

# **FUNDING STRATEGY STATEMENT**

## **MARCH 2020**



**Teesside Pension Fund**

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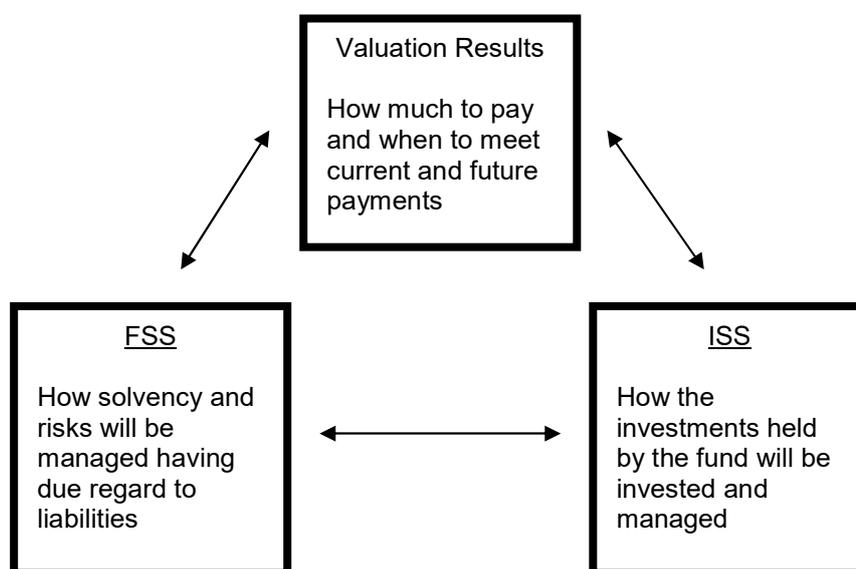


## 1. Introduction

The Local Government Pension Scheme (LGPS) Regulations 2013 require funds to produce a Funding Strategy Statement (FSS) having regard to guidance provided by the Chartered Institute of Public Finance and Accountancy (CIPFA). This is the FSS of the Teesside Pension Fund (“the fund”), which is administered by Middlesbrough Council (“the administering authority”).

It has been prepared by the administering authority in collaboration with the fund’s actuary, Aon after consultation with the fund’s officers and elected members, employers and investment advisers and is effective from 31 March 2019. The Administering Authority will next formally review the FSS as part of the triennial valuation of the Fund as at 31 March 2022 unless circumstances arise which require earlier action.

The FSS, the Investment Strategy Statement (ISS) and the Actuarial Valuation are inter-related:



### 1.1 Regulatory Framework

Members’ accrued benefits are guaranteed by statute. The Local Government Pension Scheme is paid for by contributions from both employers and scheme members. The contribution made by scheme members is fixed and generally is not subject to variation. Whereas the contribution paid by scheme employers is variable. This is designed to reflect that the pension scheme is *funded* and the amount of investment return is variable. Therefore, in order to achieve the desired *output* – a fixed benefit payable to a scheme member – three *input* elements have to be combined.

- Member contributions
- Employer contributions
- Investment returns

Because member contributions are fixed and investment returns are variable, then employer contributions have to be variable as well to ensure that any reduction in investment returns can be counterbalanced. This ensures that the required output – the member’s benefits – can be achieved.

The Regulations fix members’ contributions at a level which covers only part of the cost of accruing benefits. Employers pay the balance of the cost of delivering the benefits to members. The FSS focuses

on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers pay for their own liabilities.

The FSS forms part of a framework which includes:

- The Local Government Pension Scheme Regulations 2013 (regulation 58 is particularly relevant).
- The Rates and Adjustments Certificate, which can be found appended to the fund actuary's triennial valuation report.
- Actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- The Investment Strategy Statement.

This is the framework within which the fund's actuary carries out triennial valuations. Consequently, this sets the employers' contribution rate, and also provides recommendations to the administering authority when other funding decisions are required, such as when employers join or leave the fund. The FSS applies to all employers participating in the fund.

## **1.2 Reviews of the FSS**

The FSS is reviewed by the administering authority at least every three years as part of the triennial valuation. More frequently, Annex A is updated to reflect any changes to employers.

The FSS is a summary of the fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact Nick Orton in the first instance at [nick\\_orton@middlesbrough.gov.uk](mailto:nick_orton@middlesbrough.gov.uk) or on (01642) 729040.



## 2. Purpose of the Funding Strategy Statement

### 2.1 Purpose

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 primary contribution rates as possible;
- To support the fund's aim to enable overall employer contributions to be kept as constant as possible and (subject to the Administering Authority not taking undue risks and ensuring that the regulatory requirements are met) at reasonable cost to the taxpayers, scheduled, designating, and admitted bodies;
- To ensure that the regulatory requirements to set contributions so as to ensure the solvency and long-term cost efficiency of the fund are met; and
- To take a prudent longer-term view of funding those liabilities.

These objectives, whilst individually desirable, may be mutually conflicting.

This statement sets out how the administering authority attempts to balance the conflicting aims of affordable contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.

The fund currently has slightly negative net cash flow. It is recognised that this outflow from the fund is likely to increase as budget pressures being experienced by scheme employers leading to workforce reductions and falling active membership will result in reduced levels of income from employer and employee contributions. The FSS supports the process of ensuring adequate funds are set aside to meet future pension liabilities. LGPS regulations specify that implementation of the funding strategy is the responsibility of the fund acting on appropriate advice and following consultation.

The FSS is a comprehensive strategy for the whole fund, balancing and reconciling the many interests who arise from the nature of the Scheme and the requirement to fund benefits now and in the future.

### 3. Purpose of the fund

#### 3.1 Purpose

The fund is a vehicle by which scheme benefits are delivered. The purpose of the fund is to:

- Receive monies in respect contributions from employers and employees, transfer values and investment income.
- Pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses as defined in the LGPS Regulations 2013 and as required in the LGPS (Management and Investment of Funds) Regulations 2016.

#### 3.2 Aims

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 primary contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to the taxpayers, and scheduled, resolution and admitted bodies, while achieving and maintaining fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the fund and employers, and the risk exposure policies of the administering authority and employers alike.
- Seek returns on investments within reasonable risk parameters.

## 4. Solvency Issues, Long-term Cost Efficiency and Target Funding Levels

### 4.1 Setting the Employer Contribution Rate

Employer contributions are normally made up of two elements:

- a) the estimated cost of future benefits being accrued, referred to as the “primary contribution rate”; plus
- b) an adjustment for the funding position (or “solvency”) of accrued benefits relative to the fund’s solvency target - this is called the “secondary contribution rate”. If there is a surplus there may be a contribution reduction; if a deficit there may be a contribution addition, with the surplus or deficit spread over an appropriate period.

The primary rate for the whole fund is the weighted average (by payroll) of the individual employers’ primary rates. The secondary rate is an adjustment to the primary rate to arrive at the rate each employer is required to pay. It may be expressed as a percentage adjustment to the primary rate, and/or a cash adjustment in each of the three years beginning with 1 April in the year following that in which the valuation date falls. The secondary rate is specified in the rates and adjustments certificate. For any employer, the rate they are actually required to pay is the sum of the primary and secondary rates.

