carry out a cessation valuation to determine whether there is any deficit or surplus as defined in the FSS and in this policy.

Where there is a deficit following a cessation or indicative valuation, payment of this amount in full would normally be sought from the exiting employer. The Fund's normal policy is that this deficit, known as the cessation debt, is paid in full in a single lump sum within 28 days of the employer being notified or within 28 days of exit from the Fund in the event that an indicative valuation has been carried out.

However, the Fund will consider written requests from employers to spread the payment over an agreed period, in the exceptional circumstance where payment of the debt in a single immediate lump sum could be shown by the employer to be materially detrimental to the employer's financial situation.

In circumstances where there is a surplus, the Administering Authority will determine, at its sole discretion, the amount of exit credit (if any) to be paid to the exiting employer (see policy on Exit Credits below).

## Approach to cessation valuations

On the cessation of an employer's participation in the Fund where an employer becomes an exiting employer, the Actuary will be asked to make a termination assessment. Depending on the circumstances of the termination, this assessment may incorporate a more cautious basis of assessment of the final liabilities for the employer. Typically, this would be where the employer does not have a guarantor in the Fund who has agreed to subsume the orphaned liabilities from the exiting employer.

	<b>Employers with no guarantor in the Fund / only a guarantee of last resort</b>	<b>Employers with a guarantor</b>
<b>Financial assumptions</b>	<p>The minimum risk termination basis (unless the Administering Authority agrees otherwise, based on the advice of the Actuary).</p> <p>Adjustments may also be made to the inflation assumption to reflect the level of overall hedging in the Fund. 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). The assumptions will be based on a full yield curve and will take into account the duration of the employer's projected cashflows/liabilities.</p> <p>For an indicative cessation under Regulation 61 2(A), the discount rate determined by the</p>	<p>If the employing body has a guarantor within the Fund or a successor body exists, either of which would take over the employing body's liabilities, the Fund's policy is that the ongoing funding basis will be used for the termination assessment (unless the guarantor informs the Fund otherwise).</p> <p>For the avoidance of doubt this includes any variation to assumptions for those employers whose assets are invested in alternative strategies.</p>

	<b>Employers with no guarantor in the Fund / only a guarantee of last resort</b>	<b>Employers with a guarantor</b>
	minimum risk termination basis less 0.25% p.a. will be used.	For an indicative cessation under Regulation 61 2(A), the ongoing funding basis will be used
<b>Demographic Assumptions</b>	In line with the assumptions adopted for the 2023 valuation with the exception of a higher level of prudence in the mortality assumptions to further protect the remaining employers. The rate of improvement in the mortality rates will therefore be increased to 2.25% p.a. This will be reviewed from time to time to allow for any material changes in life expectancy trends and will be formally reassessed at the next valuation.	In line with the assumptions adopted for the 2023 valuation for ongoing funding and contribution purposes. This will be reviewed from time to time to allow for any material changes in life expectancy trends and will be formally reassessed at the next valuation.
<b>McCloud</b>	A reasonable estimate for the potential cost of McCloud will be included. This will be calculated for all scheme members of the outgoing employer (reflecting the data made available). 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.	
<b>Additional Costs</b>	A reasonable allowance for expenses may also be made at the discretion of the Administering Authority, in relation administration and other expenses. This will be allowed for in the final termination assessment.	
<b>Default policy once the termination certificate has been provided</b>	<ul style="list-style-type: none"> <li>In the case of a surplus - the Fund pays the exit credit (as determined by the Fund) to the exiting employer following completion of the termination process (within 6 months of the exit date, or within 6 months of the completion of the cessation assessment by the Actuary (if later), providing no appeals have been raised with the Fund during this time). This is subject to the exiting employer providing sufficient notice to the Fund of their intent to exit; any delays in notification will impact on the payment date.</li> <li>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.</li> </ul>	The guarantor or successor body will then subsume the assets and liabilities (and any surplus or deficit) of the employing body within the Fund under the default policy. (For Admission Bodies, this process is sometimes known as the “novation” of the admission agreement.) In some instances an exit debt may be payable by an employer before the assets and liabilities are subsumed by the guarantor, this will be considered on a case-by-case basis. No payment of an exit credit will be payable unless representation is made as set out below.

If the guarantor refuses to take responsibility, then the residual deferred pensioner and pensioner liabilities should be assessed on the termination basis. In this situation the size of the termination payment would also depend on what has happened to the active members e.g. if they all transferred back to the original Scheme Employer (or elsewhere)

and aggregated their previous benefits. As any transfer would normally be effected on a "fully funded" valuation basis the termination payment required would vary depending on the circumstances of the case. Where this occurs, the exiting employer would then be treated as if it had no guarantor as per the policy above and the termination assessment will assume that the liabilities are orphaned and the termination basis would apply.

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 any representations from the interested parties (where applicable). For example, the Fund 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. This is subject to "representation" 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 (despite any other agreements that may be in place).

With regard to subsuming the residual assets and liabilities, this may, if agreed by the successor body, constitute a complete amalgamation of assets and liabilities to the successor body, including any funding deficit/surplus on closure. In these circumstances no termination payment will be required from the outgoing employing body itself, as the deficit/surplus would be dealt with via the successor body's own recovery/spread plan.

