

# Funding Strategy Statement

## Introduction and Purpose

This is the Funding Strategy Statement (FSS) of the West Sussex County Council Pension Fund (“the Fund”), which is administered by West Sussex County Council, (“the Administering Authority”). The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. Importantly:

- Employees’ benefits are guaranteed by the LGPS Regulations.
- Employees’ contributions are fixed in the same Regulations, at a level which covers only part of the cost of the benefits.
- Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee.
- Employers need to pay the balance of the cost of delivering the benefits to members and their dependents.

The purpose of the FSS is to summarise the Administering Authority’s approach to funding its liabilities. This includes reference to the Fund’s other policies but it should be noted that it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework that includes:

- The LGPS Regulations.<sup>1</sup>
- The Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report.<sup>2</sup>
- Actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service.
- The Fund’s Investment Strategy Statement.<sup>3</sup>

The FSS has been prepared by the Administering Authority in collaboration with its actuary, Hymans Robertson LLP, and after consultation with the Fund’s employers. It has been adopted for the purpose of the 2019 Actuarial Valuation and is effective from 1 April ~~2019~~.<sup>4</sup>2020.

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<sup>1</sup> <https://www.lgpsregs.org/>

<sup>2</sup> <https://www.westsussex.gov.uk/about-the-council/pensions/local-government-pension-scheme-lgps/pension-fund/>

<sup>3</sup> <https://www.westsussex.gov.uk/about-the-council/pensions/local-government-pension-scheme-lgps/pension-fund/>

<sup>4</sup> Consultation to be launched (June 2019). Feedback will inform any revisions.

## Important Note

This Funding Strategy Statement (FSS) has been written during a period of significant uncertainty caused by:

- The McCloud case (where the Court of Appeal ruled that the 'transitional protection' offered to some members as part of the recent pension reforms amounts to unlawful discrimination – directly on grounds of age and indirectly on other grounds). The Supreme Court denied the government permission to appeal the Court's judgement in June 2019. The government is required to work with the Employment Tribunal to how the discrimination will be remedied for all the main public service pension schemes.<sup>5</sup>
- The "HM Treasury cost control mechanism" (also introduced as part of the recent pension reforms) being engaged, which may trigger changes to LGPS benefits (currently paused in light of the McCloud case).
- The "Scheme Advisory Board (SAB) cost control mechanism" (also introduced as part of the recent pension reforms) being engaged, which may trigger changes to LGPS benefits and member contributions (also paused in light of the McCloud case).

~~• The Government's decision to appeal the McCloud case.~~

At present there are no timescales for the ~~outcome of this appeal~~ changes to the Schemes to be agreed or the resulting benefit changes which will largely depend on the outcome.

~~The~~ In line with advice from MHCLG and the Scheme Advisory Board (SAB) the Administering Authority has therefore proceeded valued liabilities based on the assumption that the scheme will not change Scheme presently in April place. 2019. As a result:

- Employers should collect employee contributions on the basis of current Regulations
- The 2019 valuations will proceed on the basis of the current benefit and member contribution structure for the purposes of valuing the liabilities.

~~As~~ However, MHCLG and the SAB have also indicated that the Fund should consider the risk of the benefits being changed as a result of McCloud when there are developments, there will need to be reflection on how best to incorporate these into the 2019 Actuarial Valuation employer contribution setting process.

~~• If the Government is successful in its appeal:~~

- ~~— there will be not change to accrued benefits~~
- ~~— changes to future employee benefits are likely to be implemented as part of the "cost control mechanism" (applicable from 1 April 2019)~~
- ~~— employer contribution rates are likely to increase as a result.~~

~~• If the Government is not successful in its appeal:~~

- ~~— . The Actuary has reserved additional prudence within the court will require steps to be taken to compensate employees who were transferred to the new~~

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<sup>5</sup> <https://www.judiciary.uk/wp-content/uploads/2018/12/lord-chancellor-v-mcloud-and-ors-judgment.pdf>

~~Scheme, potentially requiring retrospective changes (from 1 April 2014) for benefits and member contributions~~

~~the SAB and HM Treasury will then review their respective "cost control mechanisms", which may or may not result in future employee benefit changes (from 1 April 2019)~~

~~it is possible that employer contribution rates could increase as a result. discount rate to reflect this uncertainty.~~

In addition to the above, the Fund is currently awaiting the outcome of several consultations or Government decisions which may affect the LGPS and the FSS, including but not limited to:

- The outcome of the Government's Fair Deal II Consultation, which may introduce new classes of employer into the LGPS.
- A further Consultation on Exit Credits.
- Rectification of issues associated with Guaranteed Minimum Pension Indexation and Equalisation.
- A review of the valuation cycle for the LGPS to align with that of the unfunded schemes (quadrennially).

~~• Revised CIPFA Guidance for the FSS.~~

The Administering Authority may revisit the FSS as and when the outcomes of the above consultations (and resulting legislative changes), decisions and guidance are known, and will seek wider consultation on any material changes in approach as a result of these changes.

# The Aims and Purpose of the Pension Fund

The Administering Authority runs the Fund, ensuring it:

- Receives the proper amount of contributions from employees and employers, and any transfer payments;
- Invests the contributions appropriately with the aim that the Fund’s assets grow over time with investment income and capital growth; and
- Uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependents (as and when members die) as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

The FSS focuses on how the Administering Authority measures employer liabilities (the value of the benefits to be paid to members), the pace at which these liabilities are funded (the balance between investment risk and the level of contributions required) and how employers or pools of employers pay for their own liabilities in order to achieve the Administering Authority’s funding aims of affordability, prudence and transparency. These aims are described in more detail below:

Aim	How this is achieved
<b>Affordability and stability of employer contributions</b>	Through minimising the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return. By reflecting the different characteristics of different employers in determining contribution rates and understanding how each employer can best meet its own liabilities over future years By using reasonable measures to reduce funding risks on employer cessations.
<b>Prudence in the funding basis</b>	By using a prudent long term view. This will help ensure that sufficient funds are available to meet all members’/dependants’ benefits as they fall due for payment.
<b>Transparency of processes</b>	By consulting and publishing this FSS. By adopting a consistent application of the FSS.

All employers are responsible for their own section of the Fund, tracked by the actuary.

## Setting Employer Contribution Rates

The way in which the Administering Authority calculates and sets employer contribution rates will vary for different employers to ensure that each employer pays for their own liabilities and the assets meet (as closely as possible) the value of its liabilities when its participation ends. In doing so, the Administering Authority recognises the balance which

needs to be struck between its need for maintaining prudent funding levels and the employers' need to allocate their resources appropriately.