The fund’s actuary is required by the regulations to report the Primary and Secondary Contribution Rates, for all employers at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay.

In effect, the Primary and Secondary Contribution Rate is a notional quantity. Separate primary contribution rates are calculated for each employer together with secondary contribution rates according to employer-specific spreading and phasing periods. The specific factors which are considered are discussed in Section 4.5.

For some employers it may be agreed to pool contributions (see Section 4.7.6).

The triennial valuation report contains details of each employer’s contribution rate for the inter-valuation period. Annex A to this document shows which employers’ contributions have been pooled with others and the deficit recovery period for individual employers.

Any costs of non ill-health early retirements must be paid as lump sum payments at the time of the employer’s decision in addition to the contributions described above or, for tax raising bodies, by instalments shortly after the decision.

Employers’ contributions are expressed generally as a percentage of payroll plus capital sums towards meeting any deficiency identified in the latest actuarial assessment of the Employer’s liabilities. Employers are able to pay additional contributions should they wish to do so. Employers are required to discuss options with the administering authority before attempting to make one-off capital payments.

### 4.2 Solvency and Target Funding Levels

The fund’s liabilities are mainly underwritten by tax-raising bodies and it is therefore able to take a medium to long-term view when determining employing bodies’ contribution rates to meet future liabilities by operating a fund with an investment strategy with this long-term view. While there is no certainty regarding investment income continuing at current levels the fund investment strategy, as set out in the Investment Strategy Statement, assesses this risk.

The fund’s actuary is required to report on the “solvency” of the whole fund at least every three years. Solvency for ongoing employers is defined to be the ratio of the market value of assets to the value

placed on accrued benefits on the fund actuary's ongoing funding basis. This quantity is known as a funding level.

The ongoing funding basis is that used for each triennial valuation and the fund actuary agrees the financial and demographic assumptions to be used for each such valuation with the administering authority.

The fund operates the same target funding level for all ongoing employers of 100% of their accrued liabilities valued on an appropriate basis. Please refer to paragraph 4.8 for the treatment of departing employers.

### **4.3 Ongoing Funding Basis**

#### ***Risk Based Approach***

The fund adopts a risk based approach to funding rather than a 'deterministic' approach. In particular the discount rate (for most employers) has been set on the basis of the assessed likelihood of meeting the funding objectives. The administering authority has considered 3 key decisions in setting the discount rate:

- The long-term Solvency Target (i.e. the funding objective - where the administering authority wants the fund to get to);
- the Trajectory Period (how quickly the administering authority wants the fund to get there); and
- the Probability of Funding Success (how likely the administering authority wants it to be now that the fund will actually achieve the Solvency Target by the end of the Trajectory Period).

These three choices, supported by modelling carried out by the fund actuary, define the discount rate and by definition the appropriate levels of employer contribution. Together they measure the associated risk (and hence also the degree of prudence) of the funding strategy. These are considered in more detail below.

#### ***Solvency Target***

The administering authority's primary aim is the long-term solvency of the fund. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term.

CIPFA defines solvency as the rate of employer contributions should be set at "such level as to ensure that the scheme's liabilities can be met as they arise". It is not regarded that this means that the pension fund should be 100% funded at all times. Rather, and 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 whole fund (assets divided by liabilities) of 100% over an appropriate time period and using appropriate actuarial assumptions; 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.

If the conditions above are met, then it is expected that the fund will be able to pay scheme benefits as they fall due.

The Solvency Target is defined as follows:

- For Scheduled Bodies, and certain other bodies where a Scheme Employer of sound covenant has agreed to subsume its assets and liabilities following the exit of the employer from the Fund, the Solvency Target is set at a level advised by the Fund Actuary as a prudent long-term funding objective for the Fund to achieve at the end of the Trajectory Period, based on continued investment in a mix of growth and matching assets intended to deliver a return above the rate of increases to pensions and pension accounts.
- For certain Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit, the Solvency Target will be set based on assumed investment in an appropriate portfolio of Government bonds after exit.

### ***Probability of Funding Success***

The administering authority considers funding success to have been achieved if the fund, at the end of the Trajectory Period, has achieved the Solvency Target. The Probability of Funding Success is the assessed chance of this happening based on the level of contributions payable by members and employers and asset-liability modelling carried out by the fund actuary.

The discount rate, and hence the overall required level of employer contributions, has been set such that the fund actuary estimates there is a 75% chance that the fund would reach or exceed its Solvency Target after 25 years.

### ***Funding Target***

The Funding Target is the amount of assets which the fund needs to hold at the valuation date to pay the liabilities at that date as indicated by the chosen valuation method and assumptions and the valuation data. The valuation calculations, including the future service costs and any adjustment for the surplus or deficiency set the level of contributions payable, then dictate the chance of achieving the Solvency Target at the end of the Trajectory Period.

Different Funding Targets apply to different employers:

- **Scheduled Bodies and certain other bodies where a Scheme Employer of sound covenant has agreed to subsume its assets and liabilities following the exit of the Employer from the Fund**  
The Administering Authority will adopt a general approach in this regard of assuming indefinite investment in a broad range of assets of higher risk than low risk assets for Scheduled Bodies and certain other bodies which are long term in nature. This is known as the Ongoing (Scheduled Body/Subsumption) Target.  
At its discretion, the Administering Authority may agree to adopt this target for certain other bodies of sound covenant open to new entrants.
- **Admission Bodies and certain other bodies whose participation is limited**  
For Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit the Administering Authority will have specific regard to the potential for participation to cease (or to have no contributing members), the potential timing of such exit, and any likely change in notional or

actual investment strategy as regards the assets held in respect of the body's liabilities at the date of exit (i.e. whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities). This is known as the Ongoing (Orphan body) Funding Target. This funding target was introduced with effect from 31 March 2019 so, for a transitional period, it has been set below its intended long term target level so that the change in Funding Target for those affected employers will be phased in.

- **Orphan liabilities**

These are liabilities with no access to funding from any employer in the Fund. To minimise the risk to other employers in the Fund, the assets notionally related to these liabilities will be assumed to be invested in low risk investments.

The key financial assumptions used for assessing the Funding Target at the 2019 valuation are summarised below.

| Assumption  | % p.a. |
|---|--------|
| Discount Rate – Ongoing (scheduled body/subsumption) Funding Target | 4.45   |
| Discount rate – Ongoing (orphan body) Funding Target                |        |
| - In service  | 4.45   |
| - Left service  | 3.00   |
| Discount rate – orphan liabilities                                  | 1.30   |
| Inflationary Salary Increases                                       | 3.1    |
| Consumer Price Indexation (CPI)                                     | 2.1    |

The above financial assumptions are adopted for most ongoing employers, but bespoke funding targets can be set at the discretion of the administering authority.

