



North East Scotland Pension Fund

Funding Strategy Statement

May 2022

Aberdeen City Council

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

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Executive Summary

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

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

The details contained in this Funding Strategy Statement will have a financial and operational impact on all participating employers in the North East Scotland Pension Fund.

It is imperative therefore that each existing or potential employer is aware of the details contained in this statement.

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

MEETING THE FUND’S SOLVENCY OBJECTIVE



The Administering Authority’s long term objective is for the Fund to achieve and maintain a 100% solvency level over a reasonable time period. Contributions are set in relation to this objective which means that once 100% solvency is achieved, if assumptions are borne out in practice, there would be sufficient assets to pay all benefits earned up to the valuation date as they fall due.

However, because financial and market conditions/outlook change between valuations, the assumptions used at one valuation may need to be amended at the next to meet the primary objectives. This in turn means that contributions will be subject to change from one valuation to another.

This objective is considered on an employer specific level when setting individual contribution rates so each employer has the same fundamental objective in relation to their liabilities. The general principle adopted by the Fund is that the assumptions used, taken as a whole, will be chosen sufficiently prudently for this objective to be reasonably achieved in the long term at each valuation.

The funding strategy set out in this document has been developed alongside the Fund's investment strategy on an integrated basis taking into account the overall financial and demographic risks inherent in the Fund to meet the objective for all employers over different periods. The funding strategy includes appropriate margins to allow for the possibility of adverse events (e.g. material reduction in investment returns, economic downturn and higher inflation outlook) leading to a worsening of the funding position which would normally lead to volatility of contribution rates at future valuations if these margins were not included.

This prudence is required by the Regulations and guidance issued by professional bodies and Government agencies to assist the Fund in meeting its primary solvency objective. Individual employer results will also have regard to their covenant strength and the investment strategy applied to the asset shares of those employers.



LONG TERM COST EFFICIENCY

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

Employer contributions are also set in order to achieve long term cost efficiency. Long term cost-efficiency requires that any funding plan must provide equity between different generations of taxpayers. This means that the contributions must not be set at a level that is likely to give rise to additional costs in the future which fall on later generations of taxpayers or put too high a burden on current taxpayers. The funding parameters and assumptions e.g. deficit recovery period must have regard to this requirement which means a level of prudence is needed. Furthermore, the FSS must have regard to the desirability of maintaining as nearly constant a primary rate of contribution as possible.

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

efficiency" of the Local Government Pension Scheme (Scotland) (the "LGPS") so far as relating to the Fund.

SURPLUS/DEFICIT SPREAD PERIOD AND CONTRIBUTIONS



As the solvency level of the Fund is 103% at the 2020 valuation date i.e. the assets of the Fund are greater than the liabilities, the surplus can potentially be used to reduce ongoing contribution requirements. However, the funding position at individual employer level will vary and for some employers a deficit recovery plan needs to be implemented such that additional contributions are paid into the Fund to meet the shortfall.

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

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

The period for recovering any deficit will vary by employer and this is covered in further detail in Section 5.

Where there is a material increase in contributions required at this valuation the employer will be able to 'phase in' their contributions over a period of 3 years in a pattern agreed with the Administering

Authority and depending on the affordability of contributions as assessed considering the covenant of an employer, with effect from 1 April 2021.

The government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. A consultation was issued in July 2020, which confirms that the remedy will have the effect of removing the current age criteria applied to the underpin implemented in 2015 for the LGPS, which would then apply to all eligible members who were in service on or before 31 March 2012. The relevant estimated costs of the remedy have been quantified and notified to employers on this basis. The final funding position and certified contributions for each employer include the estimated costs of the McCloud remedy.



ACTUARIAL ASSUMPTIONS

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

The discount rate in excess of CPI inflation (the “real discount rate”) has been derived from the expected return on the Fund’s assets based on the long term strategy set out in its Statement of Investment Principles (SIP). When assessing the appropriate prudent discount rate, consideration has been given to the level of expected asset returns in excess of CPI inflation (i.e. the rate at which the benefits in the LGPS generally increase each year). It is proposed at this valuation the real return over CPI inflation for determining the past service liabilities is 1.25% per annum and 1.50% per annum for determining the future service (“Primary”) contribution rates. This compares to 1.75% per annum (past and future) at the last valuation.

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

Where warranted by an employer’s circumstances, the Administering Authority retains the discretion to apply an adjusted discount rate to reflect the termination assumptions for that employer if it were to

exit the Fund to protect the Fund as a whole. Such cases will be determined by the Section 95 Officer and reported to the Committee.

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

EMPLOYER ASSET SHARES



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

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



FUND POLICIES

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

1. Covenant Assessment and Monitoring Policy

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

The strength of employer covenant can be subject to substantial variation over relatively short periods of time and, as such, regular monitoring and assessment is vital to the overall risk management and governance of the Fund. The employers' covenants will be assessed and monitored objectively in a

proportionate manner, and an employer's ability to meet its obligations in the short and long term will be considered when determining its funding strategy.

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

2. Admitting employers to the Fund

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

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

The key objective for the Fund is to only admit employers where the risk to the Fund is mitigated as far as possible. Certain employers may be required to provide a guarantee or alternative security before entry will be allowed, in accordance with the Regulations and Fund policies.

3. Admission Policy, Termination Policy, Flexibility for Exit Payments and Deferred Debt Agreements

When an employer ceases to participate within the Fund, it becomes an exiting employer under the Regulations. The Fund is then required to obtain an actuarial valuation of that employer's liabilities in respect of the benefits of the exiting employer's current and former employees, along with a termination contribution certificate. At the discretion of the Administering Authority, suspension notices may be agreed to in certain circumstances – see Termination Policy for further details.

