Appendix 1

West Midlands Pension Fund

Funding Strategy Statement 2017

March 2017

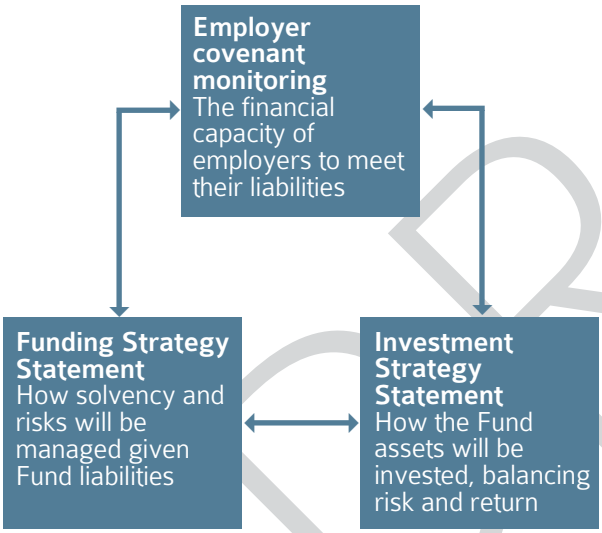
Funding Strategy Statement 2017

1) Introduction

1.1 LGPS regulations require administering authorities to prepare and maintain a Funding Strategy Statement (FSS) having regard to the guidance produced by The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Fund's Statement of Investment Principles (SIP). Revised regulations came into effect in 2013 and revised CIPFA guidance was issued in September 2016. This statement has been prepared by the West Midlands Pension Fund in accordance with the latest regulations and guidance and following consultation with appropriate persons. It reflects the shift in focus towards the regulatory requirement for administering authorities to ensure contributions are set at a level to achieve Fund solvency and long-term cost efficiency.

1.2 The FSS is supported by the Investment Strategy Statement (ISS), which replaces the SIP from April 2017, and the Fund's employer covenant monitoring framework. Together these ensure an integrated approach to funding strategy and risk management.

1.3 The statements and framework relate as follows:



1.4 The FSS summarises the Fund's approach ensuring contributions are sufficient to meet its liabilities, and includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS underpins:

- the rates and adjustments certificate (confirming employer contribution rates for the next three years);
- the Fund's policies on employer admissions and cessations; and
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service.

1.5 The FSS reflects the statutory nature of the Local Government Pension Scheme (LGPS), particularly the defined benefits payable and the benefit guarantee. The FSS sets out how benefits will be funded over the long term through an accountable, transparent process with full disclosure of valuation methodology and assumptions.

1.6 The benefits payable under the LGPS are guaranteed by statute. The Scheme is a defined benefit arrangement with a final salary element for service accrued prior to 1 April 2014 and career average revalued earnings ('CARE') benefits accruing on and after this date. There is also a '50:50' option under which members can elect to pay 50% of the contribution rate to accrue 50% of the benefits.

1.7 The Fund, like many other similar public and private sector funded schemes, has a gap between its assets and pension liabilities (a funding shortfall). A number of factors have contributed to the development of the funding gap and increases in contribution rates for employers most notably:

- increases in life expectancy and pensions longevity; and
- falling long-term interest rates and the expectations for future investment returns.

This strategy addresses the recovery of the funding shortfall in addition to setting future contributions to cover the ongoing cost of benefit accrual.

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

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

The primary rate for the whole fund is the weighted average (by payroll) of the individual employers' primary rates.

Secondary Rate
The 'secondary rate' is an adjustment to the primary rate to arrive at the total rate of contribution each employer is required to pay. The secondary rate may be expressed as a percentage adjustment to the primary rate, and/or a cash adjustment in each of the three years beginning 1 April in the year following the actuarial valuation. In line with previous valuations, each employer will have a cash adjustment to the primary rate to reflect their funding level.

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

2) Purpose of the Funding Strategy Statement

2.1 The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers pay contributions to ensure their own liabilities are fully funded.

The purpose of this FSS is:

- to establish a clear and transparent fund-specific strategy which will identify how employers' liabilities are best met going forward;
- to take a prudent longer term view of funding those liabilities;
- 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 support the desirability of maintaining as nearly constant a primary contribution rate as possible, as defined in Regulation 62(5) of the LGPS Regulations 2013.