The demographic assumptions are intended to be best estimates of future experience in the fund. They vary by age and gender reflecting the different exposure of members.

#### 4.4 Primary Contribution Rates

The future service element of the employer contribution rate is calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. The approach used to calculate each employer's primary contribution rate depends on whether or not new entrants are being admitted.

##### 4.4.1 Employers that admit new entrants

The employer's primary contribution rate will be based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year. Technically these rates will be derived using the Projected Unit Method of valuation with a one year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise.

#### 4.4.2 Employers that do not admit new entrants

Certain Admission Bodies are closed to new entrants. This is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the primary contribution rate is expected to increase as the membership ages.

To give more long term stability to such employers' contributions, the Attained Age funding method is adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both funding methods are described in the actuary's report on the valuation.

Both primary contribution rates will include expenses of administration to the extent that they are borne by the fund and include an allowance for benefits payable on death in service and ill health retirement.

#### 4.5 Adjustments for Individual Employers

The administering authority does not account for each employer's assets separately. The fund's actuary is required to apportion the assets of the whole fund between the employers at each triennial valuation.

This apportionment is carried out in order to establish contribution rates for individual employers or pools of employers and is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, nor ownership of any particular assets by any individual employer or pool

#### 4.6 Asset Share Calculations for Individual Employers

The asset share allocated to each employer will be rolled forward allowing for all cashflows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income. In general no allowance is made for the timing of contributions and cashflows for each year are assumed to be made half way through the year with investment returns assumed to be uniformly earned over that year. However, where significant one-off employer contributions have been paid, allowance is made for the timing of such contributions.

Further adjustments are made for:

- A notional deduction to meet the expenses paid from the fund in line with the assumption used at the previous valuation.
- Allowance for death in service lump sum benefits shared across all employers in the fund.
- Allowance for any known material internal transfers in the fund (cashflows will not exist for these transfers). The fund's actuary will assume an estimated cashflow equal to that which would have been paid had the members individually transferred to or from another LGPS fund unless some other approach has been agreed between the two employers.
- An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund.

In some cases information available will not allow for such cashflow calculations. In such a circumstance:

- Where, in the opinion of the fund's actuary, the cashflow data which is unavailable is of low materiality, estimated cashflows will be used.
- Where, in the opinion of the fund's actuary, the cashflow data which is unavailable is material, the fund's actuary will instead use an analysis of gains and losses to roll forward the notional asset share. Analysis of gains and losses methods are less precise than use of cashflows and involve calculation of gains and losses relative to the surplus or deficiency exhibited at the previous valuation. Having established an expected surplus or deficiency at this valuation, comparison of this with the liabilities evaluated at this valuation leads to an implied notional asset share.

- Analysis of gains and losses methods will also be used where the results of the cashflow approach appears to give unreliable results perhaps because of unknown internal transfers.

## 4.7 Stability of Employer Contributions

### 4.7.1 Deficit Recovery Periods

The administering authority instructs the actuary to adopt specific deficit recovery periods for all employers when calculating their contributions.

The administering authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table below.

| Type of Employer   | Maximum Length of Deficit Recovery Period  |
|--|--|
| Statutory bodies with tax raising powers, Colleges, Universities and Academies | A period of 20 years   |
| Community Admission Bodies with funding guarantees                             | A period of 20 years   |
| Best Value Admission Bodies  | The period from the start of the revised contributions to the end of the employer's contract. In the event of a contract being extended it is not expected that an exit valuation would be required. |
| Community Admission Bodies that are closed to new entrants e.g. Bus Companies  | A period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers.   |
| All other types of employer  | A period equivalent to the expected future working lifetime of the remaining scheme members.   |

This maximum period is used in calculating each employer's minimum contributions. Employers may opt to pay higher regular contributions than these minimum rates.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2020 for the 2019 valuation). The administering authority reserves the right to propose alternative spreading periods, for example to improve the stability of contributions.

### 4.7.2 Surplus Spreading Periods

Any employers deemed to be in surplus may be permitted, at the discretion of the administering authority, to reduce their contributions below the cost of accruing benefits, in the circumstances below:

- In line with the desirability of maintaining as nearly constant a contribution rate at this and future valuations, any employer with a funding level of between 100% - 105% will be required to pay the primary rate (i.e. the future service rate) in full, without any adjustment for a surplus.
- For tax-raising scheduled bodies, a contribution adjustment may be applied to the primary (future service) contribution rate equal to the surplus above the 105% funding level spread over 22 years.
- For other employers subject to the Ongoing (Scheduled Body / Subsumption) Funding Target, a contribution adjustment may be applied to the primary (future service) contribution rate not larger than the surplus above the 105% funding level spread over 22 years. Contribution rates will not be permitted to be reduced below the lower of:

- the contributions being paid over the year immediately following the valuation date, and
- the primary (future service) rate plus allowance for benefit improvement uncertainties.
- For employers subject to the Ongoing (Orphan body) Funding Target, a contribution adjustment for surplus will not be permitted unless the employer is over 100% funded on the expected basis to be used on exit.

#### **4.7.3 Phasing in of Contribution Rises**

Best Value Admission Bodies are not eligible for phasing in of contribution rises. Other employers may opt to phase in contribution rises as follows:

- for employers contributing at or above their primary contribution rate, phasing in the rise in employer contributions over a period of 6 years;
- for employers contributing at less than their primary contribution rate, phasing in the rise in contribution rises over a period of 3 years.

#### **4.7.4 Phasing in of Contribution Reductions**

Normally contribution reductions will not be phased but the administering authority may decide that in exceptional circumstances phasing in of contribution reductions may be appropriate.

#### **4.7.5 The Effect of Opting for Longer Spreading or Phasing-In**

Employers which are permitted and elect to use a longer deficit spreading period than was used at the 2016 valuation or to phase-in contribution changes will be assumed to incur a greater loss of investment returns on the deficit by opting to defer repayment. Thus, deferring paying contributions will lead to higher contributions in the long-term.

However any adjustment is expressed for different employers, the overriding principle is that the discounted value of the contribution adjustment adopted for each employer will be equivalent to the employer's deficit.

#### **4.7.6 Pooled Contributions**

##### **4.7.6.1 Smaller Employers**

The administering authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service. Under normal circumstances any employer other than those listed at 4.7.6.2 will not be pooled once they exceed 50 active members. Consideration may also be given to voluntary pooling arrangements between councils and admission bodies.

Community Admission Bodies that are deemed by the administering authority to have closed to new entrants are not permitted to participate in a pool.

##### **4.7.6.2 Other Contribution Pools**

Academy schools are pooled together

Colleges are pooled together.

Some Admission Bodies with guarantors are pooled with their contracting Council.

Those employers that have been pooled are identified in Annex A.

#### 4.7.6.3 Pooling of Risk Benefits

All employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service and, from 1 April 2019, survivors pensions on death in service and payment of ill health pensions – in other words, the cost of such benefits is shared across the employers in the Fund. Such benefits can cause funding strains which could be significant for some of the smaller employers without insurance or sharing of risks. The Fund, in view of its size, does not see it as cost effective or necessary to insure these benefits externally and this is seen as a pragmatic and low cost approach to spreading the risk.