Where there is **no guarantor** who would subsume the liabilities of the exiting employer, the Fund's policy is that a discount rate linked to a minimum risk basis and a more prudent longevity assumption is used for assessing liabilities on termination. With the exception of where a suspension notice has been issued, any exit payments due should be paid immediately although instalment plans will be considered by the Administering Authority on a case by case basis. Any exit credits (surplus assets

over liabilities) will be paid from the Fund to the exiting employer . The Administering Authority also reserves the right to modify this approach on a case by case basis if circumstances warrant it.

Where there is a **guarantor** who would subsume the assets and liabilities of the outgoing employer the policy is that any deficit or surplus would normally be subsumed into the guarantor and taken into account at the following valuation. This is subject to agreement from all interested parties who will need to consider any separate contractual agreements that have been put in place between the exiting employer and the guarantor. In some instances an exit debt may be payable by an outgoing employer before the assets and liabilities are subsumed by the guarantor, this will be considered on a case-by-case basis. In the case of a service which has been outsourced, this will be determined by the commercial contract and arrangements which exist between the guarantor and the outgoing employer. Where the outgoing employer is responsible for an exit debt, an exit credit may be payable to the outgoing employer if a surplus of assets over liabilities exists on termination of an admission agreement. This would be based on a determination by the Administering Authority. Please see the termination policy for full details.

The policy for repayment of exit debts:

The default position for exit payments is that they are paid in full at the point of exit (adjusted for interest where appropriate). At the discretion of the administering authority, payment plans over an agreed period or a Deferred Debt Agreement may be entered into (subject to the Fund's policy in relation to flexibility for exit payments) if an employer makes a request in writing outlining the reasons for such a request. Any deviation from this 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 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. Further details are set out with in the relevant Appendix.

2

Introduction

The Local Government Pension Scheme (Scotland) Regulations 2018 (as amended) (“the 2018 Regulations”), the Local Government Pension Scheme (Transitional) Regulations 2014 (“the 2014 Transitional Regulations”) (collectively; “the Regulations”) provide the statutory framework from which the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The key requirements for preparing the FSS can be summarised as follows:

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

Benefits

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

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

Employer Contributions

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

Primary Rate

The “Primary rate” for an employer is the contribution rate required to meet the cost of the future accrual of benefits, including ancillary death in service and ill health benefits together with administration costs. It is expressed as a percentage of pensionable pay, ignoring any past service surplus or deficit, but allowing for any employer-specific circumstances, such as its membership profile, the funding strategy adopted for that employer, the actuarial method used and/or the employer’s covenant.

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

Secondary Rate

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

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

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

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

3

Purpose of FSS in Policy Terms

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

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

The purpose of this Funding Strategy Statement is therefore:

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

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

4

Aims and Purpose of the Fund

The aims of the Fund are to:

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

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of Fund benefits, transfer values, exit credits, costs, charges and expenses as defined in the Regulations.

5

Responsibilities of the Key Parties

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

Key parties to the FSS

The **Administering Authority** should:

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

The **Individual Employer** should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)

- pay all contributions, including their own as determined by the actuary, promptly by the due date
- develop a policy on certain discretions and exercise those discretions as permitted within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain
- have regard to the Pensions Regulator's focus on data quality and comply with any requirement set by the Administering Authority in this context
- notify the Administering Authority promptly of any changes to membership which may affect future funding.
- understand the pensions impacts of any changes to their organisational structure and service delivery model, and
- understand that the quality of the data provided to the Fund will directly impact on the assessment of the liabilities and contributions. In particular, any deficiencies in the data would normally result in the employer paying higher contributions than otherwise would be the case if the data was of high quality.

The **Fund Actuary** should:

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

6

Solvency Funding Target

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

Solvency and Long Term Efficiency

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

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

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

Determination of the solvency Funding Target and Recovery Plan

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

Underlying these assumptions are the following two tenets:

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

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

In considering this the Administering Authority, based on the advice of the Fund Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful potentially taking into account any changes in funding after the valuation date up to the finalisation of the valuation by 31 March 2021 at the latest.

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

Individual employer contributions will be expressed and certified as two separate elements:

- the **Primary rate**: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits and ancillary death in service and ill health benefits
- the **Secondary rate**: a percentage of pensionable payroll over 2021/24 in respect of an employer's surplus or deficit

For any employer, the total contributions they are actually required to pay in any one year is the sum of the Primary and Secondary rates (subject to an overall minimum of zero). Both elements are subject to further review from April 2024 based on the results of the 2023 actuarial valuation.

Spreading of Surplus / recovery of Deficit contributions

It is the Fund's objective that, where a deficit exists, it is eliminated as quickly as the participating employers can reasonably afford based on the Administering Authority's view of the employer's covenant and risk to the Fund.

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

the monetary amount requested via a reduction in overall deficit contributions payable. The Administering Authority does retain ultimate discretion in applying these principles for individual employers on grounds of affordability and covenant strength.