2.2 The FSS supports the process of ensuring adequate funds are put aside on a regular basis to meet future benefit payments. This framework is designed to ensure the funding strategy is both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting objectives that need to be balanced and reconciled. Whilst the funding strategy applicable to individual employers or categories of employers must be reflected in the FSS, its focus should at all times be on those actions that are in the best long-term interests of the Fund. Consequently, the FSS is a single all-employer-encompassing strategy for the administering authority to implement and maintain.

3) Consultation

3.1 LGPS regulations require the administering authority to consult with such persons it considers appropriate in the maintenance and review of the FSS. CIPFA provides further guidance that this must include meaningful dialogue at officer and elected member level, with council tax raising authorities and with corresponding representatives of participating employers.

3.2 The Fund has undertaken a number of employer briefing sessions and outlined funding strategy at its 2016 AGM. Both covered key changes to the FSS from the prior version dated April 2014. A copy of the FSS has been sent to each employer, the Fund's Pensions Committee (elected members), Local Pensions Board (including member and employer representatives), investment advisers and other interested parties including the Fund employer peer group. The Fund has also hosted one to one consultation meetings with employers, on request.

3.3 Employers participating in the Fund have been consulted on the contents of this FSS and consideration has been given to their views accordingly. However, the FSS represents a single strategy for the Fund as a whole, adjusted for employer groups/categories based on the advice of the Fund actuary, Barnett Waddingham, who has also been consulted in preparing the content of this FSS.

4) Aims and Purposes of the Fund

4.1 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, 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 appetite of the administering authority and employers alike; and
- seek returns on investment within reasonable risk parameters.

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income; and
- pay out monies in respect of Fund benefits, transfer values, costs, charges and expenses, as defined in the Local Government Pension Scheme Regulations and as required in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (or the equivalent in Scotland and Northern Ireland).

5) Responsibilities Of The Key Parties

5.1 The administering authority is required to:

- operate the Fund;
- collect employer and employee contributions, investment income and other amounts due to the Fund as stipulated in LGPS regulations;
- pay from the Fund the relevant entitlements as stipulated in the 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 an FSS and an SIP/ISS, both after proper consultation with interested parties; and
- monitor all aspects of the Fund's performance and funding and amend the FSS/ISS accordingly.

The individual employer is required to:

- deduct contributions from employees' pay correctly;
- pay all ongoing contributions, including employer contributions determined by the Fund 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 Fund 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 the LGPS regulations;
- prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters such as pension strain costs, ill-health retirement costs, compensatory added years costs, etc;
- provide advice and valuations on the exiting of employers from the Fund;
- provide advice to the administering authority on bonds or 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.

6) Key Changes Since 2013

- Simplification – single discount rate to cover both past and future service.
- Employer categorisation – based on strength of covenant and type of employer, employers have been placed into three categories which then drive the associated funding strategy (funding target and deficit recovery period).
- Ill-health strain cost insurance – provision of an option to insure against the employer strain costs which can arise from a member receiving Tier 1 or Tier 2 ill-health early retirement benefits.

7) Solvency Issues and Target Funding Levels

7.1 LGPS regulations require each administering authority to achieve Fund solvency and long-term cost efficiency by means of employer contribution rates established by triennial valuation. LGPS administering authorities prudentially seek to achieve an appropriate balance between the income stream from contributions and investments and maintaining the ability to pay pension benefits as and when they fall due over the life of the Fund.

7.2 Securing solvency and long-term cost efficiency is a regulatory requirement whereas a constant as possible a primary contribution rate remains only a desirable outcome. Administering authorities should avoid continually extending deficit recovery periods at each and subsequent actuarial valuations. Over time and given stable market conditions, administering authorities should aim to reduce deficit recovery periods.

7.3 The LGPS regulations require the long-term funding objectives to achieve and maintain assets sufficient to cover 100% of the projected accrued liabilities. The level of assets necessary to meet this 100% funding objective is known as the funding target. The role of the actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements.

7.4 The Fund recognizes the different characteristics of the variety of participating employer organisations, and will set funding strategy (including funding target and deficit recovery contributions) appropriately having regard to factors such as:

- strength of covenant, and security of future income streams;
- support or guarantee arrangements from Scheme employers; and
- prospective period of participation in the Fund, and specifically the implications if the employer has closed membership of the Fund to new employees.