#### 4.8 Employers exiting the fund

Admission Agreements for Best Value contractors are assumed to expire at the end of the contract or any extension to the original contract. In the event that a Best Value contractor, which is already a member of the fund, wins a re-tendered contract the existing Admission Agreement will generally be allowed to continue.

Admission Agreements for other employers are generally assumed to be open-ended and to continue until the last active member ceases to contribute to the fund. These Admission Agreements can however be terminated at any point. Scheduled bodies may also exit the Fund.

If an employer exits the Fund, the administering authority instructs the fund actuary to carry out an exit valuation to determine whether there is any deficit or surplus.

On exit, the administering authority must look to protect the interests of ongoing employers and will require the actuary to adopt valuation assumptions for the exit valuation which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. To give effect to this, the administering authority will seek funding from the outgoing employer sufficient to enable it to match the liabilities remaining after any transfer of active members to another employer in the fund with low risk investments, generally Government bonds.

Any deficit would be levied on the departing admission body as a capital payment although, under exceptional circumstances, the administering authority, at its sole discretion, may allow phased payments.

Where the exit date is on or after 14 May 2018, if a surplus is shown, then the administering authority will return this surplus to the exiting employer within 3 months of the later of the exit date and the date at which all information has been provided to the administering authority to request a final exit valuation from the Actuary

For Best Value Admission Bodies, the relevant scheme employer will subsume the assets and liabilities of the exiting employer. For other employers, the administering authority may allow another participating scheme employer (such as a guarantor) to subsume the assets and liabilities of the exiting employer. The subsuming employer will assume responsibility for all assets and liabilities of the exiting employer and for the future funding of those assets and liabilities. In these circumstances, no exit payment would be required from the exiting employer. The administering authority will consider all such requests in accordance with its policy on employers exiting the Fund and retains its right to either accept or refuse such requests. Where admission bodies are pooled with the relevant contracting Council / guarantor for the purposes of setting contribution rates, any deficit or surplus on exit would remain with the contracting Council / guarantor unless the pooling arrangement states otherwise.

## **4.9 Early Retirement Costs**

### **4.9.1 Non Ill Health retirements**

The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health. Employers are required to pay additional contributions wherever an employee retires before attaining the normal retirement age. The current costs of these are specified in tables supplied by the fund's actuary which are modified from time to time.

### **4.9.2 Ill health monitoring**

The fund monitors each employer's, or pool of employers', ill health experience on an ongoing basis. It may be that an employer or group of employers exceeds the actuarial predictions in any given year. If this happens in consecutive years the fund reserves the right to increase employer contributions accordingly.

## **4.10 Long Term Cost Efficiency**

In order to ensure that measures taken to maintain stability of employer contributions are not inconsistent with the statutory objective for employer contributions to be set so as to ensure the long-term cost efficiency of the Fund, the Administering Authority has assessed the actual contributions payable by considering:

- The implied average deficit recovery period, allowing for the stepping of employer contribution changes;
- The investment return required to achieve full funding over the recovery period; and
- How the investment return compares to the Administering Authority's view of the expected future return being targeted by the Fund's investment strategy.



## 5. Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice.

### 5.1 Investment Strategy

The investment strategy currently being pursued is described in the fund's Investment Strategy Statement (ISS).

The investment strategy is set for the long-term, but is reviewed every three years as part of the fund's Asset/Liability Study to ensure that it remains appropriate to the fund's liability profile. In addition short-term investment strategy is reviewed every three months by the fund's advisors. The administering authority has adopted a strategic benchmark, which determines the mix of assets best able to meet the long-term liabilities of the fund. As at 31 March 2019 the actual assets of the fund, compared with the current strategic benchmark can be shown:

|                   | Fund Assets % | Target Strategic Benchmark % |
|-------------------|---------------|------------------------------|
| UK Equities       | 30            | 22                           |
| Overseas Equities | 45            | 28                           |
| Bonds/Cash        | 13            | 20                           |
| Property          | 9             | 15                           |
| Alternatives      | 3             | 15                           |

The investment strategy of lowest risk – but not necessarily the most cost-effective in the long-term – would be 100% investment in index-linked government bonds.

The fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from index-linked bonds

The same investment strategy is currently followed for all employers. The administering authority does not currently have the facility to operate different investment strategies for different employers.

### 5.2 Consistency with Funding Basis

The fund actuary has based the risk assessment underpinning the ongoing funding target on its asset class return, volatility and correlation assumptions. The return assumptions are best estimates of annualised returns, that is, there is a 50/50 chance that actual returns will be above or below the assumptions. The assumptions are long-term assumptions, based on 10 year and 30 year projection periods and are based on a quarterly basis.

By setting the discount rate such that it is expected that there is a 75% chance the fund would reach or exceed its Solvency Target after 25 years, the fund can demonstrate that it has taken a prudent-longer term view of funding the liabilities.

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 those required to meet the solvency target. The risk-based approach and other stability measures described in Section 5 will damp down, but not remove, the effect on employers' contributions.

### **5.3 Balance between risk and reward**

Prior to implementing its current investment strategy, the administering authority considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes like equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

### **5.4 Inter-valuation Monitoring of Funding Position**

Following the results of the April 2019 valuation, the administering authority intends to monitor investment performance relative to the growth in the liabilities by means of annual interim valuations. The results may be reported back to employers and the administering authority reserves the right to change employers contribution rates should there prove to be major differences in actual events compared to expectations set out in triennial valuations. Employers will be included in this process but they should be aware that they will need to ensure that resources are available within their organisations to enable the process to be completed correctly and efficiently.

This will ensure that employer data used in the valuation process is accurate and reflects properly the true balance between assets and liabilities.



## 6. Key Risks and Controls

### 6.1 Types of Risk

The administering authority's has an active risk management programme in place. The measures that the administering authority has in place to control key risks are summarised below under the following headings:

- Financial;
- Demographic;
- Regulatory;
- Governance; and
- Pooling

### 6.2 Financial Risks

| Risk  | Summary of Control Mechanisms   |
|---|---|
| Fund 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>Analyse progress at three yearly valuations for all employers.</p> <p>Inter-valuation investigation of liabilities between formal valuations will be obtained on an annual basis</p>               |
| Inappropriate long-term investment strategy   | <p>The fund sets fund-specific benchmarks, informed by Asset-Liability modelling of liabilities.</p> <p>The fund measures performance and sets managers' targets relative to a Liability / Customised Benchmark Portfolio.</p> <p>Fund uses two Independent investment advisors to inform strategy setting.</p> |
| Price inflation is significantly above expectation, leading to increase in liabilities  | <p>Inter-valuation monitoring, as above.</p> <p>Investment in diverse range of assets to ensure some asset values should rise in inflationary environment.</p>  |

|  |   |
|--|---|
| Active investment manager under-performance relative to benchmark  | <p>Short term (quarterly) investment monitoring analyses market performance of the investment team relative to their benchmark.</p> <p>This is supplemented with an analysis of absolute returns against a Liability Benchmark portfolio.</p> <p>This gives an early warning of contribution rises ahead. However, if underperformance is sustained over periods greater than 5 years, contributions would rise more.</p> |
| Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies | <p>Seek feedback from employers on scope to absorb short-term contribution rises.</p> <p>Mitigate impact through deficit spreading and phasing in of contribution rises.</p>  |