## **Approach for indicative valuations**

If an employer requests an indicative valuation under Regulation 61 (2A) the following principles will apply:

- For employers with no guarantor/guarantee of last resort, the Fund will adopt a future investment return assumption that has been calculated as defined in the Minimum Risk Termination Basis less 0.25% p.a.. For those employers with a guarantor, the future investment return will be calculated on the ongoing funding basis.
- An estimate of any additional liability that will be earned by current employees of the employer over 90 days will be included within the calculations, by comparing the cost of accrual against the expected contributions payable.
- Any increases in liability that occur following the indicative valuation that arise in respect of early retirements, benefit augmentations, ill-health early retirements or salary increases in excess of those assumed within the indicative valuation will be charged to the employer in addition to any cessation debt (or deducted from any cessation surplus)
- The specific date of the indicative valuation must be no earlier, and within 1 month of, the date of the employer's request.
- Allowance for actual pension increases and CARE revaluation (where known).

## **Review of the Termination Policy**

As set out in the table above, for employers without a guarantor, the financial assumptions are currently related to the yields on Government debt (known as Gilts). The principle of the termination policy and the assumptions used is to ensure (as far as possible) there is

sufficient monies to pay all the benefits due in relation to the “orphan” members of the outgoing employer as otherwise the remaining employers would potentially have to fund this via their contributions at subsequent valuations. This is why the Fund take a more cautious view as set out in this policy. For other employers, the policy is to use the appropriate ongoing funding assumptions if the orphaned liabilities are to be wholly subsumed by a guarantor in the Fund (once any exit payment is paid to/from the employer depending on the circumstances).

The policy will be reviewed as a matter of course at each actuarial valuation but will also be reviewed in times of extreme events, such as a material shift in market conditions or shift in economic/fiscal policy, which will affect the assets or liabilities of the exiting employer. This is to ensure that the approach remains appropriate, given the risk associated with funding the orphaned liabilities left behind by an exiting employer is being passed to other Fund employers, and ultimately the tax payer. This means that the assumptions (both financial and demographic) can be changed if circumstances warrant it. Employers would be notified of any change (and the rationale for the change) and the policy would be updated.

The Fund also has the discretion to apply a different approach on a case by case basis taking into account all factors (financial and non-financial) pertaining to the exiting employer.

## **Future Terminations**

In some 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.

Consideration can be given as to whether an indicative valuation under Regulation 61(a) is appropriate in these circumstances - see approach on indicative valuations above.

## **Determination notices (Employers with a guarantor)**

Where the outgoing employer is responsible for only part of the residual deficit or surplus as per a separate risk sharing agreement, the Fund’s default will also be that any surplus would be retained by the Fund in favour of the outsourcing employer/guarantor.

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.

If there is any dispute, then the following arrangements will apply:

- In the case of a surplus, the parties will need to make ‘representations’ to the Administering Authority if they believe an exit credit should be paid outside the policy set out above, or if they dispute the determination of the Administering Authority. The Fund will notify the parties of the information required to make the determination on request.
- If the Fund determines an exit credit is payable then they will pay this directly to the exiting employer within 6 months of the exit date, or within 6 months of the completion of the cessation assessment by the Actuary (if later)
- In the case of a deficit, in order to maintain a consistent approach, the Fund will seek to recover this from the exiting employer in the first instance although if this is not possible then the deficit will be recovered from the guarantor either as a further contribution collection or it will be taken into account at the next valuation depending on the circumstances.

If requested, the Administering Authority will provide details of the information considered as part of their determination.

An exit credit determination notice will be provided alongside the termination assessment from the Actuary in cases where there is an exit credit. The notice will cover the following information and process steps:

1. Details of the employers involved in the process (e.g. the exiting employer and guarantor).
2. Details of the admission agreement, commercial contracts and any amendments to the terms that have been made available to the Administering Authority and considered as part of the decision making process. The underlying principle will be that if an employer is responsible for a deficit, they will be eligible for any surplus. This is subject to the information provided and any risk sharing arrangements in place.
3. The final termination certification of the exit credit.
4. The Administering Authority’s determination based on the information provided.
5. Details of the appeals process in the event that a party disagrees with the determination and wishes to make representations to the Administering Authority.

## **POLICY IN RELATION TO THE FLEXIBILITY FOR DEBT SPREADING AGREEMENTS (DSA) AND DEFERRED DEBT AGREEMENTS (DDA)**

The Fund’s policy for spreading termination exit debts (referred to as ‘payment plans’) is as follows:

1. The default position is for exit payments to be paid immediately in full unless there is a risk sharing arrangement in place with a guaranteeing Scheme employer in the Fund whereby the exiting employer is not responsible for any exit payment. In the case of an exit credit the determination process set out above will be followed.
2. At the discretion of the Administering Authority, instalment plans over an agreed period or a Deferred Debt Agreement will only be agreed subject to the policy in relation to any flexibility in recovering exit payments.
3. The Administering Authority may in exceptional circumstances, issue written notice called a “suspension notice” to an employer to suspend that employer’s liability to pay an exit payment starting from the date when that employer would otherwise become an exiting employer. If this occurs, the employer must continue to make such contributions towards the liabilities of the Fund in respect of benefits for the employer’s current and former employees until a new and satisfactory valuation is carried out and the suspension notice is withdrawn.



As set out above, the default position for exit payments is that they are paid in full at the point of exit (adjusted for interest where appropriate). If an employer requests that an exit debt payment is recovered over a fixed period of time or that they wish to enter into a Deferred Debt Agreement with the Fund, they must make a request in writing covering the reasons for such a request. Any deviation from this default position will be based on the Administering Authority's assessment of whether the full exit debt is affordable and whether it is in the interests of other stakeholders e.g. the Fund/Other employers/taxpayers to adopt either of the approaches. In making this assessment the Administering Authority will consider the covenant of the employer and also whether any security is required and available to back the arrangements.