7.5 The Fund's policy with regards participation of non-scheduled scheme employers, including termination issues, is set out in the publication *'Policy on Termination Funding for Admission Bodies'*

7.6 The approach to the actuarial valuation process and key assumptions used at each three-yearly valuation are consulted upon and the valuation forms part of the consultation undertaken with the FSS.

7.7 Under Section 13(4)(c) of the Public Service Pensions Act 2013 The Government Actuary's Department (GAD) (as the person appointed by the responsible authority) must, following an actuarial valuation, report on whether the rate of employer contributions to the Fund are set at an appropriate level to ensure the solvency of the Fund and long-term cost efficiency of the LGPS.

7.8 In developing the funding strategy, the administering authority has had regard to the likely outcomes of the subsequent review under Section 13(4)(c) and has considered implications for its key performance indicators as determined by the Scheme Advisory Board where appropriate i.e. in England and Wales.

Determination of the Funding Target

7.9 The principal method and assumptions to be used in the calculation of the funding target are set out in Appendix 1.

7.10 Underlying these assumptions there are two tenets:

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

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

7.11 As part of each valuation, separate employer contribution rates are assessed by the actuary for each participating employer. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the various employers in the Fund. In attributing the overall investment performance obtained on the assets of the Fund to each employer, a pro-rata principle is adopted. The general approach is effectively one of applying a notional individual employer investment strategy identical to that adopted for the Fund as a whole.

7.12 The extent to which the financial health and capacity of employers impacts on their ability to withstand funding risk and increase contributions in the future is taken into account in setting the funding target as is the nature and expected future participation of non-local authority employers in the Fund.

7.13 To reflect the wide range of participating employers, the Fund has applied a past service volatility reserve for employers according to employer risk category. This volatility reserve limits the reliance on future investment returns for employers who are either:

- not government-backed in nature and may not, in the view of the administering authority, be able to withstand the funding risk; or
- are on a path to exiting the Fund.

8) Deficit Recovery Plan and Employer Contributions

8.1 The period over which an employer's past service deficit is to be recovered will be dependent on a number of factors, including the type and nature of the employer, any supporting guarantee or other forms of security, such as a charge on assets, where these can be provided.

8.2 In general, a maximum deficit recovery period of 20 years will apply, reduced from 22 years in 2013. Employers can elect a shorter period if they prefer and all contributions paid will be allocated to their individual asset share on future funding review. A shorter period may be applied in respect of particular employers where the administering authority considers this to be warranted (see below).

8.3 The Fund does not believe it appropriate for the total level of contributions to the Fund to reduce where substantial deficits remain unless there is a compelling reason to do so. A shorter maximum deficit recovery period may therefore apply to individual employers and, the Fund will apply shorter standard deficit recovery periods linked to employer categorisation, following allocation based on covenant and employer structure.

Further detail on employer categorisation and the impact on deficit recovery plan periods is set out in Appendix 2.

Employer contributions will be expressed and certified as two separate elements:

- the **primary rate**: a percentage of pensionable payroll in respect of the cost of the future accrual of benefits
- the **secondary rate**: a schedule of annual lump-sum amounts, payable over the three years to 2019/20 increasing annually in line with the valuation funding assumption for long-term pay growth (unless otherwise noted), in respect of deficit recovery.

Both elements are subject to review from April 2020 based on the results of the 2019 actuarial valuation. Where significant increases in employer contributions are required from April 2017, and an employer provides evidence to the Fund that these are not affordable, the increase from the contributions payable in the year 2017/18 may be implemented in steps, at the discretion of the administering authority and as agreed with individual employers prior to April 2017, noting that rates will need to increase to the level indicated, no later than 2019/20.

Where an employer has a guarantee from a statutory body participating in the Fund, or from another organisation approved for that purpose by the administering authority, the administering authority will recognise the requirement for the guarantor to be kept abreast of the funding position of the relevant employer, and share funding information with the guarantor on request, unless the employer indicates otherwise in writing to the Fund.

On the cessation of an employer's participation in the Fund, the actuary will be asked to make a termination assessment. Any deficit in the Fund in respect of the employer will be due to the Fund as a termination contribution, unless it is agreed by the administering authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Fund to another participating employer. Details of the approach to be adopted for such an assessment on termination are set out in the termination policy published by the Fund.

Any employing body with a surplus of assets over liabilities may have a reduction in contributions to reflect the the surplus applied over a period of 20 years.

Employers are required to meet all costs of early retirement strain (non ill-health) by immediate capital to the Fund.