### 6.3 Demographic Risks

| Risk   | Summary of Control Mechanisms  |
|--|--|
| Pensioners living longer leads to increased fund liabilities     | Set mortality assumptions with some allowance for future increases in life expectancy.   |
| Unanticipated pay rises increase final salary linked liabilities | Employers will monitor own experience and are made aware of generic impact salary increases can have upon final salary linked elements of LGPS benefits. |

### 6.4 Regulatory

| Risk  | Summary of Control Mechanisms   |
|---|---|
| Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees | <p>The administering authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself.</p> <p>It considers all consultation papers issued by the DCLG and comments where appropriate.</p> <p>The administering authority will consult employers where it considers that it is appropriate.</p> |

There are a number of uncertainties associated with the benefit structure at the current time including:

- How Government will address the issues of GMP indexation and equalisation for the LGPS beyond expiry of the current interim solution from 6 April 2021

- The remedy to compensate members for illegal age discrimination following the outcome of the McCloud/Sargeant cases. Whilst the Government's application for leave to appeal has been denied there is currently still significant uncertainty relating to the remedy and exactly how this will apply to the LGPS
- The outcome of the cost management process and whether the agreement reached in relation to the Scheme Advisory Board (SAB) process for member contributions to be reduced and benefits enhanced to achieve an additional cost of 0.9% of pay will change as a result of the McCloud/Sargeant ruling

In determining how these uncertainties should be allowed for in employer contributions from 1 April 2020 the Administering Authority will have regard to guidance issued by the SAB, taking account of the Fund Actuary's advice. At present the Administering Authority considers an appropriate course of action for the 2019 valuation is to include a loading of 0.9% of Pay within the employer contribution rates certified by the Fund Actuary that reflects the possible overall extra costs to the Fund as advised by the Fund Actuary. It is possible that the allowance within contribution rates might be revisited by the Administering Authority and Fund Actuary at future valuations (or, if legislation permits, before future valuations) once the implications for Scheme benefits and employee contributions are clearer.

In addition, a consultation document was issued by MHCLG entitled "Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk" dated May 2019. This included a proposal to change the LGPS local fund valuations to quadrennial cycles. The Administering Authority will have regard to any changes in the LGPS 2013 Regulations as a result of this consultation and consider any actions required at the 2019 or subsequent valuations, taking account of the Fund Actuary's advice.

## 6.5 Governance

| Risk   | Summary of Control Mechanisms   |
|--|---|
| The administering authority is unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements).                 | The administering authority monitors membership movements on an annual basis, via a report from the administrator.<br><br>The actuary may be instructed to consider revising the Rates and Adjustments certificate to increase an employer's contributions (under Regulation 64) between triennial valuations |
| The administering authority not advised of an employer closing to new entrants.  | Deficit contributions are generally expressed as monetary amounts (see Annex A).  |
| The administering authority fails to commission the fund actuary to carry out a termination valuation for a departing employer and losing the opportunity to call in a debt. | In addition to the administering authority monitoring membership movements on an annual basis, it requires employers with Best Value contractors to inform it of forthcoming changes.<br><br>It also operates a diary system to alert it to the forthcoming termination of Best Value Admission Agreements.   |
| An employer ceasing to exist with insufficient funding or adequacy of a bond.  | The administering authority believes that it would normally be too late to address the position if it was left until the time of departure.   |

|  |  |
|--|--|
|  | <p>The risk is mitigated by:</p> <ul style="list-style-type: none"> <li>• Seeking a funding guarantee from another scheme employer, or external body, wherever possible.</li> <li>• Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</li> <li>• Vetting prospective employers before admission.</li> <li>• Requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.</li> <li>• Imposing higher employer contributions for Employers to reduce the risk of volatile contributions and a significant debt crystallising on termination.</li> </ul> |
|--|--|

**6.6 Pooling**

| Risk   | Summary of Control Mechanisms  |
|--|--|
| Pooling investment underperformance: Investments in the investment pool not delivering the required return   | <p>Border to Coast sub-fund performance is monitored on an on-going basis, as part of a formal part of the normal Border to Coast governance, and reported upon to the Committee.</p> <p>As joint owner of Border to Coast, the administering authority has a degree of control and oversight over the funding and operation of the investment pooling company. Working collectively with the other partner funds in Border to Coast and liaising with the company on a regular basis ensures the best chance of delivering effective investment outcomes.</p> |
| Systemic and other investment risks not being properly managed within the investment pool; for example appropriate diversification, credit, duration, liquidity and currency risks | <p>Appropriate due diligence is carried out regarding the structure, targets, diversification and risk approach for each sub-fund before investment. Border to Coast sub-fund investment elements are monitored on an on-going basis, and reported to the Committee.</p>   |

## 7. Responsibilities of the Key Parties

### 7.1 Responsibilities

The efficient and effective management of the pension fund can only be achieved if all parties exercise their statutory duties and responsibilities conscientiously and diligently.

There are a wide range of stakeholders in LGPS funds, all of whom have a role in its effective management. Bankers, custodians, investment managers, auditors and legal, investments and governance advisors all form part of the fund management process. Consequently the Funding Strategy Statement (FSS) should recognise these roles and define the responsibilities attached to them. However, the primary parties to the FSS are the administering authority, scheme employers and the fund actuary. The FSS should document their specific roles in more detail.

Many of the roles and responsibilities of administering authorities, scheme employers and actuaries are set out in LGPS legislation. Others are defined in guidance and professional standards or by an agreement between the parties.

### 7.2 Responsibilities of Primary Parties

#### The administering authority is required to:

- Operate a pension fund;
- Collect employer and employee contributions, investment income and other amounts due to the pension fund as stipulated in LGPS Regulations;
- Pay from the pension fund the relevant entitlements as stipulated in LGPS Regulations;
- Invest surplus monies in accordance with the LGPS 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 Investment Strategy Statement (ISS), both after proper consultation with interested parties;
- Monitor all aspects of the fund's performance and funding, and amend the FSS accordingly;
- Effectively manage any potential conflicts of interest arising from its dual role as both fund administrator and scheme employer; and
- Enable the local pension board to review the valuation process as set out in their terms of reference.

#### The individual scheme employer is required to:

- Deduct contributions from employees' pay correctly;
- Pay all ongoing contributions, including employer contributions determined by the actuary and set out in the rates and adjustments certificate, 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 scheme benefits and early retirement strain;
- Notify the administering authority promptly of all changes to active membership which affect future funding; and
- Pay any exit payments on ceasing participation in the fund.

