



FUNDING STRATEGY STATEMENT JUNE 2021



West Midlands Pension Fund

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1 INTRODUCTION

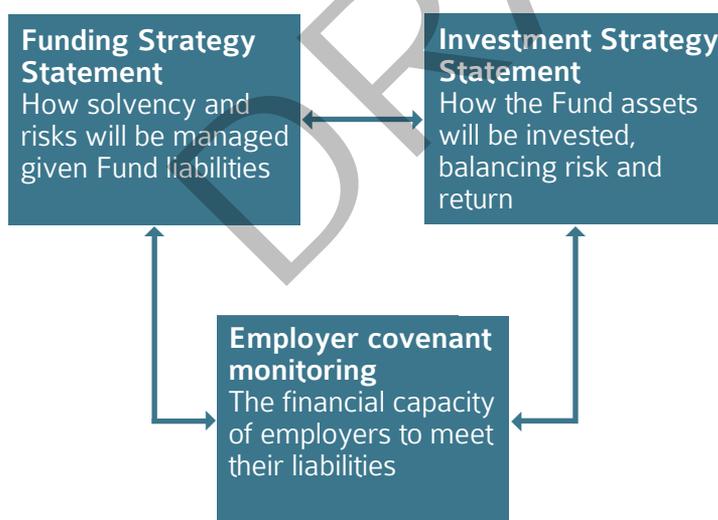
- 1.1 Local Government Pension Scheme (LGPS) regulations require administering authorities to prepare and maintain a Funding Strategy Statement (FSS) having regard to the guidance produced by The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Fund’s Investment Strategy Statement (ISS). This FSS has been prepared by the West Midlands Pension Fund based on the latest CIPFA guidance in accordance with the regulations issued in September 2016 and following consultation with appropriate persons. In line with the regulations administering authorities are required to ensure contributions are set at a level to achieve Fund solvency and long-term cost efficiency.

This FSS was initially developed for the West Midlands Pension Fund in conjunction with the 2019 actuarial valuation and with further revision following the introduction of ‘Employer Flexibility’ legislation on 23 September 2020. This latest FSS is effective from (June 2021).

This statement updates and replaces the April 2020 FSS and all previous statements and policies on funding. The statement and principles contained within reflect an evidence-based review of West Midlands’ membership and employers in the context of regulations and guidance in force at the time.

Integrated Funding Framework

- 1.2 The FSS is supported by the Investment Strategy Statement (ISS) and the Fund’s employer covenant monitoring framework. Together these ensure an integrated approach to funding strategy and risk management supporting the Fund in meeting the regulatory funding requirements.
- 1.3 The statements and framework relate as follows:



- 1.4 The purpose of the FSS is to summarise the Fund's approach to ensuring contributions are sufficient to meet pension liabilities. The parameters set within determine:
- the rates and adjustments certificate (confirming employer contribution rates for the period to the next triennial valuation);
 - funding requirement on employer admissions and cessations; and
 - actuarial factors for valuing bulk transfers, early retirement costs and the costs of additional benefits to members (for example, on purchase of added years' service).
- 1.5 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.
- 1.6 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.

Employer Contribution Requirements

- 1.7 The required levels of employee contributions are specified in the regulations. Employer contributions are determined in accordance with the LGPS regulations, following an actuarial valuation completed every three years by the actuary. The valuation is carried out based on the Administering Authority's funding strategy statement and leads to production of a rates and adjustments actuarial certificate, specifying the 'primary' and 'secondary' rate of the employer's contribution; these are defined below

Primary Rate

The 'primary rate' for an employer is the contribution rate required to meet the cost of the future accrual of benefits, allowing for employer membership profile. The primary rate for the whole fund is the weighted average (by pensionable payroll) of the individual employer's primary rates.

The Fund, like many other similar public and private sector funded schemes, had a gap between its assets and pension liabilities (a funding shortfall) on review at 31 March 2019. Although funding levels had improved since the previous review in 2016, a number of factors have contributed to the development of the funding gap over time, most notably:

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

As funding level varies over time and between employers, employers may have a funding shortfall or surplus on review at the triennial valuation.

The FSS addresses the recovery of the funding shortfall for those employers in deficit and outlines how contribution requirements are considered where a surplus exists at the valuation date. This is captured within the secondary rate.

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 within the West Midlands Pension Fund will have a cash adjustment to the primary rate to reflect their funding level. In certain circumstances secondary contributions may be expressed as a percentage of payroll as determined by the Fund.

The secondary rate for the whole Fund in each of the three years is the total monetary adjustment through individual employer secondary rates.

Funding Risks

The FSS faces a number of risks in meeting its aim of ensuring Fund solvency and long-term cost efficiency, most notably:

- funding deterioration on lower than anticipated investment returns;
- increasing benefit costs from higher rates of price inflation and increasing life expectancy;
- contribution shortfall following deterioration in employer covenant;
- employer restructuring leading to changing membership profile, maturity and/or covenant;
- changing scheme regulations and guidance which affect benefits or require a change in funding policy.

- 1.8 Following the McCloud/Sargeant ruling and in line with the requirements set out by the Ministry of Housing, Communities and Local Government (MHCLG) in August 2019, the Fund has made an allowance for the potential impact upon scheme benefits which may occur following associated remedial action.

Merger of the West Midlands LGPS Pension Funds

- 1.9 Following a process of public consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG), Regulations were laid before parliament providing for the merger of the former West Midlands Integrated Transport Authority (WMITA) pension fund into that of the main West Midlands Pension Fund. Those regulations came into force on 8 November 2019 and apply retrospectively to effect merger from 1 April 2019.

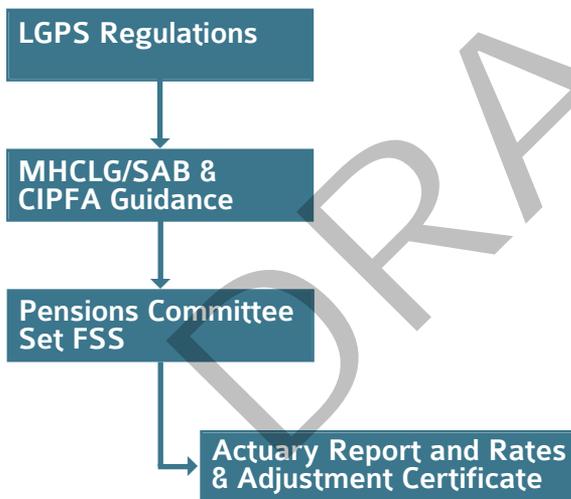
In conjunction with the merger, former employers of the WMITA pension fund now participate in the main West Midlands Pension Fund with associated assets and liabilities transferred to two separate Admission Body Funds (ABF). For the purposes of the 2019 actuarial valuation (and thereafter) the associated funding strategy statements for the new separate ABF are included as appendices to this FSS (appendices 2 and 3).

Future Review

- 1.10 This policy statement will next be reviewed in detail ahead of completion of the next triennial valuation due 31 March 2022. Key funding principles will be reviewed and monitored on an annual basis and updated following consultation and as a matter of course in the event of significant change in scheme regulation and guidance.

2 AIMS AND PURPOSES OF THE FUND

- 2.1 The aims and purpose of a pension fund operating within the Local Government Pension Scheme (LGPS) are set out in the LGPS Regulations and the Public Service Pension Act 2013. With regard to funding, they can be summarised as follows.
- 2.2 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 and total contribution rates to be kept as nearly constant as possible; and
 - seek returns on investment within reasonable risk parameters.
- 2.3 The purpose of the Fund is to:
- receive and invest 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 LGPS regulations and as required in the LGPS (Management and Investment of Funds) Regulations 2016.
- 2.4 The regulatory and governance framework in place to manage funding policy includes:



3 PURPOSE OF THE FUNDING STRATEGY STATEMENT

- 3.1 The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, together with 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 met going forward;
 - to take a prudent long-term view of funding those liabilities;
 - to ensure that the regulatory requirements to set contributions to meet the future liability to provide scheme member benefits in a way that ensures 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.

- 3.2 In line with the aims and purpose of the Fund, the funding policy objectives are:
- to ensure that pension benefits can be paid as and when they fall due over the lifetime of the Fund;
 - to ensure the solvency of the Fund;
 - to set levels of employer contribution rates to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions, while taking into account the different characteristics of participating employers;
 - to build up the required assets in such a way that employer contribution rates are kept as stable as possible, with consideration of the long-term cost efficiency objective; and
 - to adopt appropriate measures and approaches to reduce the risk, as far as possible, to the Fund, other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.
- 3.3 The FSS and wider integrated funding risk framework are designed to ensure the funding strategy is both cohesive and comprehensive for the Fund as a whole, recognising that there will be conflicting stakeholder objectives that need to be balanced and reconciled. Whilst the funding strategy applicable to individual employers is reflected in the FSS, its focus at all times are on those actions that are in the best long-term interests of the Fund. Consequently, the FSS is a single all-employer strategy for the Administering Authority to implement and maintain, with approaches for different employer category and admission body fund contained within.
- 3.4 This statement and appendices set out how the Administering Authority balances the potential conflicting areas of stability and affordability of contributions, transparency of process and prudence of funding. The Fund policies on funding in respect of the following are contained within:
- interim review;
 - new employer admissions to the Fund;
 - employers leaving the Fund (on cessation at termination);
 - bulk transfers; and
 - management of funding surplus.

Consultation Process

- 3.5 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.

In determining the funding and contribution strategy contained within the FSS, 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, supported by independent advisers as required.

As part of the 2019 valuation, the Fund undertook a number of employer briefing sessions (five in July 2019 and ten in November 2019) and outlined funding strategy at its 2019 AGM. Both covered key changes to the FSS from the prior version dated April 2019. A copy of the FSS was issued to each employer, the Fund's Pensions Committee (elected members), Local Pensions Board (including member and employer representatives), actuary, investment and risk advisers and other interested parties including the Fund employer peer group in January 2020. The Fund also hosted one-to-one consultation meetings with employers, on request. More recently, as part of the consultation on changes introduced aligned to employer flexibilities within the LGPS Regulations, the Fund's Pensions Committee, Local Pensions Board and Employer Peer Group were engaged, preceding circulation of the amended FSS to all participating employers.