Any costs (including necessary actuarial, legal and covenant advice) associated with assessing this will be borne by the employer.

Where an indicative valuation has been carried out to determine the exiting surplus or deficit no flexibility will be offered on repayment.

## **POLICY FOR SPREADING EXIT PAYMENTS**

The following process will determine whether an employer is eligible to spread their exit payment over a defined period.

1. The Administering Authority will request updated financial information from the employer including management accounts showing expected financial progression of the organisation and any other relevant information to use as part of their covenant review. If this information is not provided then the default policy of immediate payment will be adopted.
2. Once this information has been provided, the Administering Authority (in conjunction with the Fund Actuary, covenant and legal advisors where necessary) will review the covenant of the employer to determine whether it is in the interests of the Fund to allow them to spread the exit debt over a period of time. Depending on the length of the period and also the size of the outstanding debt, the Fund may request security to support the payment plan before entering into an agreement to spread the exit payments.
3. The payment plan could include non-uniform payments e.g. a lump sum up front followed by a series of payments over the agreed period. The payments required will include allowance for interest on late payment.
4. The initial process to determine whether an exit debt should be spread may take up to 6 months from receipt of data so it is important that employers who request to spread exit debt payments notify the Fund in good time
5. If it is agreed that the exit payment can be spread then the Administering Authority will engage with the employer regarding the following:
  - a. The spreading period that will be adopted.
  - b. The initial and annual payments due and how these will change over the period
  - c. The interest rates applicable and the costs associated with the payment plan devised
  - d. The level of security required to support the payment plan (if any) and the form of that security e.g. bond, escrow account etc.



- e. The responsibilities of the employer during the exit spreading period including the supply of updated information and events which would trigger a review of the situation
  - f. The views of the Fund Actuary, covenant, legal and any other specialists necessary
  - g. The covenant information that will be required on a regular basis to allow the payment plan to continue.
  - h. Under what circumstances the payment plan may be reviewed or immediate payment requested (e.g. where there has been a significant change in covenant or circumstances)
6. Once the Administering Authority has reached its decision, the arrangement will be documented and any supporting agreements will be included.

## **EMPLOYERS PARTICIPATING WITH NO CONTRIBUTING MEMBERS (DDA)**

As opposed to paying the exit debt (immediately or spread over an agreed period of time), an employer may participate in the Fund with no contributing members and utilise the “Deferred Debt Agreement” (DDA) facility at the sole discretion of the Administering Authority. This would be at the request of the employer in writing to the Administering Authority.

The following process will determine whether the Fund and employer will enter into such an arrangement:

1. The Administering Authority will request updated financial information from the employer including management accounts showing expected financial progression of the organisation. If this information is not provided then a DDA will not be entered into by the Administering Authority.
2. Once this information has been provided, the Administering Authority will firstly consider whether it would be in the best interests of the Fund and employers to enter into such an arrangement with the employer. This decision will be based on a covenant review of the employer to determine whether the exit debt that would be required if the arrangement was not entered into is affordable at that time (based on advice from the Actuary, covenant and legal advisor where necessary).
3. The initial process to determine whether a Deferred Debt Agreement should apply may take up to 6 months from receipt of the required information so an employer who wishes to request that the Administering Authority enters into such an arrangement needs to make the request in advance of the potential exit date.
4. If the Administering Authority’s assessment confirms that the potential exit debt is not affordable, the Administering Authority will engage in discussions with the employer about the potential format of a Deferred Debt Agreement. As part of this, the following will be considered and agreed:
  - a) What security the employer can offer whilst the employer remains in the Fund. In general the Administering Authority won’t enter into such an arrangement unless they are confident that the employer can support the arrangement on an ongoing basis. Provision of security may also result in a review of the recovery period and other funding arrangements.

- b) The investment strategy that would be applied to the employer e.g. the standard, medium or lower risk strategy which could support the arrangement.
- c) Whether an upfront cash payment should be made to the Fund initially to reduce the potential future debt.
- d) What the updated Secondary rate of contributions would be required up to the next valuation.
- e) The financial information that will be required on a regular basis to allow the employer to remain in the Fund and any other monitoring that will be required.
- f) The advice of the Actuary, covenant, legal and any other specialists necessary.
- g) The responsibilities that would apply to the employer while they remain in the Fund.
- h) What conditions would trigger the implementation of a revised deficit recovery plan and subsequent revision to the Secondary contributions (e.g. provision of security).
- i) The circumstances that would trigger a variation in the length of the deferred debt agreement (if appropriate), including a cessation of the arrangement (e.g. where the ability to pay contributions has weakened materially or is likely to weaken in the next 12 months). Where an agreement ceases an exit payment (or credit) could become payable. Potential triggers may be the removal of any security or a significant change in covenant assessed as part of the regular monitoring.
- j) Under what circumstances the employer may be able to vary the arrangement e.g. a further cash payment or change in security underpinning the agreement.

The Administering Authority will then make a final decision on whether it is in the best interests of the Fund to enter into a Deferred Debt Agreement with the employer and confirm the terms that are required.

- 5. For employers that are successful in entering into a Deferred Debt Agreement, contribution requirements will continue to be reviewed as part of each actuarial valuation or in line with the Deferred Debt Agreement in the interim if any of the agreed triggers are met.
- 6. The costs associated with the advice sought and drafting of the Deferred Debt Agreement will be passed onto the employer and will be invoiced to the employer by the Fund.

## **POLICY ON EXIT CREDITS**

The Administering Authority's entitlement to determine whether exit credits are payable in accordance with these provisions shall apply to all employers ceasing their participation in the Fund.