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

- The Fund does not believe it appropriate for contribution reductions to apply compared to the existing funding plan where deficits remain unless there is compelling reason to do so.
- Subject to consideration of affordability, where a deficit exists, as a general rule the deficit recovery period will reduce by at least 3 years for employers at this valuation when compared to the preceding valuation. This is to target full solvency over a similar (or shorter) time horizon. This is to maintain (as far as possible) equity between different generations of taxpayers and to protect the Fund against the potential for an unrecoverable deficit. The deficit recovery period will be set to at least cover the expected interest costs (actual interest costs will vary in line with investment performance) on the deficit. Where an employer is expected to exit the Fund then in normal circumstances, any deficit would be recovered over the remaining period to exit. Where an employer is closed to new entrants then, as a general rule, the spread period should be no more than the average expected future working lifetime of the active membership.
- Employers will have the freedom to pay above the minimum contributions if they so wish. Subject to affordability considerations and other factors, a bespoke period may be applied in respect of particular employers where the Administering Authority considers this to be warranted. The average recovery period adopted by all employers will be set out within the Actuary's report. Employers will be notified of their individual deficit recovery period as part of the provision of their individual valuation results.
- Where an employer is in surplus this will be run off over a period determined by the Administering Authority on the advice of the Actuary. This will depend on the nature of employer, allowing for the financial covenant strength and reasonable affordability of contributions. The objective is to maintain stability of total contributions at this and future valuations. Where an employer is expected to exit the Fund then in normal circumstances, the surplus would be spread over the remaining period to exit.
- In determining the actual recovery period to apply for any particular employer or employer grouping, the Administering Authority may take into account some or all of the following factors:
 - The size of the funding shortfall / surplus;
 - The business plans of the employer;

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

The objective is to recover any deficit or remove any surplus over a reasonable timeframe, and this will be periodically reviewed.

- Where increases (or decreases) in employer contributions are required from 1 April 2021, following completion of the 2020 actuarial valuation, the increase (or decrease) from the rates of contribution payable in the year 2021/22 may be implemented in steps, over a maximum period of 3 years, depending on affordability of contributions as determined by the administering authority. However, where a surplus exists or where there has been a reduction in contributions paid in respect of an employer's deficit at the valuation, the Fund would not consider it appropriate for any increase in contributions paid in respect of future accrual of benefits to be implemented in steps.
- As part of the process of agreeing funding plans with individual employers, the Administering Authority will consider the use of contingent assets and other tools such as bonds or guarantees that could assist employing bodies in managing the cost of their liabilities or could provide the Fund with greater security against outstanding liabilities.
- It is acknowledged by the Administering Authority that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Administering Authority therefore would be willing to use its discretion to accept an evidence-based affordable level of contributions for the organisation for the three years 2021/2024. Any application of this option is at the ultimate discretion of the Fund officers and Section 95 officer in order to effectively manage risk across the Fund. It will only be considered after the provision of the appropriate evidence as part of the covenant assessment and also the appropriate professional advice.
- For those bodies identified as having a weaker covenant, the Administering Authority will need to balance the level of risk plus the solvency requirements of the Fund with the sustainability of the organisation when agreeing funding plans.
- Notwithstanding the above principles, the Administering Authority, in consultation with the actuary, has also had to consider whether any exceptional arrangements should apply in particular cases.

Employers Exiting the Fund

- Employers must notify the Fund as soon as they become aware of their planned exit date. Where appropriate, or at the request of the Scheme Employer, the Fund will review their certified contribution in order to target a fully funded position at exit. Consideration will be given to any cap and collar arrangements when reviewing contribution rates.
- On the cessation of an employer's participation in the Fund, in accordance with the Regulations, the Fund Actuary will be asked to make a termination assessment, with a different actuarial basis applied to reflect whether or not the outgoing employer has a guarantor participating in the Fund who is prepared to absorb the pension obligations of the former employees. The detail is provided in the Termination Policy in the relevant Appendix which covers operational procedure (including details of repayment plans over an agreed period and Deferred Debt Agreements).
- In all cases the Administering Authority reserves the right to apply a different approach at its sole discretion, taking into account the risk associated with an employer in proportion to the Fund as a whole. Any employer affected will be notified separately.

Funding for Non-III Health Early Retirement Costs

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

7

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

The results of the 2020 valuation show the liabilities to be 103% covered by the current assets.

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

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

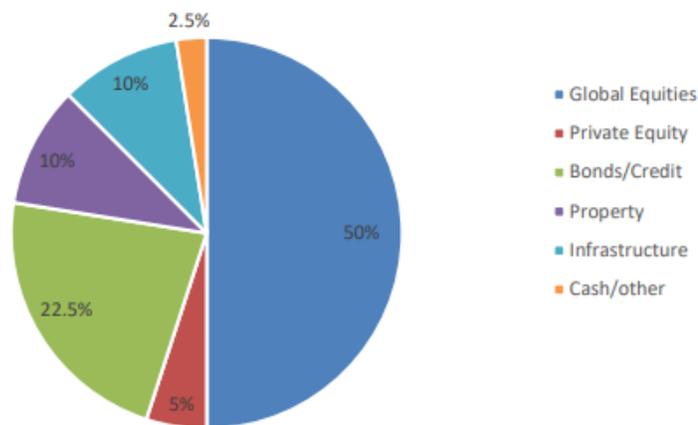
Investment of the Fund's assets in line with the minimum risk portfolio would minimise fluctuations in the Fund's ongoing funding level between successive actuarial valuations.

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

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

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

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



Based on the investment strategy above and the Actuary’s assessment of the return expectations for each asset class, this leads to an overall best estimate average expected return of 1.95% per annum in excess of CPI inflation as at the valuation date. For the purposes of setting funding strategy however, the Administering Authority believes that it is appropriate to take a margin for prudence on these return expectations. This margin, however, has been reduced to take account of the risk management strategies implemented to reduce the volatility of returns within the investment strategy.

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

Investment strategy buckets

The Fund is considering the merits of implementing a choice of investment strategies to use with employers, which would 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).

The “investment” strategies would be called:

- Standard risk strategy
- Medium risk strategy
- Lower risk strategy

The current Fund investment strategy will apply to the “standard risk”. The “medium risk strategy” and “lower risk strategy” will reduce the level of investment risk taken, and may be appropriate particularly for those employers that are considering leaving the Fund. In addition any orphaned liabilities once an employer exits the Fund will generally be moved into the lower risk strategy.