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 informed 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.

4 RESPONSIBILITIES OF THE KEY PARTIES

- 4.1 Sound and effective management of funding strategies relies on key parties exercising their statutory responsibilities.
- 4.2 The Administering Authority is required to:
- operate the Fund in line with scheme regulations;
 - collect employer and employee contributions, investment income and other amounts due to the Fund as stipulated in scheme regulations;
 - pay from the Fund the relevant entitlements as stipulated in the scheme regulations;
 - invest the Fund's assets in accordance with the Fund's ISS and the scheme 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 conjunction with the Fund's actuary;
 - prepare and maintain an FSS and an ISS, both after proper consultation with interested parties;
 - to include policies to manage and mitigate employer risk within the FSS in line with MHCLG guidance.
 - monitor all aspects of the Fund's performance and funding and amend the FSS/ISS accordingly; and
 - Effectively manage any potential conflicts of interest.
- 4.3 The **individual employer** is required to:
- calculate and deduct contributions from employees' pay correctly;
 - pay all ongoing contributions to the Administering Authority, 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 any new scheme members and any other changes to membership which may affect future funding requirements; and pay any exit payments on ceasing participation in the Fund;
- comply with all aspects of the Pensions Administration Strategy, within the context of the FSS, relating to funding or payment of contributions, for example (but not limited to):
 - provision of supporting documentation and breakdowns with payment of contributions;
 - maintain optimum data quality to include timely and accurate notification to enable accurate calculations; and
 - notify the Fund in advance of any employer initiatives (e.g. mergers, restructures), policy decisions or practices which could impact on LGPS member benefits.

4.4 **Active scheme members** are required to make contributions into the Fund as set by MHCLG.

4.5 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 having regard to the administering authority 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 costs, etc.
- provide advice and valuations on the exiting of employers from the Fund;
- provide advice and valuations relating to new employers, including recommending the level of 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;
- 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; and
- advise on other actuarial matters affecting the financial position of the Fund.

4.6 **Fund officers** undertake to:

- monitor, review and manage performance against the Fund's integrated risk management (IRM) framework, to include funding, covenant and investment developments; and
- provide regular reporting, as required (but at least on an annual basis) to Pensions Committee and the Local Pensions Board to enable their review of the effectiveness of strategies involved, including specific development arising from the IRM.

5 GENERAL FUNDING AND SOLVENCY CONSIDERATIONS

- 5.1 The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns (resulting from the investment strategy). To the extent that investment returns may be lower than expected, then higher contributions may be required from employers, and vice versa. Hence, the funding and investment strategy are inextricably linked.
- 5.2 The cost of benefits payable from the scheme in the future depends on a number of factors which are unknown in advance. Funding policy determines the pace at which contributions are collected from employers to ensure the Fund has sufficient money to pay future pensions promised to members. In consideration of the pace of funding, a further review may be required in between statutory actuarial valuations if an employer is exiting the fund or on a journey towards exit, or if there is a material change impacting employer liabilities and/or their ability to pay the contributions due.
- 5.3 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.
- 5.4 Securing solvency and long-term cost efficiency is a regulatory requirement and maintaining a constant as possible a primary contribution rate is a desirable outcome. Over time and given stable market conditions, administering authorities are expected to reduce deficit recovery periods.

Solvency

- 5.5 The notes to the Public Service Pensions Act 2013 state that solvency means that the rate of employer contributions should be set at "such a 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 rates of employer contributions are set to target a funding level (assets divided by liabilities) for the whole fund of 100% over appropriate time periods and using appropriate actuarial assumptions.

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

The Fund's actuary is required to report on the solvency of the Funds and recommend future employer contribution rates every three years. In assessing the solvency and employer contribution rates, the actuary must make a number of financial and demographic assumptions. Both the assessment of solvency and the employer contribution rates can be very sensitive to these assumptions.

The regulations specify the principles which must be used in the funding strategies. However, it is the responsibility of the Administering Authority, acting on the advice of the Fund's actuary, to determine the precise approach and the financial and demographic assumptions to be used in the actuarial valuation.

A significant factor in ensuring solvency of the Fund is the payment of contributions by employers, recovery of funding deficits and employer covenant to be able to continue to make payments required by the Fund.

The Fund carries out regular employer covenant reviews based on a range of key financial and non-financial information to monitor financial strength and ability to pay contributions. This is informed by details of funding sources and annual financial strength. In addition, membership numbers are regularly reviewed to monitor membership maturity. The results of the covenant review are used to categorise employers on risk level, with details being provided to the Fund's actuary to inform the actuarial valuation.

As required under Section 13(4)(c) of the Public Service Pensions Act, the Ministry of Housing, Communities and Local Government (MHCLG) has appointed GAD to report on whether the rate of employer contributions to the Fund is set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Local Government Pension Scheme, so far as relating to the Fund. Such reports must be made following each triennial valuation of the Fund.

Long-Term Cost Efficiency

- 5.6 The notes to the Public Service Pensions Act 2013 state "Long-term cost-efficiency implies that the rate must not be set at a level that gives rise to additional costs. For example, deferring costs to the future would be likely to result in those costs being greater overall than if they were provided for at the time".

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

In assessing whether the above condition is met, the review under Section 13(4)(c) may have regard to the following considerations:

- the implied average deficit recovery period
- the investment return required to achieve full funding over different periods, e.g. the recovery period
- if there is no deficit, the extent to which contributions payable are likely to lead to a deficit arising in the future
- the extent to which the required investment return is less than the administering authority's view of the expected future return being targeted by a fund's investment strategy, taking into account changes in maturity/strategy as appropriate.

Target Funding and Contributions Policy

- 5.7 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 advising on assumptions used, is an important feature in determining the funding requirements.

- 5.8 The Fund recognises 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.
- 5.9 The approach to the actuarial valuation process and key assumptions used at each triennial valuation are consulted upon and the associated employer contribution outcomes form part of the consultation undertaken with the FSS.
- 5.10 In developing the target funding level and associated contribution requirements, the Administering Authority has had regard to the subsequent GAD review under Section 13(4)(c) and oversight of the Scheme Advisory Board in England and Wales.
- 5.11 The principal method and assumptions to be used in the calculation of the funding target and employer contributions are set out in Appendix 1, which also includes further detail on employer categorisation and the integration of the Main Fund funding strategy with the employer covenant monitoring framework. For employers within the separate Admission Body Funds, these are set out in Appendices 2 and 3.
- 5.12 Underlying the method and 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.
- 5.13 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, in general, a principle of no cross-subsidy between the various employers in the Fund except where there are explicit exceptions set out and rationale for pooling funding and risks.
- 5.14 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.
- 5.15 The period over which an employer's past service deficit is to be recovered (or surplus released) 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.
- 5.16 The Fund does not believe it appropriate for the total level of contributions by an employer to the Fund to reduce where substantial deficits remain unless there is a compelling reason to do so.
- 5.17 Phasing of contribution increases may be considered at the discretion of the administering authority where an employer has evidenced affordability limits.
- 5.18 Any employing body with a surplus of assets over liabilities, sufficient covenant strength, and a local or central government guarantee (to include a defined link back to a local or central government body, such as wholly-owned or arms-length management organisations) may have a reduction in contributions to reflect an emerging and sustained surplus. Organisations without sufficient covenant strength i.e. category 3 employers or without a local or central government guarantee will not see a reduction in contributions unless a surplus exists on a minimum risk basis.

- 5.19 Employers are required to meet all costs of early retirement strain (non ill-health) by immediate capital payment 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, this will represent an employer-specific funding plan, and will be documented separately, together with any conditions surrounding this agreement.

On the cessation of an employer's participation in the Fund, the actuary will be asked to make a termination assessment unless the ceasing employer is a pass-through employer. 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.

Links to Investment Policy Set Out in the Investment Strategy Statement (ISS)

- 5.20 The key financial assumption in calculating the solvency and contribution rates is the rate of return which will be achieved on the Funds' investments.

The Fund's investment strategy has been considered and reviewed in conjunction with the 2019 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.

The discount rate(s) adopted in the actuarial valuation is derived by considering the expected rate of investment return which is anticipated to be achieved by the underlying investment strategy.

Future employer contributions levels will be determined, in part, by the extent to which investment returns are delivered in line with the assumptions set in the funding strategy.

As part of the investment strategy review, the future benefit cashflows are considered together with expected contribution income to access the broad mix of assets required to deliver the return required to meet benefit costs whilst balancing risk which could lead to greater future contribution volatility.

The strategic asset allocation and investment risk strategy are documented in the Fund's ISS.

- 5.21 **The Fund's policy for the review of contributions in between actuarial valuations is set out in addendum 3 of this document.**

Key Changes Since 2016

- 5.22 The following key policy changes have been made since the 2016 actuarial valuation, in light of evolving regulation and ongoing dialogue with stakeholders.

2020 FSS

- Pooling arrangements for all individual academies within a multi-academy trust (MAT) such that a single primary contribution rate is paid by the MAT.

- Exit credits (from April 2019) – clarification of funding assessment for individual employees upon exit from the Fund. Changes reflected in the Termination Policy (incorporated within Addendum 2) in more detail.
- Ill-health strain cost insurance – at the 2016 actuarial valuation the Fund implemented insurance via a third-party provider for employers on a voluntary basis to insure against the employer strain costs which can arise from a member receiving ill-health early retirement benefits. For the 2019 actuarial valuation, effective from 1 April 2020, the Fund has implemented a captive insurance arrangement, with an “ill-health reserve” retained within the Fund to cover such strain costs. This arrangement involves all participating employers with active members of 1,000 or less.
- Allowances for the potential impact of remedy applicable to benefits payable from the LGPS as a result of the McCloud ruling.
- Inclusion of the potential to review contributions in between statutory actuarial valuations in line with enabling “Employer Flexibilities” introduced to the LGPS Regulations (2013) with effect from 23 September 2020.

2021 FSS

- Mechanism to consider the establishment of individual employer arrangements to assist with the spreading of exit debt payments due to the Fund (Debt Spreading Arrangement (DSA) and Deferred Debt Arrangement (DDA)) in line with the revision to LGPS Regulations effective 23 September 2020.