The results of an indicative valuation carried out under Regulation 61 (2A) will not be used for the purposes of determining an exit credit. The surplus of assets in excess of liabilities will be assessed via a cessation valuation carried out under Regulation 61 (2).

The Administering Authority may determine the amount of exit credit payable to be zero, however, in making a determination, the Administering Authority will take into account the following factors;

- a. the extent to which there is an excess of assets in the Fund relating to that employer over the liabilities,

- b. the proportion of this excess of assets which has arisen because of the value of the employer's contributions,
- c. any representations to the Administering Authority made by the exiting employer and, where that employer participated in the scheme by virtue of an admission agreement, any body listed in paragraphs 8(a) to (d)(ii) of Part 2 of schedule 2 of these Regulations,
- d. Any guidance or statement specified under Regulation 56(4) of these Regulations, or any other guidance relating to the preparation of a funding strategy statement issued or endorsed by the Scottish Ministers;
- e. Any other relevant factors

### **Admitted bodies**

- a) The Fund will make an exit credit payment in line with any contractual or risk sharing agreements which specifically covers the ownership of exit credits/cessation surpluses or if the admission body and letting authority have agreed any alternative approach (which is consistent with the Regulations and any other legal obligations). This information, which will include which party is responsible for which funding risk, must be presented to the Fund in a clear and unambiguous document with the agreement of both the admission body and the letting authority/awarding authority/ceding employer and within one month (or such longer time as may be agreed with the Administering Authority) of the admission body ceasing participation in the Fund.
- b) In the absence of this information or if there is any dispute from either party with regards interpretation of contractual or risk sharing agreements as outlined in b), the Fund will withhold payment of the exit credit until such disputes are resolved and the information is provided to the Administering Authority.
- c) Where a guarantor arrangement is in place, but no formal risk-sharing arrangement exists, the Fund will consider how the approach to setting contribution rates payable by the admission body during its participation in the Fund reflects which party is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
- d) If the admission agreement ends early, the Fund will consider the reason for the early termination, and whether that should have any relevance on the Fund's determination of the value of any exit credit payment. In these cases, the Fund will consider the differential between employers' contributions paid (including investment returns earned on these monies) and the size of any cessation surplus.

- e) If an Admitted Body leaves on a minimum risk termination basis (because no guarantor is in place), then any exit credit will normally be paid in full to the employer.
- f) The decision of the Fund is final in interpreting how any arrangement described under b), d), e) and f) applies to the value of an exit credit payment.

### **Scheduled bodies**

- a) Where a guarantor arrangement is in place, but no formal risk-sharing arrangement exists, the Fund will consider how the approach to setting contribution rates payable by the employer during its participation in the Fund reflects which party is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
- b) Where no formal guarantor or risk-sharing arrangement exists, the Fund will consider how the approach to setting contribution rates payable by the employer during its participation in the Fund reflects the extent to which it is responsible for funding risks. This decision will inform the determination of the value of any exit credit payment.
- c) The decision of the Fund is final in interpreting how any arrangement described under a) and b) applies to the value of an exit credit payment.
- d) If a scheduled body becomes an exiting employer due to a reorganisation, merger or take-over, then no exit credit will be paid.
- e) If a scheduled body leaves on a minimum risk termination basis (because no guarantor is in place), then any exit credit will normally be paid in full to the employer.

### **General**

- i. The Fund will advise the exiting employer as well as the letting authority and/or other relevant scheme employers of its decision to make an exit credit determination under Regulation 61 (2D).
- ii. Subject to any risk sharing or other arrangements and factors discussed above, when determining the cessation funding position the Fund will generally make an assessment based on the value of contributions paid by the employer during their participation, the assets allocated when they joined the Fund and the respective investment returns earned on both.

- iii. The Fund will also factor in if any contributions due or monies owed to the Fund remain unpaid by the employer at the cessation date. If this is the case, the Fund's default position will be to deduct these from any exit credit payment.
- iv. The final decision will be made by the Chief Financial Officer of the Administering Authority, in conjunction with advice from the Fund's Actuary and/or legal advisors where necessary, in consideration of the points held within this policy.
- v. The Fund accepts that there may be some situations that are bespoke in nature and do not fall into any of the categories above. In these situations the Fund will discuss its approach to determining an exit credit with all affected parties. The decision of the Fund in these instances is final.
- vi. Where there is an exit credit payable, the Fund will advise the exiting employer of the amount due to be repaid and seek to make the payment within six months of the exit date or such longer time as the Administering Authority and the exiting employer may agree. In order to meet the six-month timeframe, the Fund requires prompt notification of an employer's exit and all data and relevant information as requested. The Fund is unable to make any exit credit payment until it has received all data and information requested.
- vii. The guidelines above at point d) in the 'Admitted Bodies' section, and at points a) and b) in the 'Scheduled bodies' section, make reference to the Fund 'considering the approach to setting contribution rates during the employer's participation'. Considering the approach taken when setting contribution rates of the exiting employer may help the Fund to understand the extent to which the employer is responsible for funding the underlying liabilities on exit. For example, if contribution rates have always been based on ongoing assumptions then this may suggest that these are also appropriate assumptions for exit credit purposes (subject to the other considerations outlined within this policy). Equally, a shorter than usual funding time horizon or lower than usual probability of success parameter may reflect underlying commercial terms about how responsibility for pension risks is split between the employer and its guarantor. For the avoidance of doubt, each exiting employer will be considered in the round alongside the other factors mentioned above.

## **Disputes**

In the event of any dispute or disagreement on the amount of any exit credit paid and the process by which that has been considered, the appeals and adjudication provisions contained in Regulations 69-73 of the LGPS (Scotland) Regulations 2018 would apply.