Employer contributions are normally made up of two elements:

1. The estimated cost of new benefits being earned by members year to year, after deducting member's contributions and adding an allowance for administration expenses, referred to as the "primary contribution rate"; plus
2. Any adjustment to the primary rate to reflect the individual circumstances of each employer is referred to as the "secondary contribution rate" which reflects any adjustments required to meet the Fund's desire for stable contribution rates and to recover any differences between the assets built up to date and the value of past service benefits.

The following sections describe how the Administering Authority sets employer contribution rates.

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# Funding Target Basis, Time Horizon and Probability

## General Principles

The Administering Authority groups employers with similar characteristics when determining employer contributions. Examples include funding sources, whether there is anyone guaranteeing an employer's participation in the Fund and whether an employer will eventually leave the Scheme. Examples of the broad categories in which employers are grouped include:

- Scheduled Bodies, Designated Employers and Academies (for the period that they have a guarantee from the Department for Education) are generally open to new entrants, are considered to be long term and have reliable funding sources.
- Admission Bodies on pass through arrangements where the assets and liabilities remain with the Local Authority, Police, other Scheduled Body or a Designated Employer.
- Admission Bodies with a guarantee from a Local Authority, Police, other Scheduled Body or a Designated Employer or appropriate security are generally closed to new entrants, are considered to be shorter term and the Administering Authority has less insight into their funding sources.
- Admission Body with no guarantee from a Local Authority, Police, other Scheduled Body or a 'Designated Employer' or appropriate security are generally closed to new entrants, are considered to be shorter term and the Administering Authority may have no insight into their funding sources.

This categorisation determines an employers funding target, the period over which this funding target should be met and the certainty required that the employer will achieve their funding target.

Please note, the above are examples of the broad categories, in practice, there are a range of employers with varying categorisations as described through this Funding Strategy Statement.

## Funding Target

The Administering Authority seeks to ensure the long-term solvency of the Fund through ensuring that it holds sufficient assets to be able to pay all its members benefits. It therefore needs to ensure that the assets held on behalf of each employer meet (as closely as possible) the value of benefits built up to date for the employer's employees and ex-employees (the liabilities) i.e. a funding position of 100%.

However, different assumptions will be applied to calculate the value placed by the actuary on the benefits built up to date (and for future benefits).

- If an employer is considered higher risk or approaching the end of its participation in the Fund or is considered higher risk, then the funding target may be set on more prudent assumptions referred to as a "gilts cessation basis" using a discount rate based on expected returns on the lowest risk investments held (government bonds) without applying a margin for greater returns from equity-type investments held.
- For other employers the actuary will calculate expected returns on the lowest risk investments held (government bonds) plus a margin to allow for the greater return

that is expected to be generated from equity-type investments held. This is referred to as the "ongoing funding basis".

- Where an employer is approaching the end of its participation in the Fund, but this is still more than [4] years away, the actuary may move the discount rate towards a gilts cessation basis gradually over time.

#### The time horizon over which the employer should achieve its funding target

Each employer in the Fund will have a time period over which they need to achieve their funding target.

Employers may be given a lower time horizon if they have a less permanent anticipated membership, is approaching the end of its participation in the Fund or do not have a known funding source to afford increased contributions if investment returns under-perform.

The longest time horizon afforded any employer in the Fund is 20 years (generally reserved for long term employers with reliable funding sources).

#### The ~~probability required~~ likelihood of achieving the funding target over a given time horizon, allowing for different likelihoods of various possible economic outcomes

It is extremely unlikely that the contribution rate will absolutely ensure that the combination of contributions and market movements will return a funding position of 100% when an employer reaches the end of their time horizon. Therefore the Administering Authority will take a view on the minimum required probability of an employer reaching their funding target over their time horizon.

Typically, a higher required probability will give rise to higher contribution rates, and vice versa.

Probabilities are applied depending on the nature and security of an employer. The Administering Authority may look for more certainty that an employer will reach its funding target over the given time if they have a less permanent anticipated membership, are approaching the end of their participation in the Fund or do not have a guarantor. ~~For~~ ~~employers~~Employers who are open to new entrants are considered to be long term and a lower level of probability may be appropriate.

In general, the Fund will require all employers to have at least a 66% chance of being fully funded by the end of their time horizon.

## Application

The application of the above factors by employer group is shown below:

	Funding Basis	Probability	<u>Maximum Time Horizon</u> <sup>6</sup>
<b>Local Authorities and Police</b>	Ongoing	66%	20 years
<b>Designating Employers</b>	Ongoing	66%	20 years
<b>Academies</b>	Ongoing	70%	20 years
<b>Other Scheduled Bodies</b>	Ongoing	70%	Future Working Lifetime
<b>Admission Body with no Guarantor</b>	<del>Gilts plus an additional allowance for future improvements in life expectancy and future administration expenses.</del> <sup>7</sup> <u>Gilts cessation basis</u> <sup>8</sup>	75% <sup>9</sup>	Minimum of Future Working Lifetime and remaining contract period
<b>Admission Body with Guarantor</b>	Ongoing	75%	Minimum of Future Working Lifetime and remaining contract period.
<b>Admission Body on pass through or other risk sharing arrangements</b> <sup>10</sup> *	Contractual	<del>75%</del> <u>Same as ceding employer</u>	Same as ceding employer

<sup>6</sup> Whilst the Administering Authority would normally expect the same period or derivation method to be used at successive triennial valuations, it reserves the right to propose alternative periods, for example where there were no new entrants— over the inter-valuation period.

<sup>7</sup> ~~Not applicable when moving towards gilts over time~~

<sup>8</sup> The Fund may gradually move employers from an ongoing basis to the gilts cessation basis over time to manage the cost of exiting the Fund. Alternative funding bases may also be used where appropriate security is put in place.

<sup>9</sup> Where an employer is nearing cessation, the Administering Authority may vary the probability of achieving the funding target to 50% to reduce the chances of a surplus on cessation.

<sup>10</sup> It should be noted that different 'pass through' arrangements have been adopted by employers when commissioning services from a third party. These arrangements may require deviations from the above, including:

- The Actuary to certify the same rate for the Admission Body as that calculated for the Scheme Employer
- The Actuary to certify a static rate for the Admission Body
- The Actuary to calculate the estimated cost of new benefits only (on the basis that assets and liabilities for the Admission Body remain with the ceding Scheme Employer)

## Achieving Stability

The Administering Authority has an overarching objective to keep contributions as stable as possible over time. Therefore, where an employer is considered relatively low risk or provides appropriate security, the Administering Authority, at its absolute discretion, may smooth changes in contributions in the expectation that the employer will still be able to meet its obligations for many years to come (or the Fund will be able to call on any security provided if required). Smoothing techniques include:

- A cap to its employer contribution rate changes within a pre-determined range ("stabilisation"). This can allow for short term investment market volatility to be managed and keep some employers' rates relatively stable. This can be viewed as a prudent long-term approach for some employers. Further details are set out in Appendix 1.
- Phasing in contribution rises or reductions.
- Use of extended time horizons (although the maximum applied is 20 years).
- Pooling of contributions amongst employers with similar characteristics. Pools currently exist for small designated employers and some academies which participate in Multi Academy Trusts. Council funded schools generally are also pooled with their funding Council (although there may be exceptions for specialist or independent schools, where applicable). Those employers which have been pooled are identified in the Rates and Adjustments Certificate and are reviewed at each valuation.