6 IDENTIFICATION AND MANAGEMENT OF RISKS

6.1 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 key risks specific to the Fund and the management or controls made to mitigate those risks.

Risk	Management/Control
<p>Investment risk - Assets do not deliver the return required to meet the cost of benefits payable from the Fund; potential drivers</p> <ul style="list-style-type: none"> • Inappropriate asset allocation and risk • Investment market failure • Manager underperformance 	<ul style="list-style-type: none"> • Investment strategy considered in context of Fund liabilities and return requirement set within the funding strategy statement • Asset liability modelling and stress testing to set strategic benchmarks within Investment Strategy Statement (ISS), with annual review • Regular monitoring of strategy asset allocation and returns relative to benchmark • Regular monitoring of manager performance
<p>Increasing maturity and benefit cashflow requirement; potential drivers</p> <ul style="list-style-type: none"> • Falling contribution income and increasing total benefit payments as more members start to draw their benefits • Declining active membership due to change in local authority service delivery models • Increasing reliance on income-generating assets 	<ul style="list-style-type: none"> • Investment strategy review develop based on future benefit cashflow projection • Modelling of investment strategy and future asset income streams • Regular monitoring of membership movements and liability profile

Increasing future benefit costs; potential drivers

- Rising levels of future inflation
- Increasing life expectancy beyond the level expected for Fund members

- Regular monitoring of funding level
- Review of scheme membership experience vs expectations as part of each triennial actuarial valuation, with fund-specific review of mortality experience
- Ongoing review and cleanse of member data records to enable accurate and up to date assessment at each triennial valuation

Employer covenant – Employers are unable to meet the cost of pension obligations and contributions to the Fund; potential drivers

- Competing pressure and/or reduction in employer's own funding and available financial resources
- Service outsourcing or restructuring shifting responsibility for pension obligations, some of which may be delayed in notification to the Fund
- Increasing scheme costs

- Regular monitoring of employer financial capacity through employer risk management framework
- Notification requirements with the Fund Pensions Administration Strategy and monitoring through the annual employer "health check"
- Employer covenant assessment and categorisation to inform funding strategy and the actuarial valuation
- Review of guarantee arrangements and exit at each triennial valuation
- Up to date admission and termination policies, linked to funding strategy
- Review and use of liability pooling arrangements where these may support greater stability in employer contributions
- Contingent security arrangements to support cash contributions to the Fund

Changing employer structure within the LGPS – impacting employer covenant and guarantor backing for groups of employers within the scheme; potential drivers

- Further increase in academisation and/or change in DfE guarantee to the LGPS
- Further outsourcing of services to employers with no local government backing
- Uncertainty and change in ability of LGPS funds to recover funding shortfalls in the event of insolvency

- Ongoing monitoring of employer movement and change in status within the scheme
- Participation in scheme-wide consultation and review on sectors within the LGPS (academy and tier 3 employers)
- Monitoring of regulatory change which may impact the priority of payments to the LGPS, including regular engagement with employers

Changing scheme regulations and guidance – impacting scheme benefits, funding strategy, actuarial valuations, investment strategy; potential drivers include

- Changes to scheme benefits from the LGPS cost management process
- Changes to the approach for setting actuarial factors (for example on early

- Ongoing horizon scanning and consideration on the Fund risk register
- Review and response to consultations on changes to the LGPS regulations and guidance which may impact scheme funding
- Participation in national review and consideration of emerging issues within the LGPS

Changing scheme regulations and guidance – impacting scheme benefits, funding strategy, actuarial valuations, investment strategy; potential drivers include

- Changes to scheme benefits from the LGPS cost management process
- Changes to the approach for setting actuarial factors (for example on early retirement)
- Remedy of benefits paid as a result of emerging cases such as McCloud
- GMP reconciliation and equalisation approach for the LGPS
- Changing regulations and guidance for administering authorities within the LGPS
- Building in an allowance in the funding valuation results
- Ongoing horizon scanning and consideration on the Fund risk register
- Review and response to consultations on changes to the LGPS regulations and guidance which may impact scheme funding
- Participation in national review and consideration of emerging issues within the LGPS

6.2 At the time of preparing the FSS applicable for the 2019 actuarial valuation, specific regulatory risks of particular interest to the LGPS are in relation to the McCloud/Sargeant judgements, the timing of future funding valuations consultation and GMP equalisation. These are outlined in the sections below.

- McCloud/Sargeant judgements
These judgements surrounds transitional protection arrangements in the Judicial and Firefighters schemes deemed age discriminatory.
A remedy is still to be either imposed by the Employment Tribunal or negotiated and applied to all public service schemes, so it is not yet clear how this judgement may affect LGPS members' past or future service benefits.
At the time of drafting this FSS, it is not yet known what the effect on the current and future LGPS benefits will be, nor the timing of such remedial action.
- Local Government Pension Scheme changes to the local valuation cycle and management of employer risk, including:
 - amendments to the local fund valuations from the current three-year (triennial) to a four-year (quadrennial) cycle;
 - proposals for flexibility on exit payments;
 - proposals for further policy changes to exit credits; and
 - proposals for changes to the employers required to offer LGPS membership.
- GMP Equalisation
Lloyd's Banking Group Pensions Trustees Ltd vs Lloyds Bank Plc & Ors judgement on how their Guaranteed Minimum Pensions (GMPs) should be equalised.

6.3 As outlined in the Fund's employer risk management 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.

6.4 Insurance of Certain Benefits

The Fund has explored arrangements 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. During the 2019/20 consultation, the Fund considered options for risk mitigation and potential to support employer contribution stability across the Fund as a whole. As a result, effective from 1 April 2020, the Fund has implemented a captive self-insurance mechanism achieved through a reserve based on the existing implicit assumption for ill-health liability exposure adopted by the Fund actuary. This captive arrangement is subject to review at subsequent actuarial valuations (unless in the instances where an employer exits the Fund, to include a debt spreading arrangement (DSA) or a deferred debt arrangement (DDA) and has been part of the captive, in which case an automatic review will be carried out) and operates as follows:

- The captive ill-health arrangement applies to all employers (both existing and new) with less than 1,000 active members as at the valuation date.
- A defined percentage of contributions or "premiums" are paid by the eligible employers into the captive arrangement which is tracked separately by the Fund actuary in the valuation calculations.
- These premiums are included in the employer's primary rate. The premium for 2020/21 to 2022/23 is less than 1% p.a. and is already included within employer contribution rates.
- The captive arrangement is then used to meet strain costs (over and above the premium paid) emerging from Tier 1 & 2 ill-health retirements in respect of active members - i.e. so there is no initial impact on the deficit position for employers within the captive.
- In the instances where a Tier 3 ill-health retirement is revised to Tiers 1 or 2 following a subsequent review, the associated strain costs will then be covered by the captive arrangement.
- The premiums are set with the expectation that they will be sufficient to cover the costs in the three years following the valuation date. If any excess premiums over costs are built up in the captive, these will be used to offset future adverse experience and/or lower premiums at the discretion of the Administering Authority based on the advice of the actuary and analysis of experience.
- In the event of poor experience over a valuation period any shortfall in the captive fund is effectively underwritten by the other employers within the arrangement.

However, the future premiums will be adjusted to recover any shortfall over a reasonable period with a view to keeping premiums as stable as possible for employers. Over time the captive arrangement is therefore intended to be self-funding and smooth out fluctuations in the contribution requirements for those employers in the captive arrangement.

- Premiums payable are subject to review at each valuation depending on experience and the expected ill-health trends. They will also be adjusted for any changes in the LGPS benefits. They will be included in employer rates at each valuation or on commencement of participation for new employers.

The Fund reserves the right to preclude the use of the ill-health captive self-insurance reserve where there is evidence to suggest a higher than anticipated experience for an individual employer. The Fund also reserves the right to enforce Regulation 36(3) of the Regulations as appropriate.

- 6.5 The Fund has implemented and maintains an internal control framework with regular risk monitoring. This includes advice from appointed advisors and quarterly reporting to Pensions Committee for review.

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APPENDIX 1: MAIN FUND – METHOD AND ASSUMPTIONS AS AT 31 MARCH 2019

Actuarial Methodology

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. Assets are taken into account at their market value. 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.

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.

Pooling of Employers for Funding Purposes

The policy of the Fund is that each individual employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly, contribution rates are typically set for individual employers reflecting their own liabilities and particular circumstances.

However, from 2019 certain groups of individual employers are pooled for the purposes of determining contribution rates to recognise common ownership and organisational structures, and to assist in managing employer exposure to individual member liability risks.

The funding pools adopted for the Fund at the 2019 valuation are summarised in the table below:

Pool	Type of pooling	Notes
Individual academies within a multi-academy trust	Primary rate contributions	Individual secondary contributions aggregated where possible
All participating employers with less than 1,000 active members	Ill-health risk only	Pooling of ill-health risk/experience via captive insurance reserve

The main purpose of pooling is to produce more stable employer contribution levels, and assist employer budgeting. The pooling arrangement will continue to be kept under review at each triennial valuation.

McCloud Provisions

The Local Government Pension Scheme (England and Wales) (LGPS) introduced a new CARE benefit structure with effect from 1 April 2014 ('the 2014 scheme'). For members who were 10 years or less from normal retirement age on 1 April 2012 (ie aged 55 or above), an underpin was provided based on the existing final salary scheme ('the 2008 scheme'). In December 2018, the Court of Appeal found that similar transitional provisions in the pension schemes for firefighters and the judiciary resulted in unlawful age discrimination. The Government have confirmed that there will need to be a remedy applied to the Local Government Pension Scheme. The actuary has estimated that the cost of remedy for the West Midlands Pension Fund could be in the region of 1.5% of total liabilities. Whilst remedy for the LGPS is yet to be agreed and the impact on individual member benefits and employer costs are unknown at this stage, allowance has been made in considering funding levels and contribution requirements following the 2019 valuation by way of a past service asset reserve of 1.5%.

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.

The discount rate assumption of 4.6% pa has been derived using the Fund's current investment strategy assuming investment returns, adjusted to allow for expenses and prudence. Underlying investment return assumptions are based on asset class characteristics and devised based on market yields smoothed six months straddling the valuation date.