# Appendix E – Review of employer contributions between valuations

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In line with the regulations that came in to force on 1 June 2022, The Administering Authority has the ability to review employer contributions between valuations. The Administering Authority and employers now have the following flexibilities:

1. The Administering Authority may review the contributions of an employer where there has been a significant change to the liabilities of an employer.
2. The Administering Authority may review the contributions of an employer where there has been a significant change in the employer's covenant.
3. An employer may request a review of contributions from the Administering Authority if they feel that either point 1 or point 2 applies to them. The employer would be required to pay the costs of any review following completion of the calculations and is only permitted to make a maximum of two requests between actuarial valuation dates (except in exceptional circumstances and at the sole discretion of the Administering Authority).

Where the funding position for an employer significantly changes solely due to a change in assets (and/or changes in actuarial assumptions), the overarching policy intent is that contribution reviews are not permitted outside of a full valuation cycle. However changes in assets would be taken into account when considering if an employer can support its obligations to the Fund after a significant covenant change (see 2. above).

The Administering Authority will consult with the employer prior to undertaking a review of their contributions including setting out the reason for triggering the review.

For the avoidance of doubt, any review of contributions may result in no change and a continuation of contributions as per the latest actuarial valuation assessment. In the normal course of events, a rate review would not be undertaken close to the next actuarial valuation date unless in exceptional circumstances. For example:

- A contribution review due to a change in membership profile would not be undertaken in the 6 months leading up to the next valuation Rates and Adjustments Certificate.
- However, where there has been a material change in covenant, a review will be considered on a case by case basis, which will determine if it should take place and when any contribution change would be implemented. This will take into account the proximity of the actuarial valuation and the implementation of the contributions from that valuation.

## **Situations where contributions may be reviewed**

Contributions may be reviewed if the Administering Authority becomes aware of any of the following scenarios. Employers will be notified if this is the case.

Consideration will also be given to the impact that any employer changes may have on the other employers and on the Fund as a whole, when deciding whether to proceed with a contribution review.

## **1) Significant changes in the employer's liabilities**

This includes but is not limited to the following scenarios:

- a) Significant changes to the employer's membership which will have a material impact on their liabilities, such as:
  - i. Restructuring of an employer
  - ii. A significant outsourcing or transfer of staff to another employer (not necessarily within the Fund)
  - iii. A bulk transfer into or out of the employer
  - iv. Other significant changes to the membership for example due to redundancies, significant salary awards, ill health retirements or a large number of withdrawals
- b) Two or more employers merging including insourcing and transferring of services
- c) The separation of an employer into two or more individual employers

In terms of assessing the triggers under a) above, the Administering Authority will only consider a review if the change in liabilities is expected to be more than 5% of the total liabilities. In some cases, this may mean there is also a change in the covenant of the employer.

Any review of the rate will only take into account the impact of the change in liabilities (including, if relevant, any underfunding in relation to pension strain costs) both in terms of the Primary and Secondary rate of contributions.

## **2) Significant changes in the employer's covenant**

This includes but is not limited to the following scenarios:

- a) Provision of, or removal of, or impairment of, security, bond, guarantee or some other form of indemnity by an employer against their obligations in the Fund. For the avoidance of doubt, this includes provision of security to any other pension arrangement, which may impair the security provided to the Fund.
- b) Material change in an employer's immediate financial strength or longer-term financial outlook (evidence should be available to justify this) including where an employer ceases to operate or becomes insolvent.
- c) Where an employer exhibits behaviour that suggests a change in their ability and/or willingness to pay contributions to the Fund.
- d) The Fund becoming subordinate behind other creditors of the employer such as banks or other pension funds.

In some instances, a change in the liabilities will also result in a change in an employer's ability to meet these obligations.

Whilst in most cases the regular covenant updates requested by the Administering Authority will identify some of these changes, in some circumstances employers will be required to agree to notify the Administering Authority of any material changes. Where this applies, employers will be notified separately and the Administering Authority will set out the requirements



Additional information will be sought from the employer in order to determine whether a contribution review is necessary. This may include annual accounts, budgets, forecasts and any specific details of restructure plans. As part of this, the Administering Authority will take advice from the Fund Actuary, covenant, legal and any other specialist adviser.

In this instance, any review of the contribution rate would include consideration of the updated funding position (both on an ongoing and termination basis) and would usually allow for changes in asset values when considering if the employer can meet its obligations on both an ongoing and termination basis (if applicable). This could then lead to the following actions:

- The contributions changing or staying the same depending on the conclusion, and/or;
- Security to improve the covenant to the Fund, and/or;
- If appropriate, a change in the investment strategy via the employer investment buckets (if implemented).
- Pre-funding for termination

## **Process and potential outcomes of a contribution review**

Where one of the listed events occurs, the Administering Authority will enter into discussion with the employer to clarify details of the event and any intent of the Administering Authority to review contributions if a contribution review is deemed necessary. Ultimately, the decision to review contributions as a result of the above events rests with the Administering Authority after, if necessary, taking advice from their Actuary, legal or a covenant specialist advisors.

This also applies where an employer notifies the Administering Authority of the event and requests a review of the contributions. The employer will be required to agree to meet any professional and administration costs associated with the review. The employer will be required to outline the rationale and case for the review through a suitable exchange of information prior to consideration by the Administering Authority.

The Administering Authority will consider whether it is appropriate to use updated membership data within the review (e.g. where the change in data is expected to have a material effect on the employer's liabilities in the Fund) and whether any supporting information is required from the employer.