The final strategic allocation for each strategy has not yet been finalised but once implemented it will be reflected in future updates of the Statement of Investment Principles.

Once 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, the 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 the employer (typically following discussions with the employer) into a medium or lower risk investment strategy to help protect against a deterioration in the funding position and protect the Fund as a whole.

8

Identification of Risks and Counter-Measures

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

The Administering Authority has been advised by the Fund Actuary that the greatest risk to the funding level is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from that assumed in the long term. The Actuary's formal valuation report includes a quantification of the key risks in terms of the effect on the funding position.

Financial

The financial risks are as follows:-

- Investment markets fail to perform in line with expectations
- Any risk management policies fail to perform in line with expectations
- Market outlook moves at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.

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

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

Demographic

The demographic risks are as follows:-

- Future changes in life expectancy (longevity) that cannot be predicted with any certainty
- Potential strains from ill health retirements, over and above what is allowed for in the valuation assumptions for employers
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)
- Unanticipated acceleration of the maturing of the Fund resulting in materially negative cashflows and shortening of liability durations

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

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

Apart from the regulatory procedures in place to ensure that ill-health retirements are properly controlled, **employing bodies should be doing everything in their power to minimise the number of ill-health retirements.**

Early retirements for reasons of redundancy and efficiency do not affect the solvency of the Fund because they are the subject of a direct charge.

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

Insurance of certain benefits

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

Regulatory

The key regulatory risks are as follows:-

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

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

Governance

The Fund has done as much as it believes it reasonably can to enable employing bodies and Fund members to make their views known to the Fund and to participate in the decision-making process. The first draft of this FSS was consulted on during Q4 2020. The revisions to the FSS have been incorporated into this draft and the updated draft was finalised following the Committee meeting on 26 March 2021. Further revisions have been incorporated into this updated draft and are to be finalised following the consultation period and the Committee meeting on 24 June 2022.

Governance risks are as follows:-

- The quality of membership data deteriorates materially due to breakdown in processes for updating the information resulting in liabilities being under or overstated
- Administering Authority unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements) with the result that contribution rates are set at too low a level
- Administering Authority not advised of an employer closing to new entrants, something which would normally require an increase in contribution rates
- An employer ceasing to exist with insufficient funding or adequacy of a bond. Where there is a guarantor body in place, any outstanding funding deficit that is not recovered from the outgoing employer / bond will need to be paid by the guarantor (or the assets and liabilities for the outgoing employer will need to be subsumed by the guarantor). For cases where there is no guarantor or bond in place, any outstanding funding deficit that is not recovered from the outgoing employer will need to be subsumed by the Fund as a whole and spread across all employers.
- An employer ceasing to exist without prior notification, resulting in a large exit credit requirement from the Fund impacting on cashflow requirements.
- Changes in the Committee membership.

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

9

Monitoring and Review

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

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

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

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

When monitoring the funding strategy, if the Administering Authority considers that any action is required, the relevant employing authorities will be contacted. In the case of admitted bodies, there is statutory provision for rates to be amended between valuations and this will be considered in conjunction with the employer affected and any associated guarantor of the employer's liabilities (if relevant).

Cost Management Process

The cost management process was set up by HMT, with an additional strand set up by the Local Government Pension Scheme (Scotland) Advisory Board (for the Scottish LGPS). The aim of this was

to control costs for employers and taxpayers via adjustments to benefits and/or employee contributions.

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

The outcome of the initial cost management valuation was expected to be implemented by now, based on data from the 2017 valuations for the Scottish LGPS. This had been put on hold due to age discrimination cases (the McCloud judgment) brought in respect of the firefighters and judges schemes, relating to protections provided when the public sector schemes were changed (which was on 1 April 2015 for the Scottish LGPS). The cost cap has now been un-paused and we expect more detail to emerge in due course over 2022. Consideration of the outcome of this process would be expected to be taken in to account at the next valuation (in 2023) unless the outcome requires this to be done prior to then.

The McCloud judgment

The government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. A consultation was issued in July 2020, which confirms that the remedy will have the effect of removing the current age criteria applied to the underpin implemented in 2015 for the LGPS, which would then apply to all eligible members who were in service on or before 31 March 2012. The relevant estimated costs of the remedy have been quantified and notified to employers on this basis. The final funding position and certified contributions for each employer include the estimated costs of the McCloud remedy.

As a consequence of McCloud, cost management had been paused until recently (HMT and GAD are now considering the LGPS specific impact before commenting on the outcomes). No allowance for cost management has been made in this valuation. This will be reconsidered once the final outcomes are known.

Appendix A – Actuarial Method and Assumptions

Method

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

Financial assumptions – solvency Funding target

Investment return (discount rate)

The discount rate has been derived based on the expected return on the Fund assets based on the long term strategy set out in the Statement of Investment Principles (SIP). It includes appropriate margins for prudence. When assessing the appropriate discount rate consideration has been given to the returns in excess of CPI inflation (as derived below). The discount rate at the valuation date has been derived based on an assumed return of 1.25% per annum above CPI inflation i.e. a real return of 1.25% per annum equating to a total discount rate of 3.35% per annum. This real return will be reviewed from time to time based on the investment strategy, market outlook and the Fund's overall risk metrics. The discount rate will be reviewed as a matter of course at the time of a formal valuation or a formal employer rate review.

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

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date (reflecting the profile and duration of the Fund's accrued liabilities) but subject to an adjustment due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index.