It may be appropriate for an alternative discount rate approach to be taken to reflect an individual employer's situation. This may be, for example, to reflect an employer targeting a cessation event or to reflect the Administering Authority's views on the level of risk that an employer poses to the Fund. The Administering Authority will incorporate any such adjustments after consultation with the employer and Fund actuary.

A lower discount rate assumption of 2.6% pa has been used to value orphan liabilities (those no longer linked to an active employer) which are backed by a lower risk investment sub fund.

- **Volatility Reserve**

A past service volatility reserve is included for those employers in category 2 or 3 (see Employer Categorisation below). 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 typically either less able to withstand funding risk; are not directly government-backed; or are on a path to exiting the Fund. In practice, this increases the pace of funding and may in future act as a cushion against future periods of lower than expected investment returns.

- **Inflation (Consumer Prices Index - CPI)**

The starting point used for future inflation is the expected future level of price inflation over a period commensurate with the duration of the liabilities, as measured by the Retail Price Index (RPI). This is derived using the 20-year point on the Bank of England implied Retail Price Index (RPI) inflation curve, with consideration of the market conditions over the six months straddling the valuation date. The 20-year point on the curve is taken as 20 years is consistent with the average duration of an LGPS Fund.

Scheme pension increases are linked to changes in the level of the Consumer Price Index (CPI) rather than RPI. Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods, and as such 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 1.0% pa. This results in a CPI inflation assumption of 2.6% pa.

- **Salary Increases**

The assumption for long-term real salary increases (salary increases in excess of price inflation) makes an allowance of 1.0% pa over the CPI inflation assumption described above. This is assumed to capture both the impact of general and promotional increases and will be kept under review or each valuation based on Fund-wide experience.

- **Pension Increases**

Increases to pensions are assumed to be in line with the CPI inflation assumption described above.

Demographic Assumptions

Mortality/Life Expectancy

The mortality in retirement assumptions are 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% pa.

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 Fund actuary and national LGPS carried out by GAD, the allowances for withdrawals and early retirements have been updated to the latest tables published by GAD. The proportions married/civil partnership assumption has remained the same since the previous 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 2019 valuation, administration expenses and 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.

A summary of the headline financial and demographic assumptions adopted at 2019 and in 2016 is included below. Further details may be found in the Fund Actuary's Valuation Report published on the Fund's website.

Comparison of Key Financial Assumptions – 2019 and 2016 Actuarial Valuations

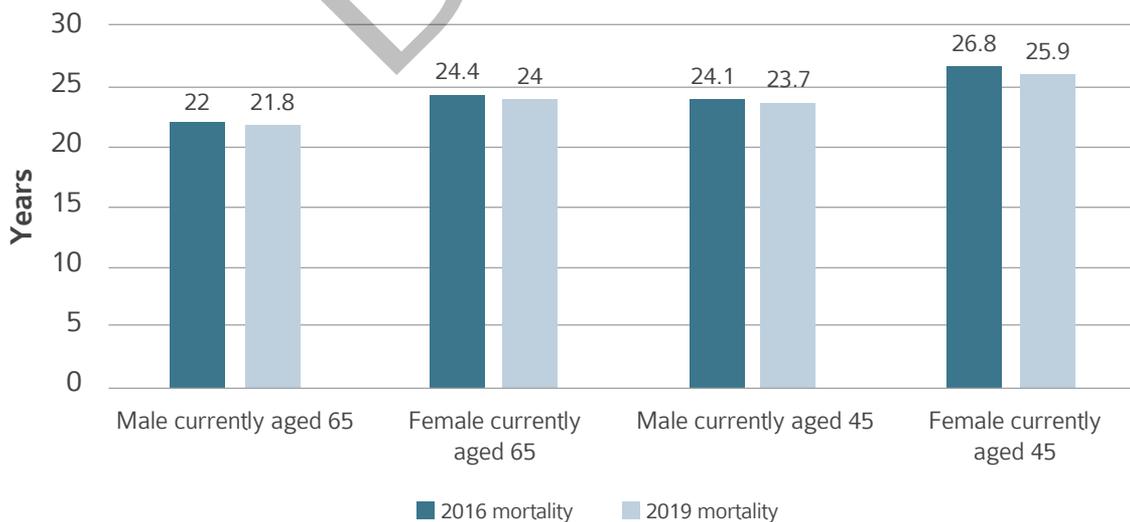
Assumption	2019	2016
Discount rate (for non-orphan liabilities)	4.6% per annum	4.7% per annum
Discount rate (for orphan liabilities)	2.6% per annum	3.3% per annum
Volatility reserve	5.0%/10.0% loading on past service liability for 'Category 2' or 'Category 3' employers	5.0%/10.0% loading on past service liability for 'Category 2' or 'Category 3' employers
Inflation/pension increases (CPI)	2.6% pa	2.4% pa
Salary increases		
- Short term	n/a	1.0% pa for three years
- Long term	3.6% pa (CPI plus 1.0% pa)	3.9% pa (CPI plus 1.5% pa)
- Salary increments	n/a	Age-related allowance
Past service asset reserve (potential McCloud remedy)	1.5% of assets	n/a

Mortality Assumptions

	2019	2016				
Pre-retirement mortality - base table	GAD 2016 tables with a rating of 115% for males and 125% for females.	GAD 2013 tables with a rating of 120% for males and 135% for females.				
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.					
	Type	Base table	Adjustments (M/F)	Type	Base table	Adjustments (M/F)
	Normal health	S3PA Heavy	85%/95%	Normal health	S2PA	110%/105%
	Ill health	S3PA Heavy	85%/95%	Ill health	S2PA	110%/105%
	Dependants	S3DMA/ S3DFA	110%/125%	Dependants	S2PMA/ S2DFA	140%/110%
Allowances for improvements in life expectancy	2018 CMI model with a long-term rate of improvement of 1.5% p.a., a smoothing parameter of 7.5 and an initial addition to improvements of 0.5% p.a.	2015 CMI model with a long-term rate of improvement of 1.5% p.a.				

The mortality assumptions above, and in particular the allowances for improvements in life expectancy, can be further illustrated by the chart below which is based upon a refresh of the Fund's own mortality experience together with observed changes to improvement rates over the last few years.

Life Expectancy



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
Allowance for withdrawals	GAD 2016 table
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', i.e. 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

Management of Funding Deficits and Surpluses

- i) 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 2022/23 increasing annually in line with the valuation funding assumption for long-term pay growth (unless otherwise noted), in respect of deficit recovery or surplus release.
- Both elements are subject to review from April 2023 based on the results of the 2022 actuarial valuation.
- ii) In general, a maximum deficit recovery period of 17 years will apply, reduced from 22 years in 2013 and 20 years in 2016. 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 Employer Categorisation below).
- iii) Where significant increases in employer contributions were required from April 2020, and an employer provided evidence to the Fund that these were not affordable, the increase from the contributions payable in the year 2019/20 may be implemented in steps, at the discretion of the Administering Authority and as agreed with individual employers prior to April 2020, noting that rates will need to be increased to cover the amount due to the Fund to cover the cost of benefits accrual over the inter-valuation period to 2022/23
- iv) In the event of the funding level showing a material and sustained surplus, this should be spread over a period with due consideration of both prudence and the desirability of maintaining as nearly constant employer contribution rates as possible.
- Organisations with sufficient covenant strength and suitable government guarantee may, as part of the 2019 actuarial valuation have surplus released over 30 years.
- v) Organisations without sufficient covenant strength i.e. category 3 employers or without a local or central government guarantee will not see a reduction in contributions unless a surplus exists on a minimum risk (cessation) basis.

Employer Categorisation

The Fund employer covenant monitoring framework (established and maintained since 2010), takes into account a number of financial, funding and structural factors needed to rate employer covenant and allocate each individual employer to a risk banding (RAG rated). More information can be found in the Fund’s ‘Employer Risk Management Framework’ located on the Fund website.

For the purpose of the triennial actuarial valuation, the Fund covenant risk ratings are used, together with employer characteristics (type of body, membership profile, level of government backing or other security) to allocate employers within the Fund into three categories to assist in determining an appropriate funding strategy.

Employers in different categories will have differential contribution plans determined by their funding target and pace of recovery of any deficit. Typically, those employers with weaker covenant would have a faster pace of recovery to mitigate overall funding risk and the impact of default on other employers.

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 17 years
- **Category 2**
 - Maximum recovery period of 12 years
 - Volatility reserve of 5% loading on past service liabilities
- **Category 3**
 - Maximum recovery period of 7 years
 - Volatility reserve of 10% loading on past service liabilities

¹Note 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.

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 17 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 17 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 17 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 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.

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 17-year recovery for all academies. This treatment is consistent with the recovery period applied to the local authorities from which the academies convert.

Further Education Colleges

- In 2019 a college insolvency regime came into effect for further education colleges (2017 Technical and Further Education Act). This regime means:
 - normal commercial insolvency law will apply to colleges. Where a college is in severe financial distress and there is no other solution, new statutory insolvency procedures can apply;
 - the college itself or its creditors can ask the court to apply a normal commercial insolvency processes. These processes include a company voluntary arrangement, administration, creditor's voluntary winding up, court-directed winding up or receivership;
 - in the case of an insolvency, the Department for Education ('DfE') can appoint an education administrator who will have wider duties. These duties will include the avoidance and minimisation of disruption to the studies or existing students as well as to secure the best outcome for learners; and

- statutory insolvency is considered a backstop. The DfE has indicated that it will use a non-statutory route in the first instance, including the commissioning of an Independent Business Review.

The Fund continues to monitor developments in this area as colleges enter into administration under this new regime and in particular the degree of risk for the Fund and its participating employers.