In all cases, the administering authority reserves the right to apply a different approach as its sole discretion, taking into account the risk associated with an employer in proportion to the Fund as a whole.

Where the administering authority does agree to an alternative contribution plan for a particular employer, as described above, this will represent an employer-specific funding plan, and will be documented separately, together with any conditions surrounding this agreement.

8.4 In determining the funding and contribution strategy above, the administering authority has had regard to:

- the responses made to the FSS consultation with employers, representatives and other interested parties;
- relevant guidance issued by the CIPFA Pensions Panel;
- the need to balance a desire to attain the funding target as soon as possible against the short-term cash constraints of participating employers; and
- the administering authority's views on the relative strength of the participating employers' covenants.

8.5 For employers where it is understood that in the event that they were unable to meet their pension obligations to the Fund, their liability would fall on other Fund employers, an employer risk reserve has been established as contingency. The reserve is based upon a review of those employers without a guarantor and the associated liability exposure and the contributions required to establish this reserve have been built into rates assessed for all employers within the Fund at this valuation. This reserve is subject to review at subsequent actuarial valuations.

9) Links To Investment Policy Set Out In The Investment Strategy Statement (ISS)

9.1 The Fund has, for many years, regularly used an asset liability study and stochastic modelling in order to assist the process of formulating a strategic asset allocation. The outcomes are reflected in the Fund's ISS.

9.2 The Fund's investment strategy has been considered and reviewed in conjunction with the valuation and the FSS. In particular, the future return expectations of the main asset classes in which the Fund invests have been considered in determining the prudent allowance for future investment returns and extent of reliance on these by employers is outlined in this FSS.

10) The Identification of Risks and Countermeasures

10.1 Evaluating risks that may impact on the funding strategy and expectations of future solvency is crucial to determining the appropriate measures to mitigate those risks. The FSS identifies those key risks specific to the Fund and the measures being taken or assumptions made to counter those risks.

10.2 Some of the key risks taken into account are:

Investment risk – the risk of investments not performing (income) or increasing in value (growth) as forecast. Examples of specific risks would be:

- assets not delivering the required return (for whatever reason, including manager underperformance);
- systemic risk with the possibility of interlinked and simultaneous financial market volatility;
- insufficient funds to meet liabilities as they fall due;
- inadequate, inappropriate or incomplete investment and actuarial advice is taken and acted upon; and
- counterparty failure.

Liquidity/maturity risk – changes in local government will impact upon the maturity profile of the LGPS and have potential cash flow implications. The increased emphasis on outsourcing and other alternative models for service delivery, which result in active members leaving the LGPS; transfers of responsibility between different public sector bodies; scheme changes which might lead to increased opt-outs; the implications of spending cuts (the ONS recently reported that employment in local government was at its lowest levels since 1999) – all of these will result in workforce reductions that will reduce membership, reduce contributions and prematurely increase retirements in ways that may not have been taken account of fully in previous forecasts.

Liability risk – life expectancy and other demographic changes resulting in benefits being paid for longer. In addition, inflation, interest rate and salary inflation will all impact upon future liabilities.

Regulatory and compliance risk – changes to legislation can impact on scheme benefits, new entrants, member options, administration and funding and investment strategy. Increased disclosure, transparency and reporting could also impact funding approaches risking a 'race to the bottom' and 'herd' behavior. Any changes agreed and proposed are evaluated and taken into account in the actuarial valuation and closely monitored between valuations in case any action is required.

Employer risks – Sustainability of an employer or their ability to meet their liabilities within the agreed funding strategy. The Fund's approach to the outcome of the valuation has had regard to balancing the needs of funding the liabilities and the cost to employers. This is reflected in the approach of placing employers into different categories and greater tailoring of funding strategy to individual employers, taking into account the risks associated with the investment strategy.

As outlined in the Fund's employer covenant framework, a risk assessment of the sustainability of all employers has been undertaken seeking to establish the risk of an employer failing to meet their pension liabilities. This has been used to determine an appropriate pace of funding

In determining the actual recovery period to apply for any particular employer or employer grouping, the administering authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of the employer;
- the assessment of the financial covenant of the employer; and the security of future income streams
- any contingent security available to the Fund or offered by the employer such as guarantor or bond arrangements, charge over assets, etc; and
- length of expected period of participation in the Fund.

