

# **FUNDING STRATEGY STATEMENT**

## **DECEMBER 2018**




**Teesside Pension Fund**

## Table of Contents

TABLE OF CONTENTS	2
1. INTRODUCTION	4
1.1 Regulatory Framework	4
1.2 Reviews of the FSS	5
2. PURPOSE OF THE FUNDING STRATEGY STATEMENT	6
2.1 Purpose	6
3. PURPOSE OF THE FUND	7
3.1 Purpose	7
3.2 Aims	7
4. SOLVENCY ISSUES AND TARGET FUNDING LEVELS	8
4.1 Setting the Employer Contribution Rate	8
4.2 Solvency and Target Funding Levels	8
4.3 Ongoing Funding Basis	9
4.4 Primary Contribution Rates	10
4.4.1 Employers that admit new entrants	10
4.4.2 Employers that do not admit new entrants	11
4.5 Adjustments for Individual Employers	11
4.6 Asset Share Calculations for Individual Employers	11
4.7 Stability of Employer Contributions	12
4.7.1 Deficit Recovery Periods	12
4.7.2 Surplus Spreading Periods	12
4.7.3 Phasing in of Contribution Rises	12
4.7.4 Phasing in of Contribution Reductions	13
4.7.5 The Effect of Opting for Longer Spreading or Phasing-In	13
4.7.6 Pooled Contributions	13
4.7.6.1 Smaller Employers	13
4.7.6.2 Other Contribution Pools	13
4.8 Employers ceasing	13
4.9 Early Retirement Costs	14
4.9.1 Non Ill Health retirements	14
4.9.2 Ill health monitoring	14
4.10 Long-term Cost Efficiency	14
5. LINKS TO INVESTMENT STRATEGY	16
5.1 Investment Strategy	16
5.2 Consistency with Funding Basis	16
5.3 Balance between risk and reward	17

5.4	Inter-valuation Monitoring of Funding Position	17
6.	KEY RISKS AND CONTROLS	18
6.1	Types of Risk	18
6.2	Financial Risks	18
6.3	Demographic Risks	19
6.4	Regulatory	19
6.5	Governance	20
7.	RESPONSIBILITIES OF THE KEY PARTIES	21
7.1	Responsibilities	21
7.2	Responsibilities of Primary Parties	21
	ANNEX A – EMPLOYERS’ CONTRIBUTIONS, SPREADING AND PHASING PERIODS	23
	ANNEX B – FURTHER EXPLANATION OF THE FUND’S TREATMENT OF EMPLOYERS	29

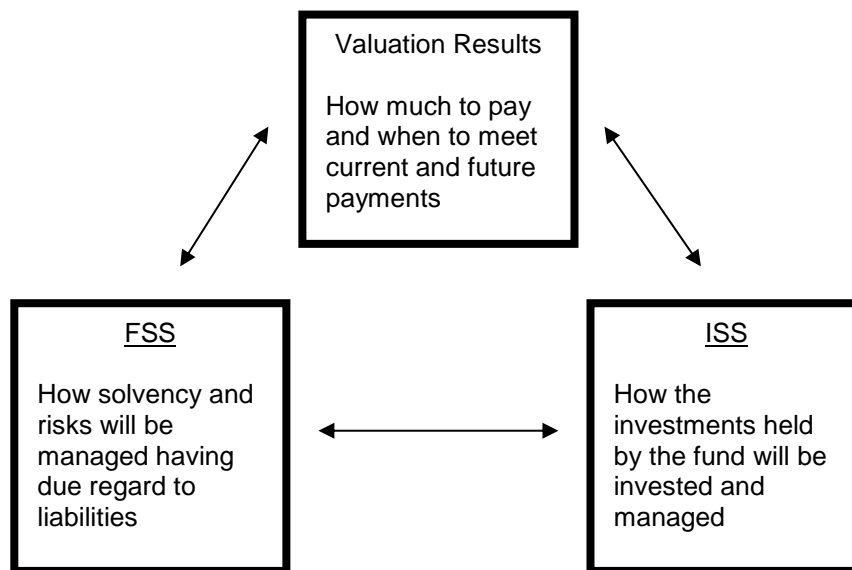


## 1. Introduction

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 2017. The Administering Authority will next formally review the FSS as part of the triennial valuation of the Fund as at 31 March 2019 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 positive net cash flow. It is, however, recognised that 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 currently has a net cash inflow and 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 complex (stochastic) risk 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.