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APPENDIX 2: ADMISSION BODY SEPARATE FUND – WEST MIDLANDS TRAVEL LIMITED (WMTL)

a) Introduction

- As noted in section 1.8, following a process of public consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG), Regulations were laid before parliament providing for the merger of the former West Midlands Integrated Transport Authority (WMITA) Fund into that of the main West Midlands Pension Fund. Those regulations came into force on 8 November 2019 and were backdated to 1 April 2020 confirming the merger.
- As a separate admission body fund, WMTL complies with all areas of this Funding Strategy Statement, save for the matters covered within this appendix.

b) Assessment of Contributions

- As part of each valuation, separate employer contribution rates are assessed by the actuary for WMTL. These rates are assessed taking into account the experience and circumstances of WMTL, following a principle of no cross-subsidy with any other Fund employer.
- In line with the status of being a separate admission body fund, WMTL has its own individual investment strategy and as such investment performance is directly attributable to the assets of the employer.

c) Links to Investment Policy Set Out in the Investment Strategy Statement (ISS)

- WMTL has its own Investment Strategy Statement (ISS).
- The Fund uses an asset liability study and stochastic modelling in order to assist the process of formulating a strategic asset allocation. The outcomes are reflected in WMTL's ISS.
- WMTL's investment strategy has been considered and reviewed in conjunction with the 2019 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 WMTL.

d) Key Assumptions

Discount rate (non buy-in pensioners)	3.2% per annum
Allowance for potential McCloud remedy (incorporated within discount rate above)	0.05% per annum
Discount rate (buy-in pensioners)	1.1% per annum
Discount rate (buy-in asset valuation)	1.1% per annum
Salary increases	2.7% per annum
Inflation/pension increases (CPI)	2.7% per annum (16-year duration)

e) Management of Funding Deficit

- 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 2022/23 increasing annually in line with the valuation funding assumption for long-term pay growth in respect of deficit recovery.

Both elements are subject to review from April 2023 based on the results of the 2022 actuarial valuation.

- ii) A deficit recovery period was set for WMTL commensurate with the risk profile and current funding position of the employer.

f) Employer Covenant

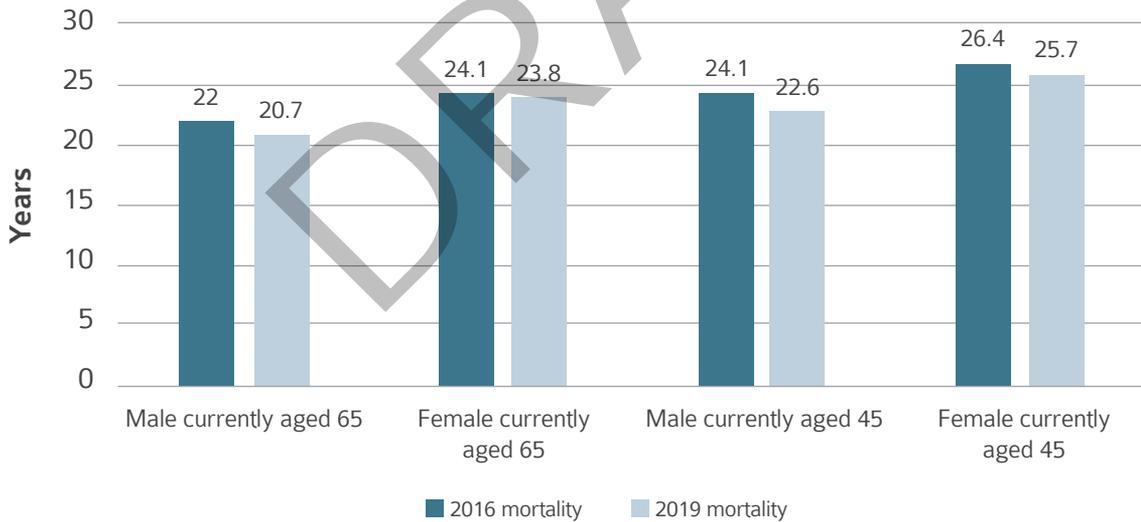
The Fund undertook a detailed assessment of WMTL to include a review of the UK bus market and the guarantee arrangements currently in place. The outcome of this assessment and the potential likelihood and scale of employer default was used in the context of the funding strategy review.

Mortality Assumptions

Post-retirement mortality - base table	S3PA Heavy tables with a multiplier of 97% for all pensioner types
Allowances for improvements in life expectancy	2018 CMI model with a long-term rate of improvement of 1.5% p.a., a smoothing parameter of 7.5 and an initial addition to improvements of 0.5% p.a.

The mortality assumptions above, and in particular the allowances for improvements in life expectancy, can be further illustrated by the chart below which is based upon a refresh of the Fund’s own mortality experience together with observed changes to improvement rates over the last few years.

Life Expectancy



Other Demographic Assumptions

Partner age difference	Males are three years older than females
Proportion married	85% of members have an eligible dependant at retirement or early death
Promotional salary scale	Included implicitly within the financial salary increase assumption
Allowance for withdrawals	GAD 2016 table
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', plus three years for active members of WMTL and plus two years for deferred members of WMTL. The future service rate has been calculated using the retirement assumption above plus one year rather than three years for active members
Allowance for 50:50 membership	We have assumed that existing members will continue to participate in their current section

McCloud/Sargeant Ruling

At the time of drafting this FSS, it is still unclear how the McCloud/Sargeant judgements will affect current and future LGPS benefits. As part of the Fund's 2019 valuation, in order to mitigate the risk of member benefits being uplifted and becoming more expensive, the potential impact of McCloud was covered by the prudence allowance included in the discount rate assumption. As the remedy is still to be agreed the cost cannot be calculated with any certainty; however, the Fund actuary expects it is likely to be less than the impact of reducing the discount rate assumption by 0.05%.

APPENDIX 3: ADMISSION BODY SEPARATE FUND – PRESTON BUS LIMITED (PBL)

a) Introduction

- As noted in section 1.8, following a process of public consultation undertaken by the Ministry of Housing, Communities and Local Government (MHCLG), Regulations were laid before parliament providing for the merger of the former West Midlands Integrated Transport Authority (WMITA) Fund into that of the main West Midlands Pension Fund. Those regulations came into force on 8 November 2019 and were backdated to 1 April 2020 confirming the merger.
- As a separate admission body fund, PBL complies with all areas of this Funding Strategy Statement, save for the matters covered within this appendix.

b) Assessment of Contributions

- As part of each valuation, separate employer contribution rates are assessed by the actuary for PBL. These rates are assessed taking into account the experience and circumstances of PBL, following a principle of no cross-subsidy with any other Fund employer.
- In line with the status of being a separate admission body fund, PBL has its own individual investment strategy and as such investment performance is directly attributable to the assets of the employer.

c) Links to Investment Policy Set Out in the Investment Strategy Statement (ISS)

- PBL has its own Investment Strategy Statement (ISS).
- The Fund uses an asset liability study and stochastic modelling in order to assist the process of formulating a strategic asset allocation. The outcomes are reflected in PBL's ISS.
- PBL's investment strategy has been considered and reviewed in conjunction with the 2019 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 PBL.

d) Key Assumptions

Discount rate	2.1% per annum
Inflation/pension increases (CPI)	2.7% per annum (16-year duration)

e) Employer Covenant

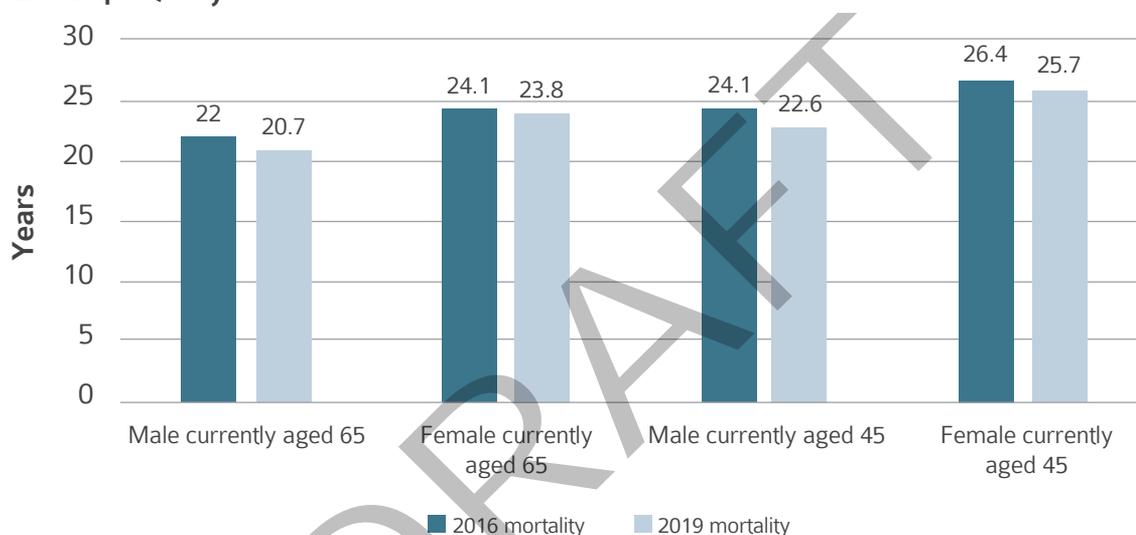
The Fund undertook a detailed assessment of PBL to include a review of the UK bus market and the guarantee arrangements currently in place. The outcome of this assessment and the potential likelihood x scale of employer default was used in the context of the funding strategy review.

Mortality Assumptions

Post-retirement mortality - base table	S3PA Heavy tables with a multiplier of 97% for all pensioner types
Allowances for improvements in life expectancy	2018 CMI model with a long-term rate of improvement of 1.5% p.a., a smoothing parameter of 7.5 and an initial addition to improvements of 0.5% p.a.

The mortality assumptions above, and in particular the allowances for improvements in life expectancy, can be further illustrated by the chart below which is based upon a refresh of the Fund's own mortality experience together with observed changes to improvement rates over the last few years.

Life Expectancy



Other Demographic Assumptions

Partner age difference	Males are three years older than females
Proportion married	85% of members have an eligible dependant at retirement or early death
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', i.e. for each tranche of benefit, the earliest age they could retire with unreduced benefits

McCloud/Sargeant Ruling

At the time of drafting this FSS, it is still unclear how the McCloud/Sargeant judgements will affect current and future LGPS benefits. However, given that the last active member of Preston Bus left service in 2006 (many years before the 2015 public service pension reforms), the Fund Actuary expects the impact on the Preston Bus liabilities to be negligible. Hence no allowance was made within the 2019 valuation of the Preston Bus liabilities for additional costs arising from the impact of these judgements.

GLOSSARY

50/50 Scheme

In the LGPS, active members are given the option of earning half of the standard LGPS benefits and paying half the standard member contribution rates.