A number of organisations have significant financial challenges due to falling revenues and/or income streams. The Fund will work with these bodies to ensure all interests are considered and an acceptable funding strategy for the pension liabilities is achieved that does not put the Fund's position at an increased risk. In respect of bodies that have fixed-term funding, the aim is that a fully funded position should be achieved with a high degree of certainty by the end of the funding period.

Governance Risks
Examples of risk include:

- administering authority unaware of structural changes in an employer's membership (eg, large fall in employee members, large number of retirements);
- administering authority not advised of an employer closing to new entrants; and
- an employer ceasing to exist with insufficient funding or adequacy of a bond.

The Fund has established inter-valuation monitoring and working relations with its employers to ensure changes are detected, discussed, evaluated and appropriate action agreed. This includes regular reviews of funding levels and the assessment of the financial standing of employers that are not tax-raising bodies.

Insurance of Certain Benefits
The Fund has explored insurance cover to help mitigate employer financial implications of unexpected additional ill-health costs, with the primary advantage being the protection of employers with weaker covenants or smaller workforce against the significant strain costs that can arise following an ill-health early retirement. The Fund has considered the associated risk mitigation and employer desirability across the Fund as a whole following extensive consultation. As a result, following quotations, the Fund will facilitate access to an ill-health insurance arrangement with effect from 1 April 2017. Any employer can elect this cover at an additional cost (premium) and any employer in category 3 will be encouraged to take out such insurance.

Appendix 1

Actuarial Valuation as at 31 March 2016

Method and Assumptions Used in Calculating the Funding Target Method

The actuarial method to be used in the calculation of the funding target is the 'projected unit' method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method implicitly allows for new entrants to the Fund on the basis that the overall age profile of the active membership will remain stable. As a result, for those employers which are closed to new entrants, an alternative method is adopted (the 'attained age' method), which makes advance allowance for the anticipated future ageing and decline of the current closed membership group in order to maintain a stable rate of contributions.

Financial Assumptions

- Investment Return (Discount Rate)
  One of the key valuation assumptions is the discount rate. The actuary estimates the future benefit cashflows which will be made to and from the Fund in the future. These cashflows are then discounted to a present day value using the discount rate. This value is essentially the estimated amount of money which, if invested now would be sufficient together with the income and growth in the accumulating assets to make these payments in future, using a prudent assumption about future investment returns (discount rate).

  The discount rate assumption is 4.7% pa which has been derived using the Fund's current investment strategy and a weighted set of assumed investment returns. A lower discount rate assumption of 3.3% pa has been used to value orphan liabilities (those no longer linked to an active employer) which are backed by a cashflow matching investment sub fund.

- Volatility Reserve
  A past service volatility reserve is included for those employers in category 2 or 3. This limits reliance on future investment return and represents an addition to the funding target (5% or 10% of liabilities) for those employers who are either less able to withstand funding risk; are not government-backed in some way; or are on a path to exiting the Fund. In practice, this increases the pace of funding and provides a cushion against future periods of lower than expected investment returns.

- Inflation (Consumer Prices Index - CPI)
  The assumption for CPI inflation is derived from the RPI assumption of 3.3% pa, which is based on information published by the Bank of England. A deduction is made to the RPI assumption due to the different ways that the indices are calculated which the Fund actuary has estimated to be 0.9% pa. In addition, the inflation risk premium (often used to reflect any long term impact of supply/demand distortions in market yields used to estimate future RPI) has been assumed to be zero. This results in a CPI inflation assumption of 2.4% pa.

- Salary Increases
  The assumption for long-term real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% pa over the inflation assumption as described above. Some allowance for promotional increases has also been included through the application of a salary scale.

  To recognise the relatively low level of general salary increases, many employers have indicated they expect to grant in the near future, and as budgeted for in the short term by many employers, the Fund has applied an assumption of CPI (currently circa 1%) pay growth over the next four years reverting to 3.9% (CPI plus 1.5%) thereafter.

- Pension Increases
  Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with CPI (eg, guaranteed minimum pensions in respect of service prior to April 1997).

Mortality/Life Expectancy

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity. The mortality tables used are adjusted to reflect the Fund specific experience analysis undertaken to inform current life expectancy. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 1.5% per annum.

Commutation

It has been assumed that, on average, members will take 50% of the additional tax-free cash available to them, as well as their accrued lump-sum entitlement. The option which members have to commute part of their pension at retirement in return for a lump-sum is a rate of £12 cash for each £1 pa of pension given up.