**The fund actuary should:**

- Prepare valuations including the setting of employers' contribution rates at a level to ensure fund solvency and long-term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and LGPS Regulations;
- Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters such as pension strain costs, ill health retirement costs, compensatory added year costs, etc.;
- Provide advice and valuations on the termination of admission agreements and exit of employers;
- 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 permitted or required by the regulations; and
- Ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the fund.

## Annex A – Employers' Contributions, Spreading and Phasing Periods

Following the 2019 valuation, the minimum employer contributions shown in the Rates and Adjustment certificate attached to the 2019 valuation report are based on the deficit recovery periods and phasing periods shown in the table below. The table also shows the individual adjustments under Regulation 62(7) to each employer's contributions from the Primary Contribution Rate.

*Table to be updated when employer contribution rates agreed*

| Employer Code                             | Employer                           | Recovery Period<br>Years | Phasing Period<br>Years |
|---|------------------------------------|--------------------------|-------------------------|
| <b>Scheduled Body Pools</b>               |                                    |                          |                         |
| Hartlepool Borough Council Pool           |                                    |                          |                         |
| 102                                       | Hartlepool Council                 |                          |                         |
| Middlesbrough Council Pool                |                                    |                          |                         |
| 104                                       | Middlesbrough Council              |                          |                         |
| 192                                       | Mouchel Ltd                        |                          |                         |
| 205                                       | Oakfields Community College        |                          |                         |
| Redcar and Cleveland Borough Council Pool |                                    |                          |                         |
| 103                                       | Redcar and Cleveland               |                          |                         |
| 197                                       | Creative Management Services Ltd   |                          |                         |
| Stockton Borough Council Pool             |                                    |                          |                         |
| 105                                       | Stockton Council                   |                          |                         |
| <b>Other Scheduled Bodies Pool</b>        |                                    |                          |                         |
| 6   | Guisborough Town Council           |                          |                         |
| 7   | Saltburn and Marske Parish Council |                          |                         |
| 20  | Loftus Town Council                |                          |                         |
| 191                                       | Ingleby Barwick Town Council       |                          |                         |
| 200                                       | Yarm Town Council                  |                          |                         |
| 214                                       | Skelton and Brotton Parish Council |                          |                         |
| 215                                       | Billingham Town Council            |                          |                         |

|                       |   | Recovery<br>Period | Phasing<br>Period |
|-----------------------|---|--------------------|-------------------|
| Employer<br>Code      | Employer                                    | Years              | Years             |
| 274                   | Lockwood Parish Council                     |                    |                   |
| College Pool          |   |                    |                   |
| 27                    | Hartlepool College of Further Education     |                    |                   |
| 33                    | Hartlepool Sixth Form College               |                    |                   |
| 37                    | Stockton Sixth Form College                 |                    |                   |
| 38                    | Cleveland College of Art and Design         |                    |                   |
| 51                    | Redcar and Cleveland College                |                    |                   |
| 57                    | Prior Pursglove College                     |                    |                   |
| 61                    | Middlesbrough College                       |                    |                   |
| 194                   | Stockton Riverside College                  |                    |                   |
| Cleveland Fire Pool   |   |                    |                   |
| 48                    | Cleveland Fire Brigade                      |                    |                   |
| 178                   | OCS Limited                                 |                    |                   |
| 202                   | Cleveland Fire Support Network              |                    |                   |
| Cleveland Police Pool |   |                    |                   |
| 49                    | Cleveland Police                            |                    |                   |
| 211                   | Steria Ltd                                  |                    |                   |
| 235                   | Police and Crime Commissioner for Cleveland |                    |                   |
| 236                   | Chief Constable for Cleveland               |                    |                   |
| Academy Pool          |   |                    |                   |
| 63                    | Unity City Academy                          |                    |                   |
| 64                    | Kings Academy                               |                    |                   |
| 181                   | Macmillan Academy                           |                    |                   |
| 206                   | Freebrough Academy                          |                    |                   |
| 207                   | North Shore Academy                         |                    |                   |
| 208                   | Thornaby Academy                            |                    |                   |
| 224                   | Eston Park Academy                          |                    |                   |
| 225                   | Brambles Academy                            |                    |                   |

| Employer |                                   | Recovery Period | Phasing Period |
|----------|-----------------------------------|-----------------|----------------|
| Code     | Employer                          | Years           | Years          |
| 226      | Pennyman Primary Academy          |                 |                |
| 227      | Chandlers Ridge Academy           |                 |                |
| 228      | Nunthorpe Academy                 |                 |                |
| 229      | Ormesby School                    |                 |                |
| 230      | KTS Academy                       |                 |                |
| 232      | Gillbrook Academy                 |                 |                |
| 233      | North Ormesby Primary Academy     |                 |                |
| 234      | Redcar Academy                    |                 |                |
| 238      | Conyers School                    |                 |                |
| 239      | St Gregory's Catholic Academy     |                 |                |
| 244      | Dyke House Academy                |                 |                |
| 245      | Caldicotes Primary Academy        |                 |                |
| 249      | Hardwick Green Primary Academy    |                 |                |
| 251      | Extol Academy Trust               |                 |                |
| 252      | Stranton Academy Trust            |                 |                |
| 253      | Eskdale Academy                   |                 |                |
| 254      | Catcote Academy                   |                 |                |
| 255      | Horizons Academy Trust            |                 |                |
| 256      | St Michaels Catholic Academy      |                 |                |
| 260      | Fredrick Nattrass Primary Academy |                 |                |
| 261      | Oak Tree Primary Academy          |                 |                |
| 262      | Outwood Academy Acklam            |                 |                |
| 263      | Dormanstown Primary Academy       |                 |                |
| 264      | Skelton Primary Academy           |                 |                |
| 265      | St Bede's Catholic Academy        |                 |                |
| 267      | Sunnyside Academy                 |                 |                |
| 268      | Rose Wood Academy                 |                 |                |
| 269      | Viewley Hill Academy Trust        |                 |                |
| 270      | Hemlington Hall Academy           |                 |                |
| 271      | Norton Primary Academy            |                 |                |
| 272      | Yarm Primary School               |                 |                |
| 273      | Grangefield Academy               |                 |                |