Actuarial Valuation

An assessment by an actuary into the ability of a pension fund to meet its liabilities. At the actuarial valuation, the Fund's actuary will assess the funding level of each participating employer and agree contribution rates with the Administering Authority to fund the cost of new benefits and make good any existing deficits.

Administering Authority

A body listed in Part 1 of Schedule 3 of the LGPS Regulations, who maintains a fund within the LGPS. Administering Authorities are typically councils based in England and Wales. The Fund's Administering Authority is the City of Wolverhampton Council.

Admission Body

An admission body is an employer admitted to the LGPS by way of an admission agreement. Admission bodies arise from contracts or outsourcing of services from local government.

Assets

Based on the assessments undertaken by the Fund actuary at each actuarial valuation, a level of contributions (primary and secondary) will be set for each participating employer within the Fund, payable in accordance with the Rates and Adjustment Certificate. Member contributions are set out in statute and collected and paid to the Fund by participating employers. The contributions received by the Fund are invested in accordance with the Fund's investment strategy and strategic asset allocation. Examples of invested assets include equities, bonds, cash and alternatives.

Asset Allocation

The breakdown of the Fund's assets in different asset classes.

Career Average Revalued Earnings ('CARE') Scheme

With effect from 1 April 2014, benefits accrued by members in the LGPS take the form of CARE benefits. Every year members will accrue a pension benefit equivalent to 1/49th of their pensionable pay in that year. Each annual pension accrued receives inflationary increases (in line with the annual change in the Consumer Prices Index) over the period to retirement.

Consumer Prices Index ('CPI')

CPI is an abbreviation standing for 'Consumer Prices Index'. CPI is a measure of inflation with a basket of goods that is assessed on an annual basis. Pension increases in the LGPS are linked to the annual change in CPI.

Deficit

An employer has a deficit when its actuary calculates that it does not currently have enough assets to pay all future commitments. Deficits are typically corrected over periods of time by the payment of additional contributions by employers.

Discount Rate

The rate of interest used to estimate the amount of money needed to be held now to meet a benefit payment occurring in the future.

Employer Covenant

The degree which an employer participating in the LGPS is able to meet the funding requirements of the scheme, both now and in the future.

Employer's Future Service Contribution Rate ('Primary Rate')

The contribution rate payable by an employer, expressed as a% of pensionable pay, as being sufficient to meet the cost of new benefits being accrued by active members in the future. The cost will be net of employee contributions and will include an allowance for the expected level of administrative expenses and investment expenses.

Funding Level

The ratio of a fund's assets to the estimated value of its past service liabilities. This is expressed as a percentage. If a fund has a funding level of 100% then the value of its assets are equal to those of its liabilities.

Funding Strategy Statement (FSS)

This is a key governance document that outlines how the Administering Authority will determine employers' contributions to the Fund and manage its funding risks.

Funding Target

An assessment of the assets required to be held now in order to meet the benefits to be paid in the future. The desired funding target is to achieve a funding level of a 100% i.e. assets equal to the past service liabilities assessed using appropriate actuarial assumptions.

Government Actuary's Department ('GAD')

The GAD is responsible for providing actuarial advice to public sector clients. GAD is a non-ministerial department of HM Treasury.

Investment Strategy

The long-term distribution of assets among various asset classes; it takes into account the Fund's objectives and attitude to risk.

Liabilities

The estimated value, using actuarial methods and assumptions, placed on the obligations of a pension scheme. These obligations include the present value of future pension benefits and contingent benefits and may include the expected value of future expenses.

Local Government Pension Scheme ('LGPS')

An occupational pension scheme for Local Government workers and other related workers made up of 88 individual funds located across England and Wales. West Midlands Pension Fund is one of the 88 individual funds.

Prudent Assumption

An assumption where the outcome has a greater than 50% chance of being achieved. Legislation requires the assumptions (when considered collectively) adopted for an actuarial valuation to be prudent.

Rates and Adjustment Certificate

In accordance with the LGPS regulations, the Administering Authority must obtain this document from an actuary which sets out the contributions payable by each employer.

Real Return or Real Discount Rate

A rate of return or discount rate net of inflation.

Scheme Employer

A Scheme Employer is an employer that is legally obliged to take part in the LGPS by virtue of the LGPS Regulations. This includes councils of all types, academy schools and certain other public sector bodies.

Section 13 Valuation

Section 13 of the Public Service Pensions Act 2013 requires that all public service pension schemes, like the LGPS, undertake an actuarial valuation that ensures their solvency and their long-term cost-efficiency.

DRAFT

ADDENDUM 1: NEW EMPLOYERS JOINING THE FUND

When a new employer joins the Fund, the Fund Actuary is required to set the contribution rates payable by the new employer and allocate a share of Fund assets to the new employer as appropriate. The most common types of new employers joining the Fund are admission bodies and new academies. These are considered in more detail below.

Admission bodies

New admission bodies in the Fund are commonly a result of a transfer of staff from an existing employer in the Fund to another body (for example as part of a transfer of services from a council or academy to an external provider under Schedule 2 Part 3 of the Regulations). Typically these transfers will be for a limited period (the contract length), over which the new admission body employer is required to pay contributions into the Fund in respect of the transferred members.

Risk-Sharing

Although a full risk transfer (as set out below) was previously the most common approach, the default approach for new admission bodies from 1 April 2019 will be for all or part of the pensions risk remains with the letting authority.

Although pensions risk may be shared, it is common for the new admission body to remain responsible for pensions costs that arise from:

- above average pay increases, including the effect on service accrued prior to contract commencement; and
- redundancy and early retirement decisions.

The Administering Authority may consider risk-sharing arrangements as long as the approach is clearly documented in the admission agreement, the transfer agreement or any other side agreement. The arrangement also should not lead to any undue risk to the other employers in the Fund. Legal and actuarial advice in relation to risk-sharing arrangements should be sought where required.

Funding at Start of Contract

Noting that the Fund's default approach is a risk-sharing basis outlines above the option remains for a new admission body upon joining the Fund, they too become responsible for all the pensions risk associated with the benefits accrued by transferring members and the benefits to be accrued over the contract length. This is known as a full risk transfer. In these cases, it may be appropriate that the new admission body is allocated a share of Fund assets equal to the value of the benefits transferred, i.e. the new admission body starts off on a fully funded basis. This is calculated on the relevant funding basis and the opening position may be different when calculated on an alternative basis (e.g. on an accounting basis).

However, there may be special arrangements made as part of the contract such that a full risk transfer approach is not adopted. In these cases, the initial assets allocated to the new admission body will reflect the level of risk transferred and may therefore not be on a fully funded basis or may not reflect the full value of the benefits attributable to the transferring members.

Contribution Rate

The contribution rate may be set on an open or a closed basis. Where the funding at the start of the contract is on a fully funded basis then the contribution rate will represent the primary rate only; where there is a deficit allocated to the new admission body then the contribution rate will also incorporate a secondary rate with the aim of recovering the deficit over an appropriate recovery period (based on the employer categorisation set out earlier in this document).

Depending on the details of the arrangement, for example based on the Fund's default position and if any risk sharing arrangements are in place, then additional adjustments may be made to determine the contribution rate payable by the new admission body. In general, the approach for these cases will be for the contribution rate to be in line with the letting authority; however, there may be cases which will be bespoke to the individual arrangement.

Security

To mitigate the risk to the Fund that a new admission body will not be able to meet its obligations to the Fund in the future, the new admission body may be required to put in place a bond in accordance with Schedule 2 Part 3 of the Regulations, if required by the letting authority and Administering Authority.

If, for any reason, it is not desirable for a new admission body to enter into a bond, the new admission body may provide an alternative form of security which is satisfactory to the Administering Authority.

New Academies

When a school converts to academy status, the new academy (or the sponsoring multi-academy trust) becomes a scheme employer in its own right.

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.

Funding at Start

On conversion to academy status, the new academy will be allocated assets based on the active cover of the relevant local authority at the conversion date. The active cover approach is based on the funding level of the local authority's active liabilities, after fully funding the local authority's deferred and pensioner liabilities.

New free schools will be allocated zero assets as they are not formed through conversion from a pre-existing school. Any liabilities that are transferred to the free school by individual members will have associated transfer of assets on an individual basis.

Contribution Rate

Where an academy joins an existing multi-academy trust in the Fund, they will pay the same primary rate as the other academies in the multi-academy trust and any additional secondary contributions will be certified for the multi-academy trust in respect of the academy.

Bulk Transfers

Bulk transfers of staff into or out of the Fund can take place from other LGPS funds or non-LGPS funds. In either case, the Fund actuary for both funds will be required to negotiate the terms for the bulk transfer – specifically terms by which the value of assets to be paid from the Fund to the other is calculated.

The agreement will be specific to the situation surrounding each bulk transfer, but in general the Fund will look to receive the bulk transfer on no less than a fully funded transfer (i.e. the assets paid from the ceding fund are sufficient to cover the value of the liabilities on the agreed basis).

A bulk transfer may be required by an issued Directions Order. This is generally in relation to an employer merger, where all the assets and liabilities attributable to the transferring employer in the original fund are transferred to the receiving fund.

ADDENDUM 2: POLICY ON TERMINATION FUNDING FOR EMPLOYERS

1 INTRODUCTION

- 1.1 This addendum covers the key elements of the Fund's 'Termination Policy' written within the context of the FSS. For further details, please refer to the Fund's Termination Policy as held on our website.

2 PRINCIPLES

2.1 Termination of an Employer's Participation

An employer's participation within the Fund ceases when they no longer have any active members within the Fund. This could happen for a number of reasons, typically:

- The last active member participating in the Fund leaves, retires or transfers to another employer and ceases to be a member of the Fund and the employer does not wish to admit any more employees to that admission agreement.
- For admission bodies, the contract to which the admission agreement relates, comes to an end or is terminated prematurely.
- The employer ceases to exist, for example it goes into liquidation or is taken over by/merged with another organisation.

When an employer's participation comes to an end, or is prematurely terminated for any reason, employees may transfer to another employer, either within the Fund or elsewhere. If this is not the case, the employees will retain pension rights within the Fund, i.e. either deferred benefits or immediate retirement benefits.