For all employers in the fund, appropriate assumptions are taken to be assumptions such that, if the fund had reached the Solvency Target, its financial position continued to be assessed by use of such methods and assumptions, and contributions were paid in accordance with those methods and assumptions, there would be an 80% chance that the fund would be at least 100% funded after a period of 25 years. (The appropriate actuarial methods are considered in paragraph 4.4 below)

This then defines the Solvency Target.

### ***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 70% 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. The key financial assumptions used for assessing the Funding Target at the 2016 valuation are summarised below.

<b>Assumption</b>	<b>% p.a.</b>
Discount Rate	4.7
Inflationary Salary Increases	3.0
Consumer Price Indexation (CPI)	2.0

The same 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 2017 for 2016 valuation). The administering authority would normally expect the same period to be used at successive triennial valuations, but would reserve 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, by spreading the surplus element over the maximum periods shown above for deficits in calculating their contributions. The Administering Authority would generally permit such a reduction in contributions for tax raising scheduled bodies, except in exceptional circumstances.

### 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 2013 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.

#### **4.8 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.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

- a) For Best Value Admission Bodies, the assumptions would be those used for an ongoing valuation to be consistent with those used to calculate the initial transfer of assets to accompany the active member liabilities transferred.
- b) For any other employer that terminates their participation, the administering authority must look to protect the interests of ongoing employers and will require the actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. This could give rise to significant payments being required.
- c) For employers with guarantors, any deficit or surplus could be transferred to the guarantor in which case it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit or surplus.

Under (a) and (b), 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 under (a), 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 the relevant contracting Council / guarantor provides that any surplus is not returned on exit.

Where the exit date is on or after 14 May 2018, if a surplus is shown under (b), 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.

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 2018, 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	43	28
Bonds/Cash	18	20
Property	8	15
Alternatives	1	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 70% 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 2016 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; and
- Governance.

### 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 underperforming.</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>
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	<p>Inter-valuation monitoring, as above.</p> <p>Some investment in bonds helps to mitigate this risk.</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>

Pay and price inflation significantly more than anticipated	<p>The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.</p> <p>Inter-valuation monitoring, as above, gives early warning.</p> <p>Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.</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.	<p>Set mortality assumptions with some allowance for future increases in life expectancy.</p> <p>Administering authority encourage any employers concerned at costs to promote later retirement culture.</p>
Deteriorating patterns of early retirements	<p>Employers are charged the extra capital cost of non ill health retirements following each individual decision.</p> <p>Employer ill health retirement experience is monitored.</p>

### 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>
Changes to national pension requirements and / or Inland Revenue rules, e.g. effect of abolition of earnings cap for post 1989 entrants from April 2006	<p>The administering authority will consult employers where it considers that it is appropriate.</p>

## 6.5 Governance

Risk	Summary of Control Mechanisms
<p>The administering authority is unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements).</p>	<p>The administering authority monitors membership movements on an annual basis, via a report from the administrator.</p>
<p>The administering authority not advised of an employer closing to new entrants.</p>	<p>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</p> <p>Deficit contributions are generally expressed as monetary amounts (see Annex A).</p>
<p>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.</p>	<p>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.</p> <p>It also operates a diary system to alert it to the forthcoming termination of Best Value Admission Agreements.</p>
<p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p>	<p>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> <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>

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

Following the 2016 valuation, the minimum employer contributions shown in the Rates and Adjustment certificate attached to the 2016 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.

Employer Code	Employer	Recovery Period Years	Phasing Period 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		
274	Lockwood Parish Council		

Employer		Recovery Period	Phasing Period
Code	Employer	Years	Years
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		
226	Pennyman Primary Academy		



Employer		Recovery Period	Phasing Period
Code	Employer	Years	Years
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 Natrass 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		
276	English Martyrs Education Trust		

		Recovery Period	Phasing Period
Employer Code	Employer	Years	Years
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		
176	Housing Hartlepool Ltd		

Employer		Recovery Period	Phasing Period
Code	Employer	Years	Years
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	Ecoclean 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		
288	Creative Management Services Ltd		

Employer Code		Employer	Recovery Period	Phasing Period
			Years	Years
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 termination 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 happens 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 any employer where the liabilities will become orphan liabilities 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. 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 orphan funding target

an interim contribution rate is set until the next Actuarial Valuation of the fund. Currently the interim contribution rates are 17% of pay for an employer open to new entrants and 18% 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.

### **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 depend upon the circumstances, and on the Funding Target adopted for the employer.

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 admission bodies with guarantors, any deficit or surplus could be transferred to the guarantor in which case it may be possible to simply transfer the former admission body's liabilities and assets to the guarantor, without needing to crystallise any deficit or surplus.

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 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.