As well as revisiting the employer's contribution plan, as part of the review it is possible that other parts of the funding strategy will also be reviewed where the covenant of the employer has changed, for example the Fund will consider:

- Whether the employer's investment strategy remains appropriate or whether they should move to an alternative strategy (in line with the Funding Strategy Statement).
- Whether the employer should fund for termination.
- Whether the Primary Contribution Rate should be adjusted to allow for any profile change and/or investment strategy change
- Whether the Secondary contributions should be adjusted including whether the length of the recovery / spread period adopted at the previous valuation remains

appropriate. At the absolute discretion of the Administering Authority this may result in an increase to the recovery period where the evidence gathered demonstrates that the existing time horizon is no longer achievable and the extension is in the best interests of the tax payer, taking into account any security that may be available.

The review of contributions may take up to 6 months from the date of confirmation to the employer that the review is taking place, in order to collate the necessary data.

Any change to an employer's contributions will be implemented at a date agreed between the employer and the Fund. The Schedule to the Rates and Adjustment Certificate at the last valuation will be updated for any contribution changes. As part of the process, the Administering Authority will consider whether it is appropriate to consult any other Fund employers prior to implementing the revised contributions. Circumstances where the Administering Authority may consider it appropriate to do so include where there is another employer acting as guarantor in the Fund, then the guarantor would be consulted on as part of the contribution review process.

The Administering Authority will agree a proportionate process for periodical ongoing monitoring and review following the implementation of the revised contribution plan. The employer will be required to provide information to the Fund to support this, which will depend in part of the reasons for triggering the contribution review.

# Appendix F – Covenant Assessment and Monitoring Policy

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Covenant is the employer's legal obligation and financial ability to meet their defined benefit obligations in the Fund now and in the future. Regular assessment and monitoring of employer covenant is undertaken to understand the current strength of the employer's covenant and how they could change in the future. This is important to assist the Fund in deciding the appropriate level of risk when setting the investment strategy, employer funding targets and, where necessary, employer recovery plans. Therefore, a sound understanding of the covenant of employers is an essential part of the integrated approach to risk management of the Fund.

Employer's covenant can change quickly and therefore assessing the covenant of employers from a legal and financial perspective is an ongoing activity. The Fund has a well-developed and proportionate framework to monitor employer covenant and identify changes in covenant. The Fund can also draw on the expertise of external covenant advisers when necessary.

## RISK CRITERIA

The assessment criteria upon which the affordability and recovery of employer contributions should be reviewed could include:

- 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, cashflow and financial ability to meet contributions (both ongoing and on exit)
- Employer's credit rating
- Position of the economy as a whole
- Legal aspects

Not all of the above would be applicable to assessing employer risk within the Fund; rather a proportionate 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.

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 a surplus or a relatively small deficit	Bodies with potentially limited life span and in deficit
Bodies with long-term funding from local or central government		No active members or closed with a significant deficit
		Relies on voluntary or charitable source of income with significant deficit

## ASSESSING EMPLOYER COVENANT

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 undertaken. The employers' covenants will be assessed and monitored objectively in a proportionate manner and their ability to meet their obligations in the short and long term will be considered when determining an individual employer's funding strategy.

- An assessment of employer covenant includes determining the following:
- Type of employer 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/spread plan should be enforced
- Whether there is an option to call in contingent assets
- Whether there is a need for monitoring of ongoing and termination funding ahead of the next actuarial valuation

The employer covenant will be assessed based on publicly available information and/or information provided by the employer. The monitoring of covenant strength along with the funding position (including on the termination basis) enables the Fund to anticipate and pre-empt employer funding issues and thus adopt a proactive approach. In order to objectively monitor the strength of an employer's covenant, adjacent to the risk posed to the Fund, a number of fundamental financial metrics will be reviewed to develop an overview of the employer's stability and a rating score will be applied using a Red/Amber/Green (RAG) rating structure. Research will be carried out into employers' backgrounds and, in addition, employers may be contacted to gather further information. Focus will be placed on the regular monitoring of employers with a proactive rather than reactive view to mitigating risk. The covenant assessment will be combined with the funding position to derive an overall risk score. Action will be taken if these metrics meet certain triggers based on funding level, covenant rating and the overall risk score

## **FREQUENCY OF MONITORING**

The funding position and contribution rate for each employer participating in the Fund will be reviewed in detail at each triennial actuarial valuation and will continue to be monitored between valuations (including on the termination basis) using an online system provided to officers by the Fund Actuary.

Employers subject to a more detailed review, where a risk criterion is triggered and are on the 'watch list', will be reviewed at least every six months.