In addition to any liabilities for current employees, the Fund will also retain liability for payment of benefits to former employees, i.e. to existing deferred and pensioner members except where this is a complete transfer of responsibility to another Fund with a different Administering Authority.

Where an admission agreement is open (or for scheme employers) and the last active member ceases membership of the scheme, the Fund will approach the relevant employer with regards to its intentions for bringing in new active members. Where an intention to allow new active members to join the scheme is identified, the Fund's policy is to allow the employer six months from the date the active member left to admit such members. During this six-month period, the Fund will require payment of a lump-sum amount broadly equivalent to the percentage of contributions calculated by the Fund actuary, based upon the pensionable payroll used in the previous actuarial valuation. It is advised this lump-sum is paid on a monthly basis, or where the period is known until the next active member joins the scheme, a prorated payment can be calculated.

In the event an employer with an open admission agreement, or a scheme employer exceeds the six-month period without any active members having joined the scheme under that agreement, the Fund will enforce termination of the employer's participation in the scheme.

2.2 Pre-Funding for Termination

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

For any employing bodies funding on such a minimum-risk strategy, a notional investment strategy may be assumed as a match to the liabilities. In particular, the employing body's notional asset share of the Fund may be credited with an investment return in line with the minimum-risk funding assumptions adopted rather than the actual (largely equity related) investment return generated by the actual asset portfolio of the Fund. The Fund reserves the right to modify this approach in any case, whether it might materially affect the finances of the scheme, or depending on any case specific circumstances.

2.3 Exiting the Fund

When an employer's participation in the Fund terminates and the employer becomes an 'exiting employer', the LGPS Regulations require that a termination valuation is carried out. The purpose of this valuation is to determine the level of any surplus or deficit in an exiting employer's share of the Fund as at the exit date and whether the exiting employer is liable to pay an exit payment or is entitled to receive an exit credit in such circumstances.

A deficit upon termination of an employer's participation might arise in the following scenarios (please note that this list is not exhaustive):

- a) Non-payment of contributions to the Fund by an employing body prior to closure.
- b) Premature termination of an employing body's participation where market values are depressed relative to the liabilities in respect of the employing body.
- c) The actual experience is less favourable than the assumptions used in setting contribution rates for that employer – for instance, higher than expected rates of early retirement on favourable terms or pay increases.
- d) Additional liabilities created as a result of the employing body closing, in particular the possible payment of immediate retirement benefits to all those over age 55 at that time.

The method used to calculate the termination valuation will ultimately depend on the characteristics of the exiting employer and in particular whether there is another scheme employer within the Fund that is prepared to act as a guarantor or succession employer for any residual liabilities and also in the context of the materiality of any impact on other participating scheme employers' contributions.

Where liabilities are "orphaned" without sufficient assets to cover the liabilities all remaining scheme employers that have active members in the Fund will have to cover any deficit arising from these liabilities via their own employer contributions, as assessed at each actuarial valuation (as required under Regulation 62 of the LGPS Regulations) or sooner if the liability profile of the employer is materially changed.

2.4 a) Policy for Employers With a Guarantor Participating in the Fund

Where the exiting employer has either:

- a guarantee from a scheme employer participating in the Fund with tax-raising powers;
- a guarantee from a central government department;
- or a guarantee from a scheme employer participating in the Fund, which benefits from a central government guarantee

then the default policy of the Fund is for the exit funding position to be based on a least risk basis, with the discount rate based upon government gilt yields of appropriate duration to the liabilities. In this instance, the scheme employer providing the guarantee will subsume all assets and liabilities from the exiting employer. No exit credit will be paid to, or any exit debt required from, the exiting scheme employer, unless the exiting employer is in surplus on the least risk valuation basis. The assets and liabilities will be subsumed within those of the guarantor employer, with future contribution requirements reassessed at each actuarial valuation.

However, for Schedule 2, Part 3 employers, where the service or contract is due to be transferred to another scheme employer participating in the Fund, subject to agreement from the guarantor, the Fund will consider the transfer of active member liabilities to the new employer based on the funding level of the previous exiting employer, as assessed in line with the assumptions consistent with the most recent actuarial valuation basis (ie, partially-funded upon commencement). This is based on the premise that the new employer has a reasonable prospect of retaining contributing employees and/or there is likely to be a succession employer to inherit liabilities.

In this instance the exiting employer will not be required to pay any exit debt and the scheme employer providing the guarantee subsumes all deferred and pensioner liabilities in respect of the exiting employer. In line with the “pass-through” arrangements outlined below, the new employer will pay the same contribution rate (primary rate only) as the scheme employer providing the guarantee scheme employer until next review.

b) Policy for Employers Without a Guarantor Participating in the Fund

Where the exiting employer does not have a guarantee as outlined in (a.) above this means that there may not be any future scheme employer or guarantor to make good any shortfall between assets and liabilities. In order to protect other scheme employers from having to meet these liabilities in the future the Fund will need to ensure that there are enough assets in the Fund that are unlikely to fall in value and provide certainty to pay benefits. This is on the basis that, upon cessation, employers in this category are no longer subject to ongoing funding but have instead exited the Fund and do not have a scheme employer to subsume their assets and liabilities. Accordingly, the policy of the Fund is for assessment of the exit funding position to be based on a least risk basis, with the discount rate based upon government gilt yields of appropriate duration to the liabilities.

2.5 **Pass-Through Arrangements**

The Fund's policy from April 2019 is for the default arrangement to be for all new Schedule 2, Part 3 employers to pay the same primary contribution rate as the guarantor employer. The Fund will not obtain an actuarial assessment upon termination, instead the scheme employer providing the guarantee employer must accept full responsibility for the Schedule 2 Part 3 scheme employer's ("contractor's") assets and liabilities in the Fund, and will correspondingly be entitled to benefit from any surplus within the Fund relating to those liabilities. This arrangement is known as a pass-through arrangement.

The contribution rates for all employers will be reviewed at each subsequent actuarial valuation in line with Regulation 62 of the LGPS Regulations.

The Fund's policy is for these pass-through arrangements to be documented in the service contract between the guarantor employer and the Schedule 2, Part 3 scheme employer, but where not agreed, the default will be for these arrangements to be included in the Fund's tripartite admission agreement.

As an alternative to the pass-through arrangement, if the guarantor employer and contractor agree to a standard admission agreement and notify the Fund within one month of the contract commencement date, the Fund may, at its discretion, implement such an admission agreement without reference to pass-through.

The Administering Authority reserves the right to modify this approach on a case-by-case basis, at its sole discretion, if the circumstances warrant it based on the advice of the Fund actuary and taking into account the risk associated with an employer in the context of the Fund as a whole. For instance, in the highly unlikely event that parties insisted upon access to the Fund through a statutory route, but did not wish to participate on a pass-through arrangement then the Fund would need to consider funding the new employer on a least risk basis.

2.6 **Policy in Relation to Flexibility for Exit Debt Payments and Deferred Debt**

The Fund's policy for termination payment plans is as follows:

- 1) The default position is for exit payments to be paid immediately in full unless under the specific circumstances outlined in section 2.4.
- 2) At the discretion of the administering authority, Debt Spreading Arrangements (DSA) over an agreed period or a Deferred Debt Agreement (DDA) may be agreed subject to the policy in relation to any flexibility in recovering exit payments.

Debt Spreading Arrangement (DSA) - Allows the Fund and the employer to enter into agreement which spreads the payment of the final exit debt calculated by the Fund actuary over an agreed period of time (the amounts and frequency of the payments in the payment plan will be agreed at the outset along with any early payment terms).

Deferred Debt Arrangement (DDA) - Allows the employer to defer its obligation to make an exit payment and continue to make past service deficit (secondary rate) contributions to the Fund. Contribution requirements will continue to be reviewed as part of each actuarial valuation under this option, which is essentially an employer continuing ongoing participation, but with no contributing members.

The default position for exit payments is that they are paid in full at the point of exit (adjusted for interest where appropriate). If an employer requests that an exit debt payment is recovered over a fixed period of time or that they wish to enter into a Deferred Debt/debt spreading arrangement with the Fund, they must make a request in

writing covering the reasons for such a request. Any deviation from this position will be based on the Administering Authority's assessment of whether the full exit debt is affordable and whether it is in the interests of other participating employers and in accordance with the Administering Authority's fiduciary duty to adopt either of the approaches. In making this assessment the Administering Authority will consider the covenant of the employer and also whether any measures to strengthen covenant are required and available to support the arrangements.

Any costs (including necessary actuarial, legal and covenant advice) associated with assessing this will be borne by the employer and will be charged up front as a default, but may be included in the contribution plan or exit debt payment at the sole discretion of the Administering Authority. This policy and processes has been established in line with the principles set out in the statutory guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG) and more detailed guidance prepared by the LGPS Scheme Advisory Board

Process for Consideration of Timing of Exit Payments

The following process will determine whether an employer is eligible to spread their exit payment over a defined period. Employers with a Debt Spreading Arrangement (DSA) are deemed to be exiting the fund and such arrangements may be appropriate for an employer with no active members, no intention of returning to active employer status in the future and they wish to crystallise any debt to the fund. Employers have an obligation to make good on the payments due under the DSA, which when completed will finalise their exit.

Policy for Spreading Exit Payments

The following process will determine whether an employer is eligible to spread their exit payment over a defined period. Employers with a Debt Spreading Arrangement (DSA) are deemed to be exiting the fund and such arrangements may be appropriate for an employer with no active members, no intention of returning to active employer status in the future and they wish to crystallise any debt to the fund. Employers have an obligation to make good on the payments due under the DSA, which when completed will finalise their exit.

- 1) The Administering Authority will request updated covenant information from the employer including (but not exclusively) management accounts and financial forecasts. If this information is not provided then the default policy of immediate payment may be adopted.
- 2) Once this information has been provided, the Administering Authority (in conjunction with the Fund Actuary, covenant and legal advisors where necessary) will review the covenant of the employer to consider the appropriateness of allowing the employer to spread the exit debt over a period of time. Depending on the length of the period and also the size of the outstanding debt, the Fund may request security to support the payment plan before entering into an agreement to spread the exit payments.
- 3) The form of the Debt Spreading Arrangement will be determined by the Fund in discussion with the employer. The payments required will include allowance for interest to reflect later payment.
- 4) The initial process to determine whether an exit debt should be spread may take up to three months from the later of date of exit or receipt of required information, therefore it is important that employers who request to spread exit debt payments notify the Fund early. There is also an expectation that any agreement to spread exit debt payments and the supporting legal documentation will be completed within twelve

months of the date of exit, with a default of immediate payment falling due where arrangements are not concluded within this timeframe.