Other Demographics
Following an analysis of Fund experience carried out by the actuary and national LGPS carried out by the Government Actuary Department, the proportions married/civil partnership assumption and allowances for withdrawals and early retirements has been modified from the last valuation. No allowance will be made for the future take-up of the 50:50 option. Where any member has actually opted for the 50:50 scheme, this will be allowed for in the assessment of the rate for the next three years.

Expenses
Expenses are met out the Fund, in accordance with the regulations. For the 2016 valuation, administration expenses have been considered in setting the discount rate. This approach will be reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

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

Full details of the assumptions adopted are set out in the actuary's formal valuation report.

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

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

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

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

Comparison of Key Financial Assumptions – 2016 and 2013 actuarial valuations

Assumption	2016	2013
Discount rate	4.7% pa	4.6% pa
Volatility reserve	5.0%/10.0% loading on past service liability for 'Category 2' or 'Category 3' employers	n/a
Inflation/pension increases (CPI)	2.4% pa	2.6% pa
Salary increases - Short term - Long term - Salary increments	 1.0% pa for four years 3.9% pa (CPI plus 1.5% pa) Age-related allowance	 1.0% pa for three years 4.35% pa (CPI plus 1.75% pa) No allowance

Summary of Key Whole Fund Assumptions Used for Calculating Funding Target

Financial Assumptions

Discount rate (for non-orphan liabilities)	4.7% per annum
Discount rate (for orphan liabilities)	3.3% per annum
Short-term salary increases	CPI (circa 1% per annum) for four years
Long-term salary increases	3.9% per annum
Inflation/pension increases (CPI)	2.4% per annum
Volatility reserve – category 2 employers	5% loading on past service liability
Volatility reserve – category 3 employers	10% loading on past service liability

Mortality Assumptions

Pre-retirement mortality - base table	GAD tables (table B8) with a rating of 120% for males and 135% for females. Saved here http://www.lgpsregs.org/index.php/dclg-publications/dclg-other
Post-retirement mortality - base table	CMI self-administered pension schemes (SAPS) tables with scheme-specific adjustments as appropriate following analysis by Barnett Waddingham's longevity table.
Allowances for improvements in life expectancy	2015 CMI model with a long-term rate of improvement of 1.5% pa

Type	Base table	Adjustments (M/F)
Normal health	S2PA	110%/105%
Ill health	S2PA	Normal health
Dependants	S2PMA/S2DFA	140%/110%

Other Demographic Assumptions

Partner age difference	Males are three years older than females
Proportion married	75% of males and 70% of females have an eligible dependant at retirement or early death
Promotional salary scale	Use GAD table (table b9) saved here: http://www.lgpsregs.org/index.php/dclg-publications/dclg-other
Allowance for withdrawals	Use GAD table (table b7) saved here: http://www.lgpsregs.org/index.php/dclg-publications/dclg-other
Allowance for cash commutation	Members will take an additional 50% of the remaining maximum tax-free cash available after members have taken the standard 3/80ths cash sum for pre-April 2008 service
Allowance for early retirements (non-ill-health)	Each member retires at their weighted average 'tranche retirement age', ie, for each tranche of benefit, the earliest age they could retire with unreduced benefits
Allowance for 50:50 membership	We have assumed that existing members will continue to participate in their current section

Appendix 2

Employer Categorisation
The Fund has had in place an employer covenant monitoring framework since 2010, which takes into account a number of financial, funding and structural factors to allocate each individual employer under a risk banding (RAG rated). More information can be found in the Fund's 'Employer Risk Management Framework' located on our website.

The purpose of this covenant framework, and the associated outcomes in terms of funding strategy, is to ensure that employers who are not as secure are not unduly subsidised by those employers with a strong covenant. Given the wide range of employer covenant strength, the Fund has determined the need for some employers to contribute more in order to mitigate those risks. Such an approach helps to ensure equitable treatment for all participating employers, with all contributions paid by an employer allocated to their asset share.

In addition and overlaying the covenant risk banding, employer type, nature (eg, government-backing), and expected duration in the Fund has been considered in order to allocate employers into a category for funding purposes.