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

Salary increases

In relation to benefits earned prior to 1 April 2015, the assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint for some employers as budgeted in their financial plan. Depending on the circumstances of the employer, the variants on short term pay that have been applied are either no allowance or allowances based on evidence from the employer of 1% or 2% per annum, or alternatively assuming the increase will be in line with the CPI assumption set out above, for each year from the valuation date up to 31 March 2023. The allowance made has been notified to each employer separately on their individual results schedule.

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

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the CPI (e.g. Guaranteed Minimum Pensions where the LGPS is not required to provide full indexation). The exception to this is for members who will reach state pension age after 5 April 2021. In line with expected future changes to the regulations, we have allowed for increases on Guaranteed Minimum Pensions to increase in line with the inflation (CPI) assumption described above.

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

Demographic assumptions

Mortality/Life Expectancy

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the Fund. The mortality base tables used are set out below, with a loading reflecting Fund specific experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary.

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

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

	Male Life Expectancy at 65		Female Life Expectancy at 65	
	2017	2020	2017	2020
Pensioners	22.6	21.4	24.6	24.1
Actives aged 45 now	25.5	23.0	27.8	26.2
Deferreds aged 45 now	23.4	21.7	26.6	25.2

For example, a male pensioner, currently aged 65, would be expected to live to age 86.4. Whereas a male active member aged 45 would be expected to live until age 88.0. This is a reflection of the expected improvement in life expectancy over the next 20 years in the assumptions above.

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

Commutation

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

Other Demographics

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

Expenses

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

Discretionary Benefits

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

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

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

As future service contributions are paid in respect of benefits built up in the future, the Primary rate should take account of the market conditions applying at future dates, not just the date of the

valuation, thus it is justifiable to use a slightly higher expected return from the investment strategy. In addition, the future liabilities for which these contributions will be paid have a longer average duration than the past service liabilities as they relate to active members only.

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

Investment Strategies

At the actuarial valuation, following implementation, for employers not in the standard risk strategy, the investment return / discount rate assumption will be adjusted accordingly.

Employer Asset Shares

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

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

At each review, cashflows into and out of the Fund relating to each employer, any movement of members between employers within the Fund, along with investment return earned on the asset share, are allowed for when calculating asset shares at each valuation. The investment return credited will depend on which investment strategy is applied to the employers' assets.

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

Summary of key whole Fund assumptions used for calculating funding target and cost of future accrual (the “primary rate”) for the 2020 actuarial valuation

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

Life expectancy assumptions

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

	Normal Health	114% S3PMA_CMI_2019 [1.75%]
		101% S3PFA_M_CMI_2019 [1.75%]
		150% S3PMA_CMI_2019 [1.75%]
Annuitant	Dependant	104% S3DFA_CMI_2019 [1.75%]
		136% S3IMA_CMI_2019 [1.75%]
	Ill Health	144% S3IFA_CMI_2019 [1.75%]

		146% S3PMA_CMI_2019 [1.75%]
	Future Dependant	
		121% S3DFA_CMI_2019 [1.75%]
		121% S3PMA_CMI_2019 [1.75%]
	Normal Health	
Active		101% S3PFA_M_CMI_2019 [1.75%]
		134% S3IMA_CMI_2019 [1.75%]
	Ill Health	
		151% S3IFA_CMI_2019 [1.75%]
		144% S3PMA_CMI_2019 [1.75%]
Deferred	All	
		116% S3PFA_M_CMI_2019 [1.75%]
		153% S3PMA_CMI_2019 [1.75%]
Future Dependant	Dependant	
		128% S3DFA_CMI_2019 [1.75%]

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

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

Appendix B – Admission Policy, Termination Policy, Flexibility for Exit Payments and Deferred Debt Agreements

Introduction

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

- Admission bodies are required to have an "admission agreement" with the Fund. In conjunction with the Regulations, the admission agreement sets out the conditions of participation of the admission body including which employees (or categories of employees) are eligible to be members of the Fund.
- Scheme Employers have a statutory right to participate in the LGPS and their staff therefore can become members of the LGPS at any time, although some organisations (Part 2 Scheme Employers) do need to designate eligibility for its staff.

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

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

Entry to the Fund

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

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

- Uncertainty over the security of the organisation's funding sources e.g. the body relies on voluntary or charitable sources of income or has no external funding guarantee/reserves;
- If the admitted body has an expected limited lifespan of participation in the Fund;
- The average age of employees to be admitted and whether the admission is closed to new joiners.

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

Admitted bodies providing a service

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

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

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

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

An exception to the above policy applies if the guarantor is not a participating employer within the NESPF, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the NESPF the Administering Authority may in this case treat the

admission body as pre-funding for termination, with contribution requirements assessed using the minimum risk methodology and assumptions.

Pre-Funding for Termination

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

Exiting the Fund

Assumptions to adopt for termination assessment

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 will be where the employer does not have a guarantor in the Fund who has agreed to subsume the orphaned liabilities from the exiting employer.

The assumptions will typically be applied based on gilt yields and inflation based on the duration of the employer liabilities. Alternative approaches may be used on the advice of the actuary to be consistent with any modified investment strategy applying to the employer.

In addition to using a more cautious discount rate, the Actuary will also use a more prudent mortality assumption when assessing the size of the liabilities for termination purposes to protect against future adverse demographic experience. In particular, the Actuary will assume a higher improvement rate for future life expectancy than is used for ongoing funding purposes by increasing the long term

improvement rate to 2.25% per annum. The rate 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.

Termination of an employer's participation

i) Admission bodies participating by virtue of a contractual arrangement

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

In circumstances where an exiting employer is expected to still be responsible for the termination position, an exit payment/exit credit may be payable from/to the exiting employer. This is subject to “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).