| Employer                     |  | Recovery Period | Phasing Period |
|------------------------------|--|-----------------|----------------|
| Code                         | Employer                                 | Years           | Years          |
| 276                          | English Martyrs Education Trust          |                 |                |
| 277                          | Easterside Academy                       |                 |                |
| 278                          | St Margaret Clithero's Primary Academy   |                 |                |
| 279                          | St Gabriel's Catholic Academy            |                 |                |
| 280                          | St Mary's Catholic Academy               |                 |                |
| 281                          | St Peters Academy of Maths and Computing |                 |                |
| 282                          | Green Lane Primary Academy               |                 |                |
| 283                          | Kader Primary School                     |                 |                |
| 284                          | Normanby Primary School                  |                 |                |
| 285                          | Nunthorpe Primary Academy                |                 |                |
| 286                          | Ingleby Manor Free School                |                 |                |
| 287                          | Hillsview Academy                        |                 |                |
| 289                          | Harrow Gate Primary Academy              |                 |                |
| 290                          | Ian Ramsey COE Academy                   |                 |                |
| 291                          | Ash Trees Academy                        |                 |                |
| 292                          | St Bede's Primary CV Academy             |                 |                |
| 293                          | St Joseph's Primary Academy              |                 |                |
| 294                          | St Paulinus PCV Academy                  |                 |                |
| 296                          | West View Academy                        |                 |                |
| 297                          | Outwood Academy Bydales                  |                 |                |
| Other Employers (Not Pooled) |  |                 |                |
| 25                           | Teesside University                      |                 |                |
| 60                           | Future Regeneration of Grangetown        |                 |                |
| 72                           | Stagecoach Transit                       |                 |                |
| 151                          | Community Integrated Care                |                 |                |
| 155                          | One Awards                               |                 |                |
| 162                          | Tristar Homes Limited                    |                 |                |
| 163                          | Coast and Country Housing                |                 |                |
| 168                          | Dimensions (UK) Ltd                      |                 |                |
| 170                          | Liberata UK Ltd                          |                 |                |
| 171                          | Durham Tees Valley Airport Limited       |                 |                |

|                  |  | Recovery<br>Period | Phasing<br>Period |
|------------------|--|--------------------|-------------------|
| Employer<br>Code | Employer                               | Years              | Years             |
| 176              | Housing Hartlepool Ltd                 |                    |                   |
| 177              | Tees Active Limited                    |                    |                   |
| 179              | Erimus Housing                         |                    |                   |
| 182              | Carillion JM Ltd                       |                    |                   |
| 189              | Ofsted                                 |                    |                   |
| 193              | Beamish                                |                    |                   |
| 195              | Fabrick Housing Group                  |                    |                   |
| 198              | Carillion AM Ltd                       |                    |                   |
| 199              | Business and Enterprise Commercial Ltd |                    |                   |
| 201              | Care Quality Commission                |                    |                   |
| 209              | Taylor Shaw Ltd                        |                    |                   |
| 210              | RM Education Ltd                       |                    |                   |
| 212              | Forward Swindon                        |                    |                   |
| 216              | Fleet Factors Ltd (MBC)                |                    |                   |
| 219              | Capita Managed IT Solutions Ltd        |                    |                   |
| 221              | Wolseley Ltd                           |                    |                   |
| 222              | The Big Life Company Ltd               |                    |                   |
| 223              | 4 Children Ltd                         |                    |                   |
| 237              | Fleet Factors Ltd (RCBC)               |                    |                   |
| 240              | KGB Cleaning and Support Services Ltd  |                    |                   |
| 241              | SLM Community Leisure Charitable Trust |                    |                   |
| 242              | SLM Food and Beverage Ltd              |                    |                   |
| 243              | SLM Fitness and Health Ltd             |                    |                   |
| 246              | One IT Solutions Ltd                   |                    |                   |
| 247              | Tascor Services Ltd (PFI)              |                    |                   |
| 248              | Tascor Services Ltd (Custody)          |                    |                   |
| 250              | Ecocleen Services Ltd                  |                    |                   |
| 257              | Taylor Shaw – Holy Rosary              |                    |                   |
| 258              | Taylor Shaw – St Peter's               |                    |                   |
| 259              | Taylor Shaw – Riverdale                |                    |                   |
| 266              | Mellors Catering Services Ltd          |                    |                   |
| 0                | Diocese of Middlesbrough Trust         |                    |                   |

| Employer |   | Recovery Period | Phasing Period |
|----------|---|-----------------|----------------|
| Code     | Employer                                | Years           | Years          |
| 288      | Creative Management Services Ltd        |                 |                |
| 295      | Mellors Catering Services Ltd (Central) |                 |                |



## Annex B – Further Explanation of the Fund's Treatment of Employers

### 1. Background

This Annex explains the fund's policies and procedures in the treatment of employers including the commencement or admission, participation and exit of employers in the fund, as administered by Middlesbrough Council.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

Where the information relates to a particular type of employer, this will be explained. If no type of employer is indicated the information relates to all employers in the Fund.

The administering authority's aim is to minimise risk to the fund by ensuring that the employers participating in the Fund are managed in a way that ensures they are able to adequately fund the liabilities attributable to them and, in particular to pay any deficit due when leaving the fund.

The administering authority has an obligation to pursue all liabilities owed so any shortfall from an individual employer does not fall back on other employers.

### 2. Process for Admission Bodies

An employer who wishes to join the fund may apply to the administering authority for admission. If admitted, that employer becomes an admission body and specified categories of its employees can participate as members of the Fund.

The administering authority is responsible for deciding whether an application from an employer to become an admission body within the Fund should be declined or accepted.

#### **Bond, Indemnity or Guarantee**

It is important to minimise the risk that a new admission body might create for the Fund and the other employers in the Fund. This risk will be taken into account by the administering authority in considering the application for admission, who may put in place conditions on any approval of admission to the fund to minimise this risk, such as a satisfactory guarantee, indemnity or bond and a satisfactory risk assessment.

An indemnity / bond is a way of insuring against the potential cost of the admission body failing by reason of insolvency, winding up or liquidation and hence being unable to meet its obligations to the Fund.

In order to reduce the risk of the liabilities not being funded at the point of exit, the Regulations require that a risk assessment be carried out, taking account of actuarial advice, on the level of risk arising on premature termination on insolvency, winding up or liquidation. This assessment is carried out by the Admission Body to the satisfaction of the administering authority. In an outsourcing situation, the risk assessment must also be to the satisfaction of the letting employer (i.e. the employer that the

outsourcing is coming from). Usually the actuarial advice is provided to the administering authority by the fund's actuary and the cost for this is recharged to the admission body or, where appropriate, to the letting employer.

The risk must be kept under review throughout the period of the admission and assessed at regular intervals and otherwise as required by the administering authority.

Where there is an employer prepared to act as a guarantor (including a letting employer in an outsourcing situation), the bond will be largely for that fund employer's protection (rather than for all employers in the fund), in which case the guarantor must decide if the admitted body will be required to provide a higher bond than that calculated by the fund's actuary.

Where the liabilities on exit from the fund cannot be fully met by a guarantor or insurer, the Regulations provide that:

- the letting employer will be liable in an outsourcing situation; and
- in all other cases the liabilities will fall on all the other employing authorities within the Fund.

### 3. Actuarial Calculations

#### **Funding Target**

The funding target relates to what is expected to happen to the liabilities in respect of the employees of the employer on exit of that employer.

For tax raising scheduled bodies, the funding target is set out in section 4 of the FSS.

For Best Value Admission the letting employer will provide a "subsumption commitment" (i.e. be responsible for the future funding of the Admission Body's pension liabilities after any exit payment has been made).