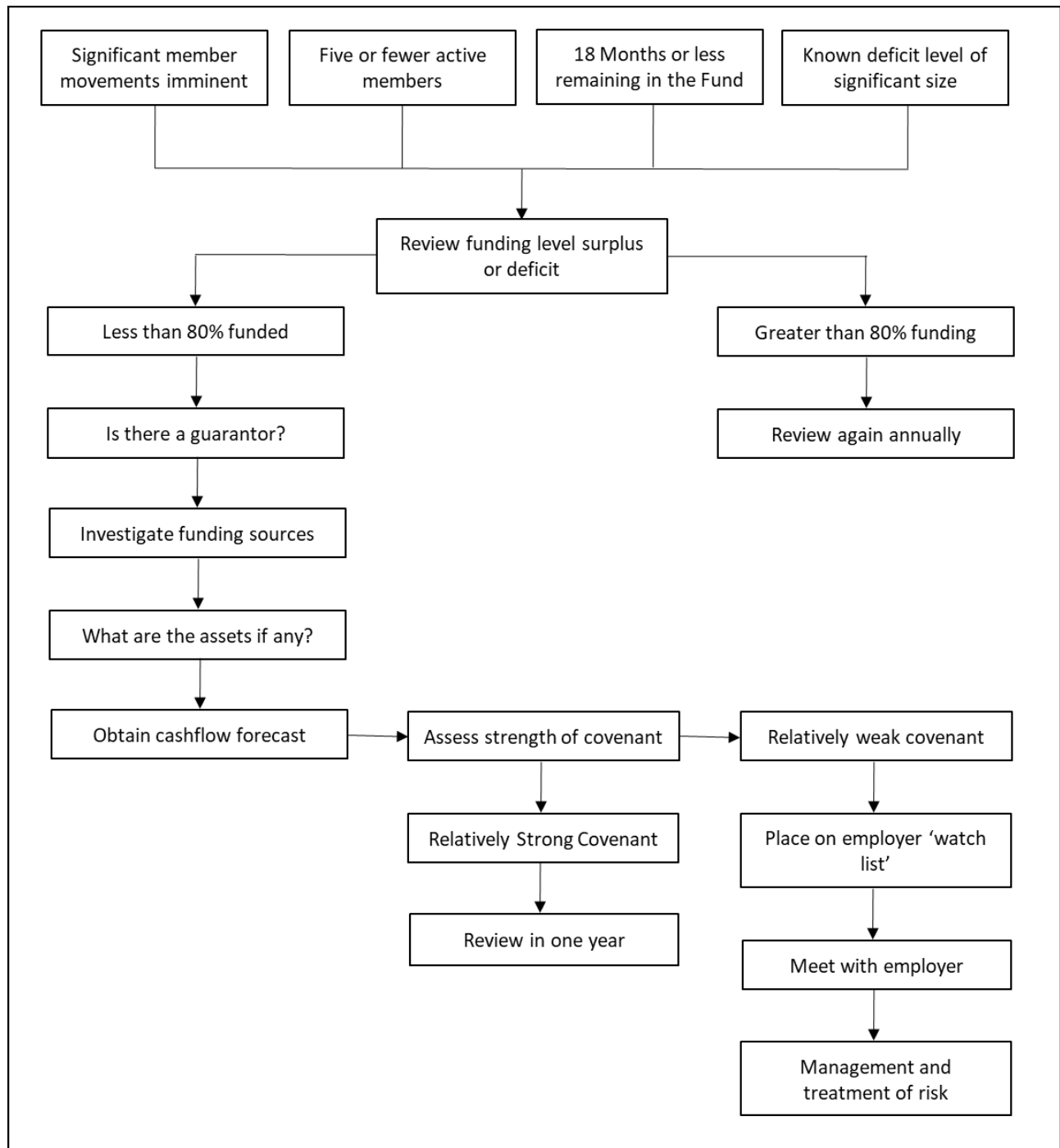
In some circumstances, employers will be required to agree to notify the Administering Authority of any material changes in covenant. Where this applies, employers will be notified separately.

## **COVENANT RISK MANAGEMENT**

The focus of the Fund's risk management is the identification and treatment of the risks and it will be a continuous and evolving process which runs throughout the Fund's strategy. Mechanisms that will be explored with certain employers, as necessary, will include but are not limited to the following:

1. Parental Guarantee and/or Indemnifying Bond
2. Transfer to a more prudent funding/investment approach
3. Shortened recovery periods/lengthened surplus spread periods and increased cash contributions
4. Managed exit strategies
5. Contingent assets and/or other security such as escrow accounts.

## FLOW CHART GUIDE TOWARDS MONITORING OF THE EMPLOYER COVENANT



# Appendix G – Glossary of terms

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## **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 FSS. 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.

## **Benefits**

The benefits provided by the Fund are specified in the governing legislation contained in the Regulations referred to within the FSS. Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure for members. The Fund is a defined benefit arrangement with principally final salary related benefits from 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.

## **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). See also ‘index linked gilts’ and ‘gilts’ below.

## **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.

## **CMI**

Acronym standing for “Continuous Mortality Investigation”. The CMI carry out research in relation to mortality and morbidity experience, which can then be used by actuaries to assess the funding required by pension funds and other bodies.



**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.

**Deferred Debt Agreement (DDA)**

A written agreement between the Administering Authority and an exiting Fund employer for that employer to defer their obligation to make an exit payment and continue to make contributions at the assessed Secondary rate until the termination of the DDA.

**Debt Spreading Agreement (DSA)**

A written agreement between the Administering Authority and an exiting Fund employer where the Fund agree to receiving the payment of the exit Debt in installments across a specified period/payment plan.

**Deferred Employer**

An employer that has entered into a DDA with the Fund.

**Deficit**

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

**Deficit recovery / Surplus spread period**

The target length of time over which the current deficit or surplus is intended to be eliminated. A shorter deficit recovery period will give rise to higher annual contributions, and vice versa. A shorter surplus spread period will give rise to lower annual contributions, and vice versa.

**Derivatives**

Financial instruments linked to the performance of specific assets which can be used to magnify or reduce exposure to those assets.

**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 i.e. the liabilities. A higher discount rate means lower liabilities and vice versa.

**Early Retirement Strain**

The additional cost incurred by a scheme employer as a result of allowing a Scheme Member aged 55 or over to retire before Normal Retirement Age and to receive a full pension based on accrued service at the date of retirement without full actuarial reduction.

**Employing bodies**

Any organisation that participates in the LGPS, including admission bodies and Fund employers.

