DRAFT

FUNDING STRATEGY STATEMENT

ABERDEEN CITY COUNCIL TRANSPORT PENSION FUND

{NOVEMBER} 2017

Aberdeen City Council

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

I

EXECUTIVE SUMMARY

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

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

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

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

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

THE FUND’S OBJECTIVE

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

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

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

SOLVENCY AND LONG TERM COST EFFICIENCY

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

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

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

DEFICIT RECOVERY PLAN AND CONTRIBUTIONS

As the solvency level of the Fund is 93% at the valuation date i.e. the assets of the Fund are less than the liabilities, a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall, which will increase ongoing contribution requirements.

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

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

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

ACTUARIAL ASSUMPTIONS

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

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

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

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

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

FUND PRACTICES

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

1. Covenant assessment and monitoring

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

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

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

CONTENTS

APPENDICES

1 INTRODUCTION

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

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

BENEFITS

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

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

EMPLOYER CONTRIBUTIONS

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

PRIMARY RATE

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

SECONDARY RATE

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

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

2
PURPOSE OF FSS IN POLICY TERMS

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

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

The purpose of this Funding Strategy Statement is therefore:

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

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

3
AIMS AND PURPOSE OF THE FUND

THE AIMS OF THE FUND ARE TO:

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

THE PURPOSE OF THE FUND IS TO:

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

4
RESPONSIBILITIES OF THE KEY PARTIES

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

KEY PARTIES TO THE FSS

The **Administering Authority** should:

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

The **Individual Employer** should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain, and
- have regard to the Pensions Regulator's focus on data quality and comply with any requirement set by the Administering Authority in this context, and
- notify the Administering Authority promptly of any changes to membership which may affect future funding.

The **Fund Actuary** should:

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

5
SOLVENCY FUNDING TARGET

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

SOLVENCY AND LONG TERM EFFICIENCY

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

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

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

DETERMINATION OF THE SOLVENCY FUNDING TARGET AND RECOVERY PLAN

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

Underlying these assumptions are the following two tenets:

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

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

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

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

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

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

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

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

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

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

FUNDING FOR NON-ILL HEALTH EARLY RETIREMENT COSTS

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

TERMINATION APPROACH

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

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

6

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

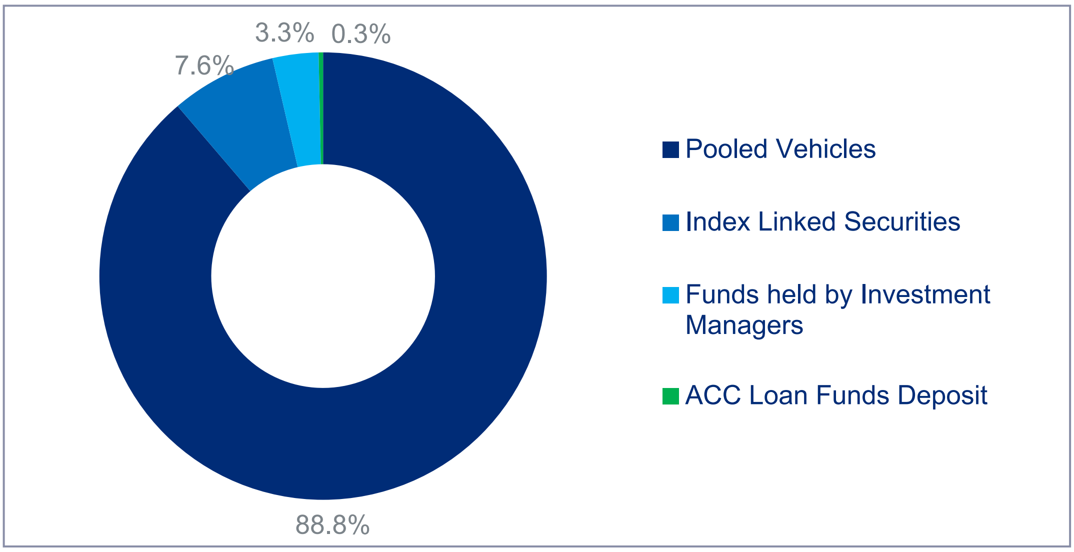
The results of the 2017 valuation show the liabilities to be 93% covered by the current assets.

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

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

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

The investment strategy (at 31 March 2017) is:



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

DE-RISKING OBJECTIVE/FLIGHT PATH FRAMEWORK

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

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

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

7 IDENTIFICATION OF RISKS AND COUNTER-MEASURES

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

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

FINANCIAL

The financial risks are as follows:-

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

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

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

DEMOGRAPHIC

The demographic risks are as follows:-

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

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

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

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

INSURANCE OF CERTAIN BENEFITS

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

REGULATORY

The key regulatory risks are as follows:-

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

GOVERNANCE

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

Governance risks are as follows:-

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

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

8
MONITORING AND REVIEW

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

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

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

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

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

APPENDIX A - ACTUARIAL METHOD AND ASSUMPTIONS

METHOD

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

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

Investment return (discount rate)

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

Inflation (Consumer Prices Index)

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

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

Salary increases

In relation to benefits earned prior to 1 April 2015, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 2.0% p.a. over the inflation (CPI) assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint as budgeted in the employer's financial plan. The allowance for short term pay restraint, is a salary increase assumption of CPI, equal to 2.9% for the year to 2018.

Pension increases/Indexation of CARE benefits

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

DEMOGRAPHIC ASSUMPTIONS

Mortality/Life Expectancy

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

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

Commutation

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

Other Demographics

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

Expenses

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

Discretionary Benefits

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

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

Long-term yields	
Market implied RPI inflation	3.4% p.a.
Investment return/Discount Rate	1.6% p.a.
CPI price inflation	2.9% p.a.
Long Term Salary increases	4.9% p.a.
Short Term Salary increases	2.9% for the year to 31 March 2018
Pension increases/indexation of CARE benefits	2.9% p.a.

Life expectancy assumptions

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

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

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

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

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

APPENDIX B – EMPLOYER RECOVERY PLAN

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

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

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

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

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

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

Other factors affecting the Employer Recovery Plan

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

APPENDIX C - GLOSSARY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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