In some instances, the outgoing employer may only be responsible for part of the residual deficit or surplus as per a separate risk sharing agreement. The default is that any surplus would be retained by the Fund in favour of the outsourcing employer/guarantor unless agreed otherwise by all parties. For the avoidance of doubt, where the outgoing employer is not responsible for any costs under a risk sharing agreement then the default position is no exit credit will be paid.

No payment of an exit credit will be payable unless representation is made as set out below:

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

- In the case of a surplus, 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 completion of the final cessation by the Actuary.
- 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 at the next valuation depending on the circumstances.

If requested, the Administering Authority may provide details of the information considered as part of the 'determination'.

As the guarantor will generally absorb the residual assets and liabilities, it is the view of the Actuary that the ongoing valuation basis described above should be adopted for the termination calculations. For the avoidance of doubt this includes any variation to assumptions for those employers whose assets are invested in alternative strategies. This is the way the initial admission agreement would typically be structured i.e. the admission would be fully funded based on liabilities assessed on the valuation basis.

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 below 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 and the representations from the interested parties. For the avoidance of doubt in the case of an Exit Credit the determination process will be followed as set out above.

- **ii) Non-contract based admission bodies with a guarantor in the Fund**

The approach for these will be the same as (i) above and will depend on whether the guarantor is prepared to accept responsibility for residual liabilities.

iii) Admission bodies with NO guarantor in the Fund

These are cases where the residual liabilities would be “orphaned” within the Fund, although it is possible that a bond would be in place. The termination calculation would be on the termination basis as noted above.

The actuarial valuation and the revision of any Rates and Adjustments Certificate in respect of the outgoing admission body must be produced by the Actuary at the time when the admission agreement ends; the policy will always be subject to change in the light of changing economic circumstances and legislation.

The policy for such employers will be:

- In the case of a surplus, the Fund pays the exit credit to the exiting employer following completion of the termination process (within 6 months of completion of the cessation by the Actuary). 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.
- In the case of a deficit, the Fund would require the exiting employer to pay the termination deficit to the Fund as an immediate lump sum cash payment (unless agreed otherwise by the Administering Authority at their sole discretion) following completion of the termination process.

The Administering Authority also reserves the right to modify this approach on a case by case basis at its sole discretion if circumstances warrant it based on the advice of the Actuary. Where the approach is modified, a separate schedule will be provided to that employer. Setting out the approach to adopt and this will be done using consistent principles.

The above funding principles will also impact on the **bond requirements** for certain admitted bodies. The purpose of the bond is that it should cover any unfunded liabilities arising on termination that cannot be reclaimed from the outgoing body.

Allowing for the McCloud Remedy in Termination Valuations

The government has confirmed that a remedy is required for the LGPS in relation to the McCloud judgment. A consultation was issued in July 2020, which confirms that the remedy will have the effect of removing the current age criteria applied to the underpin implemented in 2015 for the Scottish LGPS, which would then apply to all eligible members who were in service on or before 31 March 2012.

As part of any termination assessment, a reasonable estimate for the potential cost of McCloud will be included.

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

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

Policy in relation to the flexibility for spreading exit debt payments 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.

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.

The following policy and processes will be followed in line with the principles set out in the statutory guidance published XX YY 2022.

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

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:
 - 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.
 - The investment strategy that would be applied to the employer e.g. the standard, medium or lower risk strategy which could support the arrangement.
 - Whether an upfront cash payment should be made to the Fund initially to reduce the potential future debt.
 - What the updated secondary rate of contributions would be required up to the next valuation.
 - 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.
 - The advice of the Actuary, covenant, legal and any other specialists necessary.
 - The responsibilities that would apply to the employer while they remain in the Fund.
 - What conditions would trigger the implementation of a revised deficit recovery plan and subsequent revision to the secondary contributions (e.g. provision of security).
 - 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.
 - 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.

Future Terminations

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

'Minimum Risk' Termination basis

The minimum risk financial assumptions that applied at the actuarial valuation date (31 March 2020) are set out below in relation to any liability remaining in the Fund. These will be updated on a case-by-case basis, with reference to prevailing market conditions at the relevant employing body's cessation date.

Minimum risk assumptions	31 March 2020
Discount Rate	0.70% p.a.
CPI price inflation	2.10% p.a.
Pension increases/indexation of CARE benefits	2.10% p.a.

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

In particular, since the valuation date it has been confirmed that RPI inflation will be reformed with effect from 2030 to align the index with the CPIH inflation measure. This therefore needs to be reflected when deriving an updated market estimate of CPI inflation.

For example, when assessing a termination position (at March 2020) we will adjust the market RPI inflation to arrive at the CPI inflation assumption by deducting 0.6% per annum when assessing an employer's termination position. This adjustment will be kept under review over time.

All demographic assumptions will be the same as those adopted for the 2020 actuarial valuation, except in relation to the life expectancy assumption. Given the minimum risk financial assumptions do not protect against future adverse demographic experience a higher level of prudence will be adopted in the life expectancy assumption.

The termination basis for an outgoing employer will include an adjustment to the assumption for longevity improvements over time by increasing the rate of improvement in mortality rates to 2.25% p.a. from 1.75% used in the 2020 valuation for ongoing funding and contribution purposes.

Appendix C – Review of Employer Contributions between Valuations

In line with the Regulations that came into 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. 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 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 and employers will be notified if the Administering Authority becomes aware of any of the following scenarios.

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 (for employers not included in the captive arrangement) or 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 this 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 (once implemented).

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.