**Employer's Primary Contribution Rate ("Future Service Rate")**

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 Contribution Rate for the whole Fund is the weighted average (by payroll) of the individual employers' Primary Contribution Rates.

**Equities**

Shares in a company which are bought and sold on a stock exchange.

**Exit Credit**

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

**Fund / Scheme Employers**

Employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the Part 2 Fund Employers. For example, these include councils, colleges, universities and academies

**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.

**Gilts**

Loans made to the UK Government, which the Government undertakes to repay at an agreed later date. The "coupon" (i.e. the interest paid as part of the loan agreement) and the final settlement amount will be a fixed amount and agreed at the outset of the loan.

**Government Actuary's Department (GAD)**

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.

**Guarantee of Last Resort**

For the purposes of the FSS, a guarantee of last resort refers to the situation where an employer has exhausted all alternative options for payment of an exit debt and so the debt is recovered from another employer in the Fund, however the liabilities are not subsumed in this case.

**Hedging**

A strategy that aims to reduce funding volatility and provide higher certainty of returns. This is achieved by investing in assets (usually bonds or gilts) that capture levels of real yield based on agreed levels so the assets mimic the change in liabilities.

**Index-Linked Gilts**

Loans made to the UK Government, which the Government undertakes to repay at an agreed later date. The coupon (i.e. the interest paid as part of the loan agreement) and the final settlement amount are adjusted in line with the movements in RPI inflation in order to retain their 'real' value over time and protect against the potential effects of inflation.

**Investment Strategy**

The long-term distribution of assets among various asset classes that takes into account the Funds objectives and attitude to risk. Often documented and detailed in the Statement of Investment Principles (SIP).

**Letting Employer**

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

**LGPS**

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

**Liabilities**

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

**Long-term cost efficiency**

This is a measure of the extent to which the Fund's policies properly address the need to balance immediate budgetary pressures with the undesirability of imposing an excessive debt burden on future generations.

**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 Termination 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 can be used as a benchmark to assess the level of reliance on future investment returns in the funding strategy and therefore the level of risk appetite in a Funds choice of investment strategy.

**Ongoing 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 determined based on the expected long term return achieved on the Fund's investments. This is expressed as an expected return over CPI.

**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.

**Payment Plans**

Include DDA's and DSA's as defined above.

**Phasing/stepping of contributions**

On occasions where 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 of the Employers' Contribution**

See definition of Employer's Primary Contribution Rate.

**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 Regulations, which must be updated at least every three years at the conclusion of the formal valuation. This is completed by the Actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three-year period until the next valuation is completed.

**Real Return or Real Discount Rate**

A rate of return or discount rate net of (CPI) inflation.

**Recovery Plan / Spread Period**

If the funding level of an employer is not equal to 100% at the valuation date (i.e. the assets of the employer are more or less than the liabilities), a recovery plan may be needed to return the funding level back to 100% over a fixed period ("the recovery period or surplus spread period", as defined in the FSS). The recovery plan will set out the Secondary contributions payable by an employer over the recovery / spread period. Secondary contributions can be positive or negative (i.e. an off-set to future accrual costs) but there are restrictions over which negative Secondary contributions will be applied, as set out in the Fund's policy.

**SAB Funding Basis or SAB Basis**

A set of actuarial assumptions determined by the LGPS Scheme Advisory Board (SAB). Its purposes are to set out the funding position on a standardised approach so that comparisons can be made with other LGPS Funds, and to assist with the "Section 13 review" as carried out by the Government Actuary's Department. The assumptions used can be substantially different from the actuarial assumptions used to calculate the Fund's solvency funding position and contribution outcomes for employers in the local funding valuation.

**Scheduled bodies**

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

**Scheme Employers**

Organisations that participate in the Fund.

**Secondary Rate of the Employer's Contribution**

An adjustment to the Primary Rate to reflect any past service deficit or surplus, to arrive at the rate each employer is required to pay. The Secondary Rate in the NESPF is typically expressed as a percentage adjustment to the Primary Rate, but can be expressed as a cash adjustment in each of the three years beginning 1 April in the year following that in which the valuation date falls. 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 subject to a minimum of zero. Secondary Rates for the whole fund in each of the three years shall also be disclosed. These will be

calculated as the weighted average based on the whole fund payroll in respect of percentage rates and as a total amount in respect of cash adjustments.

### **Section 13 Valuation**

In accordance with Section 13 of the Public Service Pensions Act 2013, the Government Actuary's Department (GAD) have been appointed by Scottish ministers in connection with reviewing the 2023 Scottish 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.

### **Strain Costs**

The costs arising when members retire before their normal retirement date and receive their pensions immediately without actuarial reduction. So far as the Fund is concerned, where the retirements are not caused by ill-health, these costs are invoiced directly to the retiring member's employer at the retirement date and treated by the Fund as additional contributions, unless agreed with the Administering Authority. The costs are calculated by the Actuary.

### **Surplus Buffer**

Where an employer has a funding level above 100%, this is the surplus held back to act as a cushion against future adverse experience. It is retained in the employer's asset share, rather than used to reduce future contributions, to aid future contribution rate stability.

### **Surplus Spread Period**

See definition of Recovery Plan/Spread period

### **Suspension Notice**

A notice that may be issued to an employer to suspend that employer's liability to pay an exit payment in circumstances where the employer would otherwise exit. Should a notice be made, the employer must continue to make such contributions towards the liabilities of the fund in respect of benefits for the employer's current and former employees until a new and satisfactory valuation is carried out and the suspension notice is withdrawn. A side legal agreement may be required alongside such notices.

### **Valuation Funding Basis**

See definition of Ongoing Funding Basis.

### **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.