Best Value Admission Bodies and other employers subject to a subsumption commitment from another scheduled body employer in the Fund (e.g. via a guarantee) will be subject to the funding target of the body providing the subsumption commitment.

Outstanding liabilities of employers from whom no further funding can be obtained are known as orphan liabilities. The administering authority must look to protect the interests of ongoing employers and will require the actuary to adopt valuation assumptions for such employers which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future.

To achieve this, the exit valuation for an employer is carried out to enable the Fund to match the transferring liabilities with low risk investments. (Generally Government fixed-interest and index-linked bonds).

#### **Initial notional asset transfer**

When a new employer starts in the Fund, and members transfer from another employer in the Fund, a notional transfer of assets is needed from the original employer to the new employer.

When a new admission body starts in the Fund, they will usually start as fully funded. This means that any past service surplus or deficit for the members who are transferring to the new employer remains with the original employer and does not transfer to the new employer.

Another option for the initial notional asset transfer is to allow for the funding level of the original employer, and therefore to transfer any past service surplus or deficit in respect of the transferring membership to the new employer. This approach would normally apply to new scheduled bodies.

For academies, a prioritised share of fund approach is followed. This involves fully funding the non-active members of the original employer, and using the residual assets to calculate the funding level applicable to the active members of the original employer, to a maximum of the overall funding level of the original employer. This funding level is then used to calculate the notional asset transfer to the new employer.

Where the new employer will participate in a pool of employers, the notional asset transfer would be to the relevant pool of employers.

### **Employer Contribution Rate**

#### **Initial Rate**

When a new employer joins the fund, the fund's actuary determines the initial employer contribution rate payable.

Where the new employer:

- has less than 10 members,
- the notional asset transfer is on a fully funded approach, and
- is not subject to the ongoing (orphan body) funding target

an interim contribution rate is set until the next Actuarial Valuation of the fund. Currently the interim contribution rates are 17.9% of pay for an employer open to new entrants and 18.9% of pay for an employer closed to new entrants. The administering authority may change these interim contribution rates from time to time at its discretion.

Where the new employer joins a pool of employers, then it will generally pay the employer's contribution rate applicable to that pool. New academies will automatically join the Academy Pool.

In other cases, the fund's actuary will calculate an individual contribution rate for the new employer to be paid from commencement.

The employer contribution rate will be set in accordance with the Funding Strategy Statement, taking into consideration elements such as:

- Any past service or inherited liabilities.
- Whether the new employer is open or closed to new entrants.
- For admission bodies, whether the admission agreement is fixed term or not, and the period of any fixed term contract period.

- The funding target that applies to the employer.
- Other relevant circumstances.

### **Varying the Employer Contribution Rate**

The Regulations require a triennial Actuarial Valuation of the fund. As part of each Actuarial Valuation the contribution rates paid by each employer in the fund are reviewed and may be increased or reduced.

The employer contribution rate set for admission bodies may also be reviewed outside of the triennial Actuarial Valuations where there has been a material change of circumstances, such as the basis of the admission changing from open to closed or where it otherwise appears likely that the admission body may exit from the Fund.

In particular, where an employer has a subsumption guarantee from another employer in the fund, annual reviews of contribution rates are anticipated in the period prior to exit.

### **Exit from the Fund (terminations)**

If an exit is triggered, the employer will be responsible for all costs (including any deficit). An exit valuation will be carried out when an employer becomes an "exiting employer", i.e. it either:

- ceases to be a Fund employer (including ceasing to be an admission body participating in the Fund),  
or
- no longer has any active members contributing towards the Fund.

If an employer exits the fund (for example, an admission body's admission agreement is terminated), the administering authority will instruct the fund's actuary to carry out an exit valuation to determine whether there is any deficit or surplus in the fund.

The assumptions adopted to value the departing employer's liabilities for this valuation will be set to enable the Fund to match the exiting employer's former liabilities (after any transfer of active members to other employers in the fund) with low risk investments (generally Government fixed-interest and index-linked bonds).

Any deficit would normally be levied on the departing employer as a single capital payment although, under exceptional circumstances, the administering authority may, at its sole discretion, allow phased payments.

For Best Value Admission bodies, and other employers where the administering authority has agreed that another employer within the fund may subsume the assets and liabilities of the exiting employer (ie the subsuming employer will assume responsibility for all assets and liabilities of the exiting employer and for the future funding of those assets and liabilities), the assets, liabilities and any deficit or surplus will be transferred to the subsuming employer. In such cases, no exit payment would be required from the exiting employer, but any surplus revealed by the exit valuation would be paid to the employer as an exit credit.

At the administering authority's discretion it is possible to suspend a demand for an exit payment for up to 3 years where the administering authority believes that the employer is likely to have one or more active members contributing to the fund within the period specified in the suspension notice. The Administering Authority considers that it may be appropriate to exercise that discretion in relation to Town and Parish Councils.

If this occurs, the Fund will issue written notice of the period of the suspension notice. Whilst under such a suspension notice, the employer must continue to pay any deficit payments and the fund's actuary will recalculate any deficit at the next Actuarial Valuation.

Where the exit date is on or after 14 May 2018, if a surplus is shown in the exit valuation, then the Administering Authority will return this surplus to the exiting employer within 3 months of the later of the exit date and the date at which all information has been provided to the Administering Authority to request a final exit valuation from the Actuary, unless the agreement between the exiting employer and any employer providing a subsumption commitment provides that any surplus is not returned on exit.

### **Pooled employers**

#### **1. Admission bodies pooled with the fund employer**

Where an admission body is pooled with the outsourcing employer the exit valuation will be carried out in accordance with the agreement between the admission body and the outsourcing body. Generally, any deficit or surplus on exit would remain with the contracting Council / guarantor unless the pooling arrangement states otherwise.

#### **2. Other pools of employers**

When a pooled employer (other than those admission bodies pooled with the original outsourcing employer, covered in 1 above) is exiting the fund, the assets notionally allocated to the relevant employer are deemed to be equal to the product of the liabilities relating to that employer and the funding level of the pool as a whole. Normally the funding level of the pool will be measured at triennial Actuarial Valuation dates and will then be rolled forward on a pooled basis between Actuarial Valuations.

### **Responsibilities of employers in the Fund**

Individual employers will pay for any legal and actuarial costs incurred on their behalf.

The administering authority expects all employers in the Fund to take into consideration the effect of their behaviours on the Fund and any pool they are part of, for example when considering:

- Discretions policies
- Outsourcing decisions
- Salary increases

Employers should have regard to the fund administration strategy at all times.

All employers need to inform the Fund of any changes to the organisation that will impact on their participation in the Fund. This includes change of name or constitution or mergers with other organisations or other decision which will or may materially affect the employer's Fund membership.

Employers considering outsourcing any services should have regard to and adhere to the requirements of the Fair Deal Policy/Best Value direction. They should also advise the administering authority at the earliest opportunity and before any transfer of staff so that the necessary paperwork and calculations can be completed.