These smoothing techniques will temporarily produce lower or higher contribution levels than would otherwise have applied. It should be noted, that paying lower contributions, even in the short term, may lead to higher contributions in future.

In addition to the above, the Administering Authority will usually require Scheduled Bodies to pay their primary rate where an employer is in surplus. The Administration will consider exceptions to this where an employer is at least 120% funded.

## Payment and Review of Contribution Rates

The rates for all employers are shown in the Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. It should be noted:

- The Rates and Adjustment Certificate shows employer contributions expressed as minimum contributions, with employers able to pay contributions at a higher rate. Account of any higher rate will be taken into account by the actuary at subsequent valuations.
- Where employers are in surplus, the secondary rate will be set as a percentage of pay. Where an employer is in deficit, the secondary rate is set as monetary amounts or a percentage of pay.<sup>11</sup> Exceptions to these guidelines may apply where an employer anticipates large increases in membership (e.g. as a result of auto-enrolment), in which case the Administering Authority reserves the right to require deficit/deficits to be repaid as a percentage of pay with a monetary underpin. Alternative arrangements can be agreed at the ultimate discretion of the Administering Authority.
- The Administering Authority, taking advice from its actuary, may permit some employers to elect to make an advance / lump sum payment at the start of a financial year, or valuation period. In these circumstances a contribution rate adjustment reflecting appropriate actuarial discounts may apply. However, employers adopting this approach should acknowledge the risks involved, particularly in respect of the impact of investment return during the inter-~~valuation period.~~ valuation period. The relevant discount for the valuation is included as part of the Rates and Adjustment Certificate. A timetable for the agreement to any lump sum payment is shown below. The process must be agreed by the Administering Authority, the Employer and their auditors in advance of any prepayment.

<u>2020/21</u>	<u>2021/22</u>	<u>2022/23</u>	<u>Action</u>
<u>13/03/2020</u>	<u>12/03/2021</u>	<u>11/03/2022</u>	<u>Employer to notify the Administering Authority of the estimated payroll to be used in calculating the advance / lump sum payment</u>
<u>20/03/2020</u>	<u>19/03/2021</u>	<u>18/03/2022</u>	<u>Administering Authority agrees payroll to be used and sets the amount of advance / lump sum payment</u>
<u>19/04/2020</u>	<u>19/04/2021</u>	<u>19/04/2022</u>	<u>Advance / lump sum payment made</u>
<u>01/03/2021</u>	<u>01/03/2022</u>	<u>01/03/2023</u>	<u>Administering Authority and Employer begin checks on whether there is any underpayment (true-up) which needs to be invoiced within normal accounting timetables due to actual pay being greater than that estimated.</u>

<sup>11</sup> The Fund prefers secondary rates to be a percentage of pay where monetary amounts would be less than £20,000 per annum. Initial results will be presented as a percentage of pay, however employers do have the option to discuss retaining annual cash amounts with the Administering Authority.

- Review of the rates for all employers may be triggered by significant events including but not limited to:
  - changes to LGPS Regulations
  - significant reductions in payroll
  - altered employer circumstances including where an employer is approaching cessation or closes their membership to new entrants
  - Government restructuring affecting the employer's business
  - failure to pay contributions or arrange appropriate security as required by the Administering Authority
  - ~~The result~~ outcomes of the McCloud case and cost sharing mechanisms (if permitted in Regulation at that time).

It should be noted that any review may ~~be to~~ require increased contributions ~~by strengthening the actuarial assumptions adopted and/or an increased level of security or guarantee.~~

# **Additional Employer Costs**

## **Non ill-health early retirement costs**

When the actuary calculates an employers liabilities he will assume that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire).<sup>12</sup>

Therefore, no allowance is made for premature retirement except on grounds of ill-health.

As a result, employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age.

The Administering Authority's requires employers to make upfront payment of strain charges following any decision to allow early payment of benefits (other than ill health).

An employer can request to pay instalments over a three year period, but this would be by exception.

The Chief Finance Officer to agree exceptions to the current practice.

## **Ill-health early retirement costs**

When the actuary calculates an employers liabilities he will make an allowance of ill-health early retirements where a member is entitled to receive early payment of their benefits.<sup>13</sup>

The Administering Authority monitors each employer's ill-health experience on an ongoing basis against an allowance determined by the actuary.

If the cumulative strain cost of an employer's ill-health retirements in any financial year exceeds the allowance at the previous valuation, the employer may be charged additional contributions on the same basis as applied for non ill-health cases.

However individual employers may take out ill-health insurance on an individual basis. Under these circumstances:

- the Administering Authority would not monitor the employer's ill health experience against the actuary's allowance
- the employer will be charged additional contributions whenever an employee retires early on ill health grounds under the expectation the employer can recoup the charges from their insurer
- the Administering Authority may allow the insurance premium to be offset against their certified contribution rates. This arrangement is allowed for the period the insurance is in place.

# **New Employers**

## **General Principles**

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<sup>12</sup> The relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014.

<sup>13</sup> The relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014.

## Scheduled Bodies

Scheduled Bodies are listed in LGPS Regulations and therefore, it is unusual for new Scheduled Bodies to join the Fund. As these events are rare and tend to be unique in nature, the Administering Authority does not have a prescribed method for allocating an initial funding position. This would be determined on a case by case basis.

The new body's contribution rate would be determined in line with the guidance in this FSS.

## Designating Employers

Typically, new Designating Employers constitute new membership in the Scheme (there is no past service liabilities at outset), therefore, no assets are usually transferred to the new employer at outset. However this would be determined on a case by case basis.

The new Designating Employers initial contribution rate will be set equal to that of the Small Scheduled Bodies pool.

## Academies & Free Schools

The initial liabilities of a new Academy or Free School will be based the past service liabilities of its active members in the Fund on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status.

The new Academy or Free School will then be allocated an initial asset share from West Sussex County Council's (WSCC's) assets in the Fund. This asset share will be calculated using the estimated funding position of WSCC at the date of Academy or Free School conversion, having first allocated assets in WSCC's share to fully fund deferred and pensioner members subject to a maximum of 100% of liabilities. The asset allocation will be based on market conditions and the new Academy or Free School's active membership in the Fund on the day prior to conversion. The initial assets are then determined by multiplying this funding level by the new Academy or Free School's initial liabilities.