Outlined below are the categories and what these mean in terms of deficit recovery period and funding strategy, in general:

Allocated Category[1]	Fund Covenant Risk Rating	General Features
Category 1	Green	Government-backed/guarantee for Government-backed organisation and over 100% funded
Category 2	Green/Amber	Guarantee/Strong balance sheet relative to pension liability
Category 3	Red/Critical (Black)	Exiting/Weak balance sheet relative to pension liability

- **Category 1**
  - Maximum recovery period of 20 years
- **Category 2**
  - Maximum recovery period of 15 years
  - Volatility reserve of 5% loading on past service liabilities
- **Category 3**
  - Maximum recovery period of 10 years
  - Volatility reserve of 10% loading on past service liabilities

Transferee Admission Bodies
For transferee admission bodies where admission to the LGPS is via a contract or other arrangement, the maximum recovery period will be aligned to the contract length, capped at the maximum recovery period for category of employer or the maximum recovery period of 20 years (whichever is lower), or as otherwise agreed with the ceding local authority.

For transferee admission bodies where closed to new entrants, the maximum recovery period will be aligned to the future working lifetime of its membership, if less than the contract length, capped at the maximum recovery period for category of employer or the maximum recovery period of 20 years (whichever is lower), or as otherwise agreed with the ceding local authority.

Community Admission Bodies
For community admission bodies, where closed to new entrants (or deemed to be so based on membership activity over previous six years), the maximum recovery period will be aligned to the future working lifetime of its membership, capped at the maximum recovery period for category of employer or the maximum recovery period of 20 years (whichever is lower), or such other period agreed by the employer and approved by the administering authority.

Academies
Academies will be treated in accordance with the factors and legislation that lead to their creation. In July 2013, the Department for Education (DfE) provided a guarantee that in the event of the closure of an academy trust, any outstanding liabilities, where not met from the trust's assets on closure, would be met by the DfE in full. However, the DfE has the right to withdraw the guarantee at any time and in practice has not always (based on limited experience to date which is being explored further with the DfE) paid the full debt to the Fund. Grounds for withdrawing the guarantee include if the contingent liability levels set by the DfE are exceeded or if projected costs are no longer affordable from within the DfE's existing budget or are not approved by Treasury. The Treasury also reserves the right to re-assess the approval of the guarantee at a later date due to spending considerations or policy developments.

[1]Note that within the preliminary results issued to employers the category's were labelled 'low', 'medium' and 'high', these correspond to category 1, 2 and 3 respectively in the table above.

Therefore, to reflect the DfE guarantee, to include the potential for it to be withdrawn or amended, all academies will be considered to have the same covenant strength and placed in the employer category 2. However, so as to distinguish the unique nature of academies in terms of the Fund's employer base and reflecting the additional level of security the guarantee provides when compared to bodies with no guarantee, the Fund will adopt a 20-year recovery for all academies. This treatment is consistent with the recovery period applied to district councils from which the academies convert.

Contribution rates for academies will be calculated to meet the broad intentions of ensuring they are in a similar financial position in respect of pension liabilities pre- and post-transfer to academy status at inception. The policy applied to academies will be reviewed from time to time and as and when any further guidance emerges.

Further Education Colleges

In 2013, the Local Government Association (LGA) provided guidance which confirmed that further education colleges were stand-alone organisations with no backing if they fail and, therefore, of an increased risk profile to the Fund.

In addition, in October 2016, the Department for Education (DfE) released the response to a consultation on developing an insolvency regime for the further education and sixth form college sector. Essentially, the main focus of the consultation was to put in place procedures for colleges, broadly in line with those afforded to companies under the Insolvency Act 1986 (IA86), eg, in the private sector, to facilitate the rehabilitation of a college where possible; and where not, an orderly winding-up through voluntary or compulsory liquidation. The primary intention is continuity of service to protect learners via the introduction of a Special Administration Regime (SAR).

Whilst the Fund appreciates there is a robust financial monitoring and intervention regime planned for such organisations post-area review, the new regime could represent a greater degree of risk for the Fund and its other participating employers.

The categorisation of further education colleges represents the financial risk review and nature of employer relative to other employers in the Fund. The Fund will continue to review how the funding strategy applies to this group of employers, as the sector consolidates following the Area Review and the insolvency regime is finalised.

Any pension liability resulting from a college which becomes insolvent falls on the other employers within that Fund and ultimately the taxpayer; therefore, measures need to be in place to ensure that the associated risk is mitigated as much as possible. In line with guidance from CIPFA, the Fund is required to guard against the consequences of the risk of employer default.

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