- 5) If it is agreed that the exit payments can be spread then the Administering Authority will engage with the employer regarding the following:
 - a) The spreading period that will be adopted (note in general it is expected that the spreading period for a DSA will be shorter than that of a DDA).
 - b) The initial and annual payments due and how these will change over the period.
 - c) The interest rates applicable and the costs associated with the payment plan.
 - d) The level of security required to support the payment plan (if any) and the form of that security e.g. bond, escrow account etc.
 - e) The responsibilities of the employer during the exit spreading period including the supply of relevant information and events which would trigger a review of the situation.
 - f) The covenant information that will be required on a regular basis to allow the payment plan to continue.
 - g) The circumstances under which the payment plan may be reviewed or terminated to potentially include immediate payment of outstanding debt (e.g. where there has been a significant change in covenant or circumstances).
- 6) Once the Administering Authority has reached its decision, the arrangement will be legally documented and any supporting agreements will be included.

In the event that the Administering Authority believes that the exiting employer may be at increased risk of being able to honour remaining payments, the Administering Authority will initiate a review and may terminate the DSA to ensure arrangement remain appropriate for the Fund and do not adversely impact the other participating employers.

The exiting employer may also request to terminate the DSA early, in which case an immediate payment of the outstanding debt, as set out in the schedule to the DSA will be payable.

Once the exit debt payment has been made in full, the exiting employer has no further obligation to the Fund.

Employers Participating With No Contributing Members

As opposed to triggering and paying an immediate exit debt an employer may request to participate in the Fund with no contributing members and utilise a "Deferred Debt Agreement" (DDA) at the sole discretion of the Administering Authority. This would be at the request of the employer in writing to the Administering Authority ahead of exit. These arrangements may be appropriate for an employer which, although they have no active members, may return to active employer status at some point. Alternatively, a DDA can be used for employers who do wish to exit, but do not wish to crystallise their debts to the Fund. In this instance the employer would continue to have exposure to funding risk for the duration of the DDA.

The following process will determine whether the Fund and employer will enter into such an arrangement:

- 1) The Administering Authority will request updated covenant information from the employer including (but not exclusively) management accounts and financial forecasts. If this information is not provided then a DDA may not be entered into by the Administering Authority

- 2) Once this information has been provided, the Administering Authority will firstly consider whether it would be in the best interests of the Fund and participating employers to enter into such an arrangement with the employer. This decision will be informed by review of covenant, affordability and potential funding risk to the employer and other employers within the fund (based on advice from the Actuary, covenant and legal advisor where necessary).
- 3) The initial process to determine whether a Deferred Debt Agreement could apply may take up to three months from receipt of the required information. Any employer considering a DDA request to the Administering Authority must inform the Fund in advance of the exit (or potential exit) date.
- 4) Noting the steps above, if the Administering Authority deems that a Deferred Debt Agreement is appropriate it will base discussions with the employer about the potential format of the agreement upon the principles set out in the LGPS Scheme Advisory Board's guidance, issued March 2021. As part of this, the following will be considered and where relevant, recorded within the legal agreement:
 - Any security the employer can offer whilst the employer is participating within the Fund. As a general principle, the Administering Authority will not enter into such an agreement unless they are confident that the employer can support the arrangement over the duration of the agreement.
 - The categorisation that would be applied to the employer for funding purposes
 - Any upfront cash payment payable to the Fund at the outset to reduce the outstanding debt.
 - The updated secondary rate of contributions (payment plan) required up to the next valuation.
 - The financial information that will be required on a regular basis to allow the employer to remain in the Fund and online monitoring that will be undertaken by the Fund.
 - The advice of the Fund actuary, covenant, legal and any other specialists necessary.
 - The responsibilities that would apply to the employer while they remain in the Fund.
 - Conditions that may trigger the implementation of a review of the DDA and revised payment plan.
 - Potential triggers might include the removal or loss of any security or a significant change in covenant assessed as part of the regular monitoring.
 - The circumstances under which the employer may be able to vary the arrangement e.g. a further cash payment or change in security underpinning the agreement.

The Administering Authority make a final decision on whether it is in the best interests of the Fund and other participating employers to enter into a Deferred Debt Agreement with the employer and confirm the terms that are required.

- 5) For employers who enter into a Deferred Debt Arrangement, contribution requirements will continue to be reviewed as part of each actuarial valuation or in line with the Deferred Debt Agreement in the interim if any of the agreed triggers are met.
- 6) The costs associated with the advice sought and drafting of the Deferred Debt Agreement will be passed onto the employer as part of the arrangements and contribution requirements.

Unless otherwise agreed, a DDA will terminate on the first of the following events:

- the deferred employer enrolls new active members;
- the duration of the agreement has elapsed;
- the take-over, amalgamation, insolvency, winding up or liquidation of the deferred employer;
- having monitored the employer's ongoing ability to support its obligations, the Administering Authority is satisfied that the DDA may cease with no further obligation from the employer

The deferred employer can also choose to terminate the DDA at any point. Notice should be given to the administering authority at the earliest opportunity.

Termination clauses will be included in the formal DDA legal agreement.

Once a termination of the DDA has been triggered, the deferred employer becomes an exiting employer under Regulation 64(1). The administering authority will obtain from the Fund Actuary an exit valuation calculated at the date the DDA terminates, and advise the employer of any further payments due.

Once the exit debt payment has been made in full, the exiting employer has no further obligation to the Fund.

If the termination has been triggered because the deferred employer has enrolled new active members then the deferred employer becomes an active employer in the Fund and an immediate exit payment may not be required; this may instead be incorporated in the revised rates and adjustments certificate that will be provided in respect of the active employer. The employer remains responsible for all previously accrued liabilities and the revised contributions required from the active employer will be calculated in line with the Fund's FSS.

ADDENDUM 3: POLICY ON CONTRIBUTION REVIEWS INTER-VALUATION

Introduction

In line with the Regulations that came into force on 23rd September 2020, the Administering Authority has the ability to review employer contributions between valuations. The Administering Authority and employers now have the following flexibilities:

- 1) The Administering Authority may review the contributions of an employer where there has been, or where there is likely to be, a significant change to the liabilities of an employer.
- 2) The Administering Authority may review the contributions of an employer where there has been a significant change in the employer's covenant.
- 3) An employer may request a review of contributions from the Administering Authority if they feel that either point 1 or point 2 applies to them and that employer would be required to pay the costs of any review.

Where the funding position for an employer significantly changes solely due to a change in assets (and changes in actuarial assumptions), the Regulations do not allow employer contributions to be reviewed outside of a full valuation. However, changes in assets may be taken into account when considering an employer's ability to support its obligations to the Fund after a significant covenant change (see 2. above).

The Administering Authority undertakes to consult with the employer prior to undertaking a review of their contributions including setting out the reason for triggering the review.

For the avoidance of doubt, any review of contributions may result in no change and a continuation of contributions as per the latest actuarial valuation assessment. In the normal course of events, a rate review would not be undertaken close to the implementation of the rates from the latest actuarial valuation, unless there are exceptional circumstances.

Circumstances Whereby Contributions May be Reviewed

Contributions may be reviewed if the Administering Authority becomes aware of any of the following scenarios. Employers will be notified if this is the case.

Employers may also request a review as a result of the following scenarios and subject to required contribution payments and monthly membership data being up to date, as well as ensuring there are no significant historical data gaps in accordance with the employer obligations outlined within the Pensions Administration Strategy.

1) Significant Changes in the Employer's Liabilities

This includes but is not limited to the following scenarios:

- a) Significant changes to the employer's membership which will have a material impact on their liabilities, such as:
 - i) Restructuring of an employer (for instance, which results in a material change in the purpose, nature or scale of the organisation)
 - ii) A significant outsourcing or transfer of staff to another employer in the Fund
 - iii) A bulk transfer into or out of the employer
 - iv) Other significant changes to the membership for example due to redundancies, significant salary awards, ill health retirements, large number of withdrawals
- b) Two or more employers merging including insourcing and transferring of services
- c) The separation of an employer into two or more individual employers

In terms of assessing the triggers under a) above, the Administering Authority will only consider a review if there is a demonstrated and evidenced expectation of a significant change in liabilities. In some cases this may mean there is also a change in the covenant of the employer.

Any review of the contributions will consider the effect of the new active membership profile on the primary rate of contributions and the impact of the change in liabilities on the secondary contributions.

2) Significant Changes in the Employer's Covenant

This includes, but is not limited to the following scenarios:

- a) Provision of, or removal of, or impairment of, security, bond, guarantee or some other form of indemnity by an employer against their obligations in the Fund. For the avoidance of doubt, this includes provision of security to any other creditor which may impair the security provided to the Fund.
- a) Material change in an employer's immediate financial strength or longer-term financial outlook (evidence should be available to justify this)
- a) Change in potential outcome and recovery by the Fund, where an employer exhibits behavior that suggests a change in their ability and/or willingness to pay contributions to the Fund.

In some instances, a change in the liabilities will also result in a change in an employer's ability to meet these obligations.

Whilst in most cases the regular covenant updates requested by the Administering Authority will identify some of these changes, employers will be required to notify the Administering Authority of any material events. The Administering Authority will set out notifiable events requirements in the Pensions Administration Strategy.

Additional information will be sought from the employer in order to determine whether a contribution review is appropriate. This may include annual accounts, budgets, forecasts and any specific details of restructure plans. As part of the review, the Administering Authority will take advice from the Fund Actuary, covenant, legal and any other specialist adviser, as deemed appropriate.

In this instance, any review of the contribution rate would include consideration of the updated funding position both on an ongoing and termination basis (if applicable).

Timing and Charges Associated With a Contributions Review

Where an employer makes a request for a contribution review, it is considered that it should be limited to a maximum of one request per calendar year, unless circumstances dictate a further review is deemed appropriate and at the sole discretion of the Fund