The new Academy or Free School's initial contribution rate will be set equal to that of WSCC except:

- where a new Academy is part of a Multi Academy Trust (MAT) already participating in the Fund, where the new Academy can elect to be pooled with the other Academies in the MAT (and within the Fund) for contribution rate purposes. In this scenario, the Academy's initial contribution rate will be set equal to that of the MAT's pooled rate.
- where a new Academy or Free School wishes to pay an individual rate calculated by the Fund Actuary.

At subsequent valuations an Academy or Free School's rate will be determined on an individual basis, unless pooled with their MAT in which case they will pay the MAT rate as determined in line with the guidance in this FSS.

It should be noted that its underlying cashflows and experience will be tracked individually by the actuary whether pooled or not.

## Admission Bodies

## Contractors

Where there is a new Admission Body set up as a result of a TUPE transfer of ~~some~~ staff from the letting employer to the contractor, the Admission Body would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees.

Unless agreed otherwise with the Administering Authority, the funding level will be calculated as the market value of assets being equal to the value placed by the actuary on the benefits built up to date for the transferring employees (so the admission body will start fully funded on an ongoing funding basis).

The contractor's initial contribution rate will be set on an individual basis except if agreed otherwise between the letting authority, the contractor and the Administering Authority.

Employers who "outsource" have some flexibility in the way they deal with the pension risk potentially taken on by the contractor, such as Pass Through. Under Pass Through, the contractor pays the certified rate ~~and~~with the contract price being adjusted such that the contractor's pension costs ~~and~~do not change i.e. the letting employer retains some (but possibly not all) pensions risks - and the associated assets and liabilities. The application of any Pass Through arrangement is a contractual provision between the contractor and Employer. Employers may choose to put other risk sharing arrangements in place, in consultation with the Fund. It should be noted, that where investment risks will remain with the letting employer, no pension fund assets or liabilities will transfer to the contractor's portion of the Fund.

#### Other

The Administering Authority will only consider requests from Community Admission Bodies (or other similar bodies, such as Section 75 NHS Partnerships) to join the Fund if they are sponsored by a Scheduled Body, guaranteeing their liabilities and also providing a form of security. Given the rare occurrence of these bodies joining the Fund, their initial asset allocation and contribution rate will be considered on a case by case basis considering the guidance provided by this FSS.

## Application

The application of the above factors by employer group is shown below:

	<b>Asset Allocation</b>	<b>Initial Rate</b>	<b>Treatment at subsequent valuations</b>
<b>Local Authorities and Police</b>	Determined on a case by case basis in line with FSS.	Determined on a case by case basis in line with FSS.	Determined on a case by case basis in line with FSS.
<b>Designating Employers</b>	N/A	Small Scheduled Bodies Pooled rate.	Small Scheduled Bodies Pooled rate.
<b>Academies</b>	Estimated funding position of the active liabilities of WSCC after fully funding WSCC's deferred and pensioner liabilities. This is subject to a maximum initial funding level of 100%	Option to pay WSCC's rate, a rate determined by the actuary in line with the FSS or if part of a MAT may elect to pay rate equal to that of the MAT's pooled rate.	Determined on an individual basis, or MAT pooled rate.
<b>Other Scheduled Bodies</b>	Determined on a case by case basis in line with FSS.	Determined on a case by case basis in line with FSS.	Determined on a case by case basis in line with FSS.
<b>Admission with Guarantor</b> <b>Body no</b>	Where contractor, fully funded on the Fund's ongoing funding basis, otherwise determined on case by case basis.	Determined on an individual basis.	Determined on an individual basis.
<b>Admission with Guarantor</b> <b>Body</b>	Where contractor, fully funded on the Fund's ongoing funding basis, otherwise determined on case by case basis.	Determined on an individual basis.	Determined on an individual basis.
<b>Admission on pass through / other risk sharing arrangements</b> <b>Body</b>	Determined on a case by case basis	Determined on a case by case basis	Determined on a case by case basis

# Exiting employers: cessation valuations

## General Principles

The Administering Authority may consider any of the following as triggers for the cessation on an employer's participation in the Fund:

- Last active member ceasing participation in the Fund;
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Administering Authority;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Administering Authority.

## Assessment

On cessation, the Administering Authority will instruct the actuary to carry out a cessation valuation to determine whether there is any deficit or surplus.

The actuary will adopt an approach which, to the extent reasonably practicable, protects other employers in the Fund from the likelihood of any material loss emerging in future. This may include making an allowance for future administration costs associated with administering the benefits of the former employer's members and the risk of members living longer than anticipated.

Where there is a deficit:

- The normal approach is for payment of this amount in full by the Admission Body as a single lump sum payment.
- In some instances, the Administering Authority has the discretion to defer charging a cessation liability for up to three years if the employer is expected to acquire one or more active members in the Scheme over the period by issuing a written notice ("a suspension notice").
- If it is not possible for the deficit to be paid as a single lump sum the Administering Authority may permit the employer to make regular contributions to fund the remainder of the employer obligations over an appropriate period alongside provision of suitable security (bond, indemnity or guarantee). The Administering Authority would reserve the right to invoke the cessation requirements in the future.
- In the event that the Administering Authority is not able to recover the required payment in full and there is no guarantor, then the unpaid amounts fall to be shared amongst all of the other employers in the Scheme. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

Where there is a surplus:

- An employer is entitled to receive an exit credit from the Administering Authority. This must be paid within three months of the date on which the employer ceased to

participate in the Fund, or such longer time as the Administering Authority and exiting employer agree.<sup>14</sup>

### Employers with no remaining active members

When an employer ceases their participation in the Fund, and provided their exit obligations are met, they will have no further obligation. However as member benefits are guaranteed, it is expected that one of two situations will eventually arise:

- The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other employers participating in the Fund will be required to contribute to pay all remaining benefits: this will be done by the actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations; or
- The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the remaining assets would be apportioned pro-rata by the actuary to the other employers participating in the Fund at successive formal valuations.