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 impact 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 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 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 3 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 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 D – Covenant Assessment and Monitoring Policy

Introduction

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

1.1 ADMISSION BODIES

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

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

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

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

1.2 EMPLOYER COVENANT

An employer's covenant underpins its legal obligation and ability to fund the Scheme now and in the future. The strength of covenant depends upon the robustness of the legal agreements in place and

the likelihood that the employer can meet them. The covenant effectively underwrites the risks to which the Scheme is exposed, including underfunding, longevity, investment and market forces.

An Assessment of employer covenant focuses on determining the following:

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

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

2 RISK

2.1 DEFINITION OF RISK

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

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

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

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

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

2.2 IDENTIFYING RISK

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

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

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

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

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

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

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

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

2.3 LEVELS OF RISK

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

Participating Employers

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

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

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

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

2.4 NATURE OF RISK

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

- a) Non-payment of contributions to the Fund by an employer prior to closure
- b) Premature termination of a contract where market values are depressed relative to the liabilities in respect of an admission body, assessed on consistent assumptions to those adopted in the previous actuarial valuation.
- c) The reality is less favourable than the assumptions used in setting contribution rates for that employer – for instance, lower than expected investment returns, higher than expected rates of early retirement or excessive pay increases.
- d) Additional liabilities created as a result of the body closing, in particular the possible payment of immediate retirement benefits to all those eligible at that time.
- e) A pre-existing deficit in the Fund (past service liability).
- f) A change from open to closed status.

3 ASSESSMENT OF RISK

3.1 RISK CRITERIA

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

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

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

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

- The scale of obligations to the pension scheme relative to the size of the employer's operating cashflow.
- The relative priority placed on the pension scheme compared to corporate finances.
- An estimate of the amount which might be available to the scheme on insolvency of the employer as well as the likelihood of that eventuality.

3.2 RISK PARAMETERS

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

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

4 MONITORING/SCREENING OF THE EMPLOYER COVENANT

4.1 ASSESSING THE EMPLOYER COVENANT

The employer covenant should be assessed objectively and the ability of employers or guarantors to meet their obligations should be viewed in the context of the Fund's exposure to risk and volatility, while preserving the interests of other employers within the Fund. The monitoring of covenant strength by itself does not strengthen the Fund's security; however, it does enable the Fund to anticipate and pre-

empt employer funding issues and thus adopt a proactive approach with a view to reminding employers of their obligations and managing their expectations. In order to objectively monitor the strength of an employer's covenant, adjacent to the risk posed to the Fund, the proposal is for a number of fundamental financial metrics to be appraised to develop an overview of the employer's stability. These financial metrics centre around the following:

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

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

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

4.2 FREQUENCY OF MONITORING

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

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

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

4.3 EMPLOYER MEETINGS

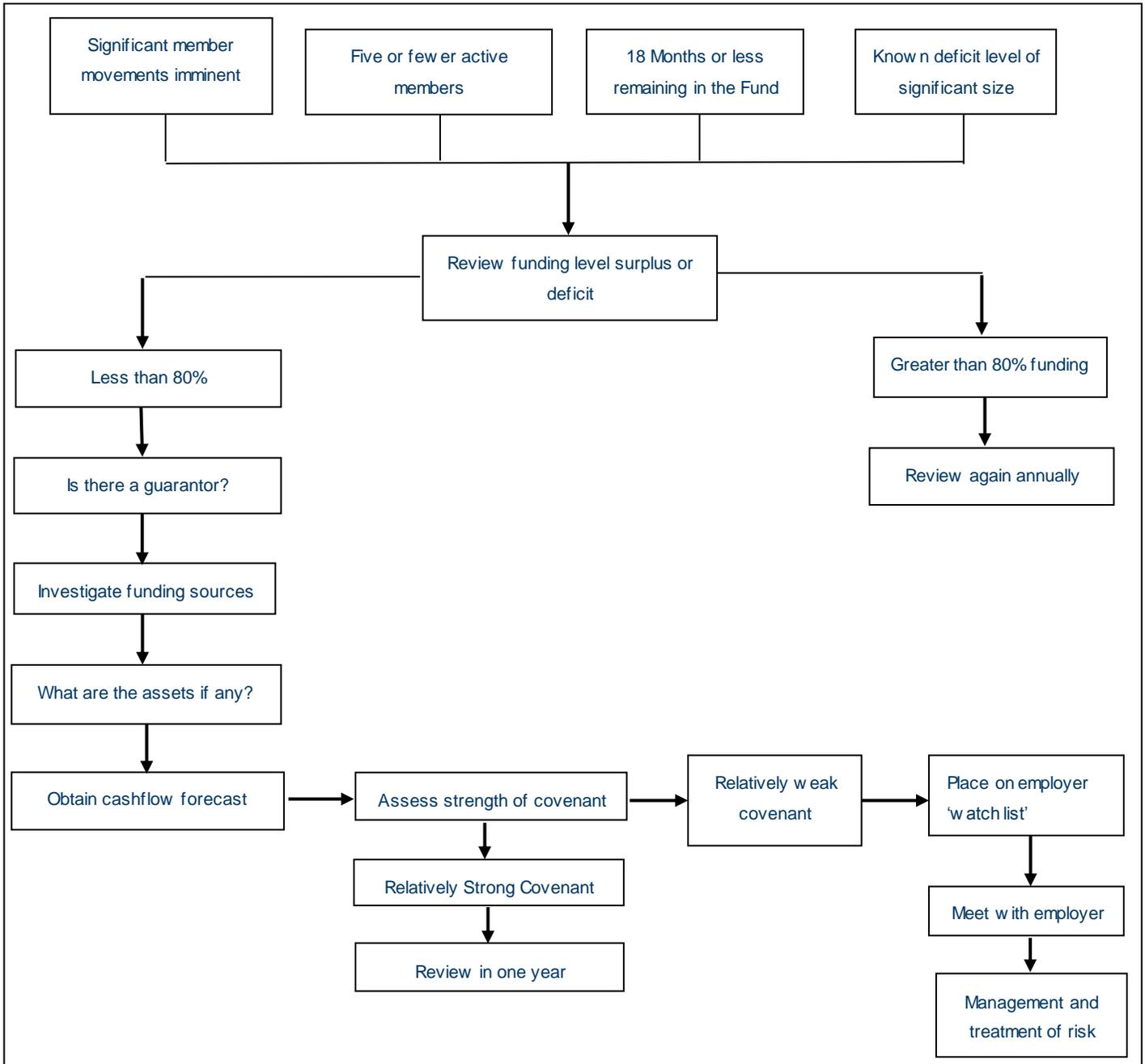
As a basis for the monitoring of employers within the Fund, meetings are to be scheduled with those organisations where there is a particular concern over strength of their covenant, accrual of liabilities