### **Application**

The application of the above factors by employer group is shown below:

	<b>Basis</b>	<b>Exit Liability Payment Terms</b>	<b>Exit Credit Payment Terms</b>
<b>Local Authorities and Police</b>	Gilts cessation basis	Immediate, Payment Plan or Suspension Notice	Within three months of the date on which the employer ceased
<b>Designating Employers</b>	Gilts cessation basis	Immediate, Payment Plan or Suspension Notice	Within three months of the date on which the employer ceased
<b>Academies</b>	Gilts cessation basis	Immediate, Payment Plan or Suspension Notice	Within three months of the date on which the employer ceased
<b>Other Scheduled Bodies</b>	Gilts cessation basis	Immediate, Payment Plan or Suspension Notice	Within three months of the date on which the employer ceased
<b>Admission Body with no Guarantor</b>	Gilts cessation basis	Immediate or Payment Plan	Within three months of the date on which the employer ceased
<b>Admission Body with Guarantor</b>	Ongoing basis	Immediate or Payment Plan	Within three months of the date on which the employer ceased

<sup>14</sup> Currently being reviewed by Central Government

<b>Admission Body on pass through / other risk sharing arrangements</b>	Ongoing basis <u><a href="#">15*</a></u>	Immediate or Payment Plan <u><a href="#">but note Contractual provisions from related Employer.</a></u>	Within three months of the date on which the employer ceased <u><a href="#">but note Contractual provisions from related Employer.</a></u>
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[15 It should be noted that in most circumstances, the Fund assumes all liabilities and assets of employers admitted under 'pass through' remain with the Scheme Employer as they typically retain nearly all the pensions risks of the members involved. Therefore, the Fund refers to the contractual agreement between the employer and the Scheme Employer for instruction on how any exit credit/debt is to be determined, if available.](#)

## Other Actuarial Matters

### Security as a requirement for participation

All new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond. The Administering Authority requires security to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit on the employer's appropriate cessation basis.

In addition it should be noted:

- Where the Admission is to a contractor, the Administering Authority requires that the security must be to the satisfaction of the Administering Authority as well as the [Scheme Employer](#) letting [employerthe contract](#).
- Where a new admission body is not a contractor, the security must be to the satisfaction of the Administering Authority (and any employer providing a guarantee where applicable).
- All security requirements must be reassessed periodically, [but no less often than each formal valuation of the Fund](#).

### Security in the context of setting employer contribution rates

The Administering Authority may permit greater flexibility within the framework for setting employer contributions if the employer provides added security to the satisfaction of the Administering Authority. Such security may include, but is not limited to a suitable bond, a legally-binding guarantee from an appropriate third party or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan; and/or
- whether the Admission Agreement is likely to be open or closed to new entrants

It should be noted, that Local Authorities and the Police are already afforded the maximum flexibility in respect of setting contribution rates due to the security of their funding sources. Therefore, this policy does not apply to them.

## **Policies on bulk transfers**

Bulk transfers of members take place where ten or more members transfer to another Administering Authority's LGPS fund or where two or more members transfer to a non-LGPS fund. Each case will be treated on its own merits, but in general, where active members are transferring the Administering Authority will pay bulk transfers in line with factors provided by the Government Actuary's Department for individual transfers with an allowance for known fund returns between the transfer date and payment date. This also forms the minimum amount the Fund will accept on a transfer in.

~~For~~The Administering Authority reserves the right to use alternative approaches if an Employer has an 'exit event' as a result of the bulk transfer.

For transfers involving deferred and pension members (such as when employers in different funds merge) the Administering Authority will pay the asset share attributed to the transferring members including an allowance for known fund returns between the transfer date and payment date. This also forms the minimum amount the Fund will accept on a transfer in.

The Administering Authority permits shortfalls to arise on bulk transfers if the employer participating in the Fund has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's contributions to the Fund to increase between valuations. Where this is not met, the Administering Authority may require a higher transfer amount or immediate contribution from the employer(s) involved.

## Appendix 1 – Stabilisation

“Stabilisation” is an approach used by the Administering Authority to allow for short term investment market volatility to be managed and keep some employers’ rates to be relatively stable.

The application for Scheduled Bodies is shown in more detail below (provided there are no anticipated material events e.g. significant reductions in active membership):

Type of employer	<u>Councils near full funding</u>	<u>Other Councils</u>
<b>MaxMin cont. level</b>	<del>To be determined as part of the 2019 Valuation modelling</del> 18% of pay	18% of pay
<b>Max cont. level</b>	<u>2018/19 Rate</u>	<u>N/A</u>
<b>Max cont. increase</b>	1%	3%
<b>Max cont. decrease</b>	1%	3%

Employers whose contribution rates have been “stabilised” may therefore be paying more or less than they might otherwise have paid at any one time. Employers should be aware that:

- Their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the choice of method;
- Lower (higher) contributions in the short term will be assumed to incur a greater loss (gain) of investment returns on any deficit. Thus, deferring (or not) a certain amount of contribution may lead to higher (lower) contributions in the long-term; and
- It may take longer to reach full funding, all other things being equal.

## Appendix 2 – Funding strategy and links to investment strategy

### General Principle

The Fund has built up assets over the years and continues to receive contribution and other income. All of this must be invested in a suitable manner.

The investment strategy is set by the Administering Authority and describes the precise mix, manager make up and target returns.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out as part of each actuarial valuation and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers. ~~Link between funding strategy and investment strategy~~

### Link between funding strategy and investment strategy

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the Actuarial Valuation and funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa

Therefore, the funding and investment strategies are inextricably linked.

### How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the actuary, the current funding policy is consistent with the current investment strategy of the Fund. The asset outperformance assumption contained in the discount rate is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government.

However, in the short-term – such as ~~the three-yearly assessments~~ at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium-term, asset returns will fall short of this target. The stability measures described above will damp down, but not remove, the effect on employers' contributions.

### How does this differ for a large stable employer?

The actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

- **Prudence** - the Fund should have a reasonable expectation of being fully funded in the long-term;
- **Affordability** – how much can employers afford;

- **Stewardship** – the assumptions used should be sustainable in the long-term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position;
- **Stability** – employers should not see significant moves in their contribution rates from one year to the next, and this will help to provide a more stable budgeting environment.

The key objectives often conflict. For example, minimising the long-term cost of the scheme (i.e. keeping employer rates affordable) is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down fairly frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

Therefore, a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling (“ALM”). An ALM is a set of calculation techniques applied by the actuary, to model the range of potential future solvency levels and contribution rates.

The actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach. The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes struck an appropriate balance between the above objectives. In particular the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority’s aims of prudent stewardship of the Fund.

Whilst the current stabilisation mechanism is to remain in place until ~~2020~~2023, it should be noted that this will need to be reviewed following the ~~2019~~2022 valuation.

### **Does the Administering Authority monitor its overall funding position?**

The Administering Authority monitors the relative funding position, i.e. changes in the relationship between asset values and the liabilities value, at least quarterly. It reports this regularly to the Pensions Panel.

# **Appendix 3 - Statutory reporting and comparison to other LGPS funds**

## **Background**

Under Section 13(4)(c) of the Public Service Pensions Act 2013 The Government Actuary's Department (GAD) must, following each actuarial valuation, report to the Ministry of Housing, Communities & Local Government (MHCLG) on whether the rate of employer contributions are set at an appropriate level to ensure the solvency of each fund in the LGPS England & Wales and to ensure the long term cost efficiency of each fund in the LGPS England & Wales.

This additional oversight may have an impact on the strategy for setting contribution rates at future valuations.

## **Solvency**

For the purposes of Section 13 of the Public Service Pensions Act 2013, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if the rate of employer contributions is set to target a funding level for the Fund of 100% over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds); and either

- employers collectively have the financial capacity to increase employer contributions, and/or the Fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or
- there is an appropriate plan in place should there be, or if there is expected in future to be, no or a limited number of fund employers, or a material reduction in the capacity of fund employers to increase contributions as might be needed.

## **Long term cost efficiency**

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long term cost efficiency if the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual, with an appropriate adjustment to that rate for any surplus or deficit in the fund.

In assessing whether the above condition is met, GAD may have regard to following absolute and relative considerations. A relative consideration is primarily concerned with comparing LGPS pension funds with other LGPS pension funds. An absolute consideration is not primarily concerned with comparing funds with a given benchmark.

Relative considerations include:

- the implied deficit recovery period; and
- the investment return required to achieve full funding after 20 years.

Absolute considerations include:

- if there is a deficit, the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on the deficit over the current inter-valuation period;
- if there is no deficit, the extent to which contributions payable are likely to lead to a deficit arising in the future;
- the extent to which the required investment return under “relative considerations” above is less than the estimated future return being targeted by the Administering Authority’s investment strategy;
- the extent to which contributions actually paid have been in line with the expected contributions based on the extant rates and adjustment certificate; and
- the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual experience of the Fund.

MHCLG may assess and compare these metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

## Appendix 4 – Regulatory framework

### Background

The Funding Strategy Statement is the framework within which the actuary carries out valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund.

The Ministry of Housing, Communities and Local Government (MHCLG) has stated that the purpose of the FSS is:

- “to establish a **clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and
- to take a **prudent longer-term view** of funding those liabilities.”

The requirement to maintain and publish a FSS is contained in the LGPS Regulations which are updated from time to time.

In publishing the FSS the Administering Authority has to have regard to any guidance published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and to its Investment Strategy Statement.

The FSS applies to all employers participating in the Fund.

### Consultation

The FSS must first be subject to consultation with such persons as the Authority considers appropriate.

The Administering Authorities consultation process for this FSS was as follows:

- a) The Administering Authority hosted employer events in May 2019, July 2019 and November 2019 at which questions regarding the funding strategy could be raised and answered.
- b) A draft version of the FSS was issued to all participating employers and the Pension Advisory Board in May and June 2019 for comment;
- c) The FSS was updated where required and then published, in March 2020.

### Publication

The FSS is made available through the following routes:

- Published on the website, at [www.westsussex.gov.uk/pensions](http://www.westsussex.gov.uk/pensions);
- A full copy linked from the annual report and accounts of the Fund;
- Copies made available on request.

## **Review**

The FSS is reviewed in detail at each valuation.

It is possible that minor amendments may be needed between valuations. These would be needed to reflect any regulatory changes or alterations to the way the LGPS operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications;
- amendments affecting only one class of employer would be consulted with those employers; and/or
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Pensions Panel and would be included in the relevant Panel Meeting minutes.

## **Related policy documents**

The FSS is a summary of the Administering Authority's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published including the Investment Strategy Statement, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at [www.westsussex.gov.uk/pensions](http://www.westsussex.gov.uk/pensions).

## **Appendix 5 – Responsibilities of key parties**

The efficient and effective operation of the Fund needs various parties to each play their part.

### **The Administering Authority should:-**

- operate the Scheme as per the LGPS Regulations;
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Scheme Employer;
- collect employer contributions and employee contributions, investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's investment strategy and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the actuary;
- prepare and maintain a Funding Strategy Statement ("FSS") after consultation;
- provide data and information as required by GAD to carry out their Section 13 obligations;
- notify the actuary of material changes which could affect funding; and
- monitor all aspects of the Fund's performance and funding and amend the related policy document as necessary and appropriate.

### **The Individual Employer should:-**

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own, as determined by the actuary by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership which could affect future funding.

**The actuary should:-**

- prepare valuations, including the setting of employer contribution rates. This will involve agreeing assumptions with the Administering Authority having regard to the FSS and LGPS Regulations and targeting each employer's solvency appropriately;
- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
- provide data and information required by GAD to carry out their Section 13 obligations;
- advise on the termination of Admission Bodies' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

**Other parties:-**

- investment advisers (either internal or external) should ensure the Fund's investment strategy remains appropriate and consistent with its funding strategy;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets in line with the investment strategy;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements including the Administering Authority's own procedures;
- The Ministry of Housing, Communities and Local Government (as assisted by the Government Actuary's Department) and the Scheme Advisory Board, should work with LGPS funds to meet Section 13 requirements.

## Appendix 6 – Key risks and controls

### Types of risk

The Administering Authority has an active risk management programme in place. The measures that it has in place to control key risks are summarised below under the following headings:

- Financial (F);
- Demographic (D);
- Regulatory (R); and
- Governance (G).

### Financial risks

	<b>Risk</b>	<b>Summary of Control Mechanisms</b>
F	Assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term.	<p>Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.</p> <p>Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.</p> <p>Analyse progress at three-yearly valuations for all employers.</p> <p>Inter-valuation roll-forward of liabilities between valuations at whole Fund level.</p>
F	Inappropriate long-term investment strategy.	<p>Consider overall investment strategy options as an integral part of the funding strategy.</p> <p>Use asset liability modelling to measure 4 key outcomes.</p>
F	Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	<p>Stabilisation modelling at whole Fund level allows for the probability of this within a longer-term context.</p> <p>Inter-valuation monitoring, as above.</p> <p>Some investment in bonds helps to mitigate this risk.</p>

	<b>Risk</b>	<b>Summary of Control Mechanisms</b>
F	Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring of active managers relative to their benchmark.
F	Pay and price inflation significantly more than anticipated.	<p>Focus the actuarial valuation process on real returns on assets, net of price and pay increases.</p> <p>Inter-valuation monitoring, as above, gives early warning.</p> <p>Some investment in bonds also helps to mitigate this risk.</p> <p>Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.</p>
F	Effect of possible increase in employer contribution rate on service delivery and admission/scheduled bodies	An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions.
F	Orphaned employers give rise to added costs for the Fund	<p>The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.</p> <p>If it occurs, the actuary calculates the added cost spread pro-rata among all employers—(see 3.9).</p>
<u>F</u>	<u>Effect of possible asset underperformance as a result of climate change</u>	<p><u>Explicitly consider ESG issues when setting the overall funding and investment strategies.</u></p> <p><u>Carry out scenario testing on potential Government policy changes when evaluating funding and investment strategies.</u></p>
D	Pensioners living longer, thus increasing cost to Fund.	<p>Set mortality assumptions with some allowance for future increases in life expectancy.</p> <p>The Fund actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect</p>

	<b>Risk</b>	<b>Summary of Control Mechanisms</b>
		the assumptions underpinning the valuation.
D	Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.
D	Deteriorating patterns of early retirements	Employers are charged the extra cost of non ill-health retirements following each individual decision.  Employer ill-health retirement experience is monitored, and insurance is an option.
D	Effects of Auto enrolment	Mechanism for reviewing and addressing the factors in the Regulations to ensure that systems (Payroll, Pensions and HR) can support auto-enrolment, e.g. correct processing and timely payment of contributions
R	Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.  Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.
R	Time, cost and/or reputational risks associated with any MHCLG intervention triggered by the Section 13 analysis (see Section 5).	Take advice from Fund Actuary on position of Fund as at prior valuation, and consideration of proposed valuation approach relative to anticipated Section 13 analysis
R	Changes by Government to particular employer participation in LGPS funds, leading to impacts on funding and/or investment strategies.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.  Take advice from Fund Actuary on impact of changes on the Fund and amend strategies as appropriate.

	<b>Risk</b>	<b>Summary of Control Mechanisms</b>
G	Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	<p>The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.</p> <p>The actuary may revise the rates and Adjustments certificate to increase an employer's contributions (under Regulation <a href="#">3864</a>) between triennial valuations</p> <p>Deficit contributions expressed as monetary amounts, <a href="#">except where value is less than £20,000 p.a.</a></p>
G	Actuarial or investment advice is not sought, or is not heeded or proves to be insufficient in some way	<p>The Administering Authority maintains close contact with its specialist advisers.</p> <p>Advice is delivered via formal meetings involving Elected Members, and recorded appropriately.</p> <p>Actuarial advice is subject to professional requirements such as peer review.</p>
G	Administering Authority failing to commission the Fund actuary to carry out a termination valuation for a departing Admission Body.	<p>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.</p> <p>Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.</p>
G	An employer ceasing to exist with insufficient funding or adequacy of a bond.	<p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.</p> <p>The risk is mitigated by:</p> <p>Seeking a funding guarantee from another scheme employer, or external body, wherever possible <a href="#">(see Notes (h) and (j) to 3.3).</a></p> <p>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</p>

	<b>Risk</b>	<b>Summary of Control Mechanisms</b>
		<p>Vetting prospective employers before admission.</p> <p>Where permitted under the Regulations, requiring a bond to protect the Fund from various risks.</p> <p>Requiring new Admission Bodies to have a guarantor.</p> <p>Reviewing bond or guarantor arrangements at regular intervals <del>(see Note (f) to 3.3).</del></p> <p>Reviewing contributions well ahead of cessation if thought appropriate <del>(see Note (a) to 3.3).</del></p>

## Appendix 7 – Actuarial assumptions

### Background

Actuarial assumptions are expectations of future experience used to place a value on future benefit payments (“the liabilities”).

Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants’ benefits.

### 2019 valuation assumptions

Changes in assumptions will affect the measured value of future service accrual and past service liabilities, and hence the measured value of the past service deficit. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The table below shows the recommended assumptions for the 2019 valuation relative to the assumptions used in the 2016 valuation. The Administering Authority believes that these assumptions are appropriate for the West Sussex Fund.

Assumption	31 March 2019	31 March 2016
<b>Financial assumptions</b>		
<b>Discount rate</b>	<u>3.1% p.a.</u>	3.8% p.a.
<b>Salary growth</b>	<u>2.8% p.a.</u>	2.9% p.a.
<b>Pension Increases</b>	<u>2.3% p.a.</u>	2.1% p.a.
<b>Demographic assumptions</b>		
<b>Longevity Baseline Improvements</b>	<u>Club Vita</u>  <u>CMI 2018 Smoothed</u> <u>1.5% p.a. long term</u>	Club Vita “Non-peaked” CMI 2013 projections subject to a 1.5% underpin
<b>Withdrawals</b>	<u>2019</u>	2016
<b>Ill health retirements</b>	<u>2019</u>	2016
<b>Promotional salary growth</b>	<u>2019</u>	2016
<b>Cash commutation</b>	<u>50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2008 (equivalent 75% for service from 1 April 2008)</u>	<u>75%—max 50% of future retirements elect to exchange pension for additional tax free cash up to HMRC limits for service to 1 April 2008 (equivalent 75% for service from 1 April 2008)</u>

<b>50:50 option take up</b>	<u>1% uniformly distributed across age, service and salary range)</u>	1%
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The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower liability values and lower employer costs. A more prudent basis will give higher liability values and higher employer costs.

### **Basis Used**

The Administering Authority's standard funding basis is described as the "ongoing basis", which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Scheme in the long-term.

However, in certain circumstances a more prudent basis applies.

### **What assumptions are made in the ongoing basis?**

#### **a) Investment return / discount rate**

The key financial assumption is the anticipated return on the Funds's investments. ~~This "discount rate" assumption makes allowance for an anticipated out-performance of assets returns relative to long-term yields on UK Government bonds ("gilts"). There is, however, no guarantee that the mix of assets returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.~~

Given the ~~very~~ long-term nature of the liabilities, a long term view of prospective ~~asset~~ returns ~~from growth-seeking assets~~ is taken. ~~The long-term in In setting this context would be assumption, the Actuary has modelled the annual returns over the next 20 to 30 years or years on the Fund's investment portfolio under 5,000 different economic scenarios. The investment return assumption has then been set such that more than 75% of the scenarios produced a return in excess of the assumption.~~

For the purpose of the valuation at 31 March 2019 and setting contribution rates effective from 1 April 2020, the actuary has assumed that future investment returns earned by the Fund over the long term ~~as derived using the above methodology~~ will be ~~[X.X%]~~ 3.1% per annum ~~greater than gilt yields at the time of the valuation.~~

In the opinion of the actuary, based on the current investment strategy, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

## b) Pension Increase and Salary growth

[TBC]

~~The same salary assumptions are applied to all employers.~~

### Pension increases

The table below details the salary increase, CARE revaluation rate and benefit increase assumptions at 31 March 2019. The equivalent assumptions used in the 2016 valuation are shown for comparison.

<u>Assumption</u>	<u>31 March 2019</u>	<u>31 March 2016</u>
<u>Benefit Increases and CARE revaluation (CPI) (% pa)</u>	<u>2.3%</u>	<u>2.1%</u>
<u>Salary Increases (% pa)</u>	<u>2.8% <sup>16</sup></u>	<u>2.9% <sup>17</sup></u>

Since 2011 the consumer prices index (CPI), rather than the retail prices index (RPI), has been the basis for increases to public sector pensions in deferment and in payment. The basis of such increases is set by the Government and is not under the control of the Administering Authority or any employers.

[TBC]

The same salary assumptions are applied to all employers.

## c) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the Club Vita's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future.

[TBC]The proposed longevity assumptions result in the following typical future life expectancies from age 65 (figures for 2016 shown for comparison):

<u>Assumption</u>	<u>31 March 2019</u>	<u>31 March 2016</u>
<b>Male</b>		
<u>Pensioner</u>	<u>22.2</u>	<u>23.6</u>
<u>Non-Pensioner</u>	<u>23.3</u>	<u>26.0</u>
<b>Female</b>		
<u>Pensioner</u>	<u>24.2</u>	<u>25.0</u>
<u>Non-Pensioner</u>	<u>25.9</u>	<u>27.8</u>

<sup>16</sup> CPI plus 0.5%

<sup>17</sup> CPI plus 0.7% (equivalent to RPI less 0.3%)

## **General**

The same financial assumptions are adopted for all employers, in deriving the past service deficit and the contribution rate unless otherwise deemed appropriate. These calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

## **Other Actuarial Bases**

The Fund may adopt alternative actuarial bases for some employees for both funding valuations and exit valuations as set out in the sections on funding target basis and exiting employers above.

The gilts cessation basis assumes the fund will invest in fixed interest gilts to 'match' the expected cashflows of an exiting employer's membership. The discount rates adopted are set in line with the Bank of England yield curve. To be consistent with these discount rates, CPI will be determined by subtracting 1% p.a. from the corresponding Bank of England inflation curve. Further allowances for longevity improvements beyond those made in the 2019 valuation may be considered by the Administering Authority as well.

Where an employer is approaching exit, or where additional security is put in place, the fund may consider alternative strategies that lie between the gilts cessation basis and the ongoing basis.

## Appendix 8 – Glossary

<b>Actuarial assumptions/basis</b>	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of <b>the funding target</b> . The main assumptions will relate to the <b>discount rate</b> , salary growth, pension increases and longevity. More prudent assumptions will give a higher liability value, whereas more optimistic assumptions will give a lower value.
<b>Administering Authority</b>	The council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
<b>Admission Bodies</b>	Employers which voluntarily participate in the Fund, so that their employees and ex-employees are <b>members</b> . There will be an Admission Agreement setting out the employer's obligations.
<b>Covenant</b>	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.
<b>Deficit</b>	The shortfall between the assets value and the <b>funding target</b> . 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).
<b>Designating Employer</b>	Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund.
<b>Discount rate</b>	The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day. This is necessary to provide a <b>funding target</b> which is consistent with the present day value of the assets, to calculate the <b>deficit</b> . A lower discount rate gives a higher liabilities value, and vice versa. It is similarly used in the calculation of the <b>Primary and Secondary rates</b> .
<b>Employer</b>	An individual participating body in the Fund, which employs (or used to employ) <b>members</b> of the Fund. Normally the assets and <b>funding target</b> for each employer are individually tracked, together with its <b>Primary rate</b> at each <b>valuation</b> .
<b>Funding target</b>	The actuarially calculated present value of all pension entitlements of all <b>members</b> of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the deficit. It is calculated on a chosen set of <b>actuarial assumptions</b> .
<b>Gilt</b>	A UK Government bond, i.e. a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed

interest”, where the interest payments are level throughout the gilt’s term, or “index-linked” where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency.

**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.

**Letting employer** An employer which outsources or transfers a part of its services and 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. A letting employer will usually be a local authority, but can sometimes be another type of employer such as an academy.

**LGPS** The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members’ contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 101 funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.

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

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

**Primary contribution rate** The employer contribution rate required to pay for ongoing accrual of active members’ benefits (including an allowance for administrative expenses). [See Appendix D for more details.](#)

**Pooling** Employers may be grouped together for the purpose of calculating contribution rates, so that their combined membership and asset shares are used to calculate 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. ~~For further details of the Fund's current pooling policy (see 3.4).~~

**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. A membership (or liability) profile might be measured for its **maturity** also.

**Rates and Adjustments Certificate**

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

**Scheduled Bodies**

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

**Secondary contribution rate**

The difference between the employer's actual and Primary rates. In broad terms, this relates to the shortfall of its asset share to its funding target. ~~See Appendix D for further details.~~

**Stabilisation**

Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these.

**Valuation**

An actuarial investigation to calculate the **funding targets** as well as the **Primary rates** and **Secondary rates** for employers. This is normally carried out in full every three years (last done as at 31 March 2013/2016), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the funding targets and contribution rates are based on long-term bond market yields at that date also.

## Appendix 9 – Previous Valuation Results

### Summary of Past Valuation Results

A summary of the whole Fund valuation results and key assumptions for each of the previous ~~three~~five valuations is given below. For further details relating to the previous valuation results and assumptions please refer to the relevant valuation reports.

### Valuation Results

Valuation date	31 March 2007	31 March 2010	31 March 2013	31 March 2016	31 March 2019
Assets (£m)	1,549	1,759	2,370	2,989	<u>4,374</u>
Liabilities (£m)	1,763	2,047	2,741	3,141	<u>3,919</u>
Surplus/(Deficit) (£m)	(214)	(288)	(371)	(152)	<u>455</u>
Funding level	88%	86%	86%	95%	<u>112%</u>

### Assumptions

Valuation date	31 March 2007	31 March 2010	31 March 2013	31 March 2016	31 March 2019
Discount rate p.a.	6.1%	6.1%	4.6%	3.8%	<u>3.1%</u>
Salary growth p.a.	4.7%	1% for 2 years then 5.3%	3.8%	2.9%	<u>2.8%</u>
Pension increases p.a.	3.2%	3.3%	2.5%	2.1%	<u>2.3%</u>
Longevity – baseline table	PXA92 mortality tables (with age ratings)	Club Vita Curves	Club Vita Curves	Club Vita Curves	<u>Club Vita Curves</u>
Longevity – future improvements	calendar year 2017 for current pensioners, calendar year 2033 for prospective pensioners	80% of medium cohort with a 10 year lag and 1.0% p.a. minimum improvements	'non-peaked' CMI 2010 projections with 1.25% underpins and declining mortality at older ages	'non-peaked' CMI 2013 projections with 1.5% underpins and declining mortality at older ages	<u>Smoothed CMI 2018 projections with 1.5% underpins and declining mortality at older ages</u>

**Appendix 10 - Rates and adjustments certificate**