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

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

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

4.4 GUIDE TOWARDS MONITORING OF THE EMPLOYER COVENANT



5 MANAGEMENT OF RISK

5.1 OVERVIEW

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

5.2 INITIAL STEPS

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

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

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

5.3 BOND/GUARANTEE

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

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

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

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

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

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

5.4 SHORTENED RECOVERY PERIOD

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

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

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

5.5 CONTINGENT ASSETS

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

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

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

5.6 PHASED IMPLEMENTATION OF EMPLOYER CONTRIBUTION RATE

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

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

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

5.7 INFLATED EMPLOYER CONTRIBUTION RATE (RISK PREMIUM)

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

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

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

6. TRANSFER OF RISK FOR OUTSOURCED BODIES

6.1 TRANSFER OF RISK

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

7. TREATMENT OF MATERIALISED RISK

7.1 OVERVIEW

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

7.2 TERMINATION OF AN ADMISSION AGREEMENT

In the event of termination of an admission agreement, for any one of the reasons covered in section 2.4, it will be necessary for the Fund actuary to calculate the associated deficit or surplus. The organisation in question will be responsible for paying the actuary's fee for this work, and the Administering Authority reserves the right to include it in the termination assessment and final contribution due from the employer or recharge it directly from the employer. The Fund will emphasise to employers their responsibility for the position upon termination; however, in certain circumstances where an exit payment is required, it may not be possible for an organisation to pay the total

termination deficit in one lump-sum. In this scenario, the Fund would request the organisation provides a payment plan for review and, if this is not satisfactory, consideration will be given to an independent financial and governance review (see 7.6). In addition, in certain circumstances the Fund may agree to issue 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. Should this occur, 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. The Fund reserves the right to require a side legal agreement alongside any suspension notices detailing the terms of the arrangement including for example the length of such a notice, and the conditions for cessation of the agreement/notice.

In addition, at the discretion of the administering authority, payment plans over an agreed period or a Deferred Debt Agreement may be entered into if an employer makes a request in writing outlining the reasons for such a request. Any deviation from this 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 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.

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

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

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

7.4 INDEPENDENT FINANCIAL AND GOVERNANCE STANDING REVIEW BY THIRD PARTY AUDITOR

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

This review would be centred upon the financial measures and wider robustness of the governance of the organisation, particularly with a view to instances of substandard management or negligent practice.

The appraisal also provides the Fund with an external audit of the monitoring and risk aversion process employed, which is aimed at preserving the interests of all other participating employers and/or guarantor. The key objectives of this review will be to evaluate the financial standing and underlying governance arrangements, specifically:

- an assessment of the strength of the balance sheet and, based on this, drawing conclusions on the affordability of proposed termination payments. This element of the review will include, for example, structure/liquidity ratios; and
- a high-level evaluation of the body's overall governance structures and the adequacy of management's medium-term planning arrangements in addressing weaknesses and risks; and
- to develop an assessment methodology that can be applied to bodies in assessing their capability and capacity to manage and meet pension liabilities.

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

Appendix E – Glossary

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

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

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

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

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

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

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

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

Covenant: the assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it

appears that the employer may have difficulties meeting its pension obligations in full over the longer term or affordability constraints in the short term.

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

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

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.

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

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

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

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

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

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

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

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

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

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

Hedging: a strategy that aims to reduce funding volatility using Liability Driven Investment (LDI) or other techniques. This is achieved by investing in assets that capture levels of yields based on agreed trigger levels so the assets mimic the change in liabilities.

Investment Strategy Bucket: this describes a bespoke investment strategy which applies to one or more employers and is dependent on the liability and risk profile.

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

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

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

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

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

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

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

Minimum Risk Basis: an approach where the discount rate used to assess the liabilities is determined based on the market yields of Government bond investments based on the appropriate duration of the liabilities being assessed. This is usually adopted when an employer is exiting the Fund. At the valuation date this was equivalent to a discount rate of CPI less 1.4% p.a.

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

Payment plans: Sometimes known as “Debt Spreading Arrangements” this is where the Fund agree to receiving the payment of the exit Debt in installments across a specified period/payment plan.

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

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

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

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

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

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

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

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

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

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

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

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

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

Section 13 Valuation: in accordance with Section 13 of the Public Service Pensions Act 2014, the Government Actuary's Department (GAD) have been commissioned to advise the Scottish Public Pensions Agency (SPPA) in connection with reviewing the 2020 LGPS actuarial valuations. All LGPS Funds therefore will be assessed on a standardised set of assumptions as part of this process.

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

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.

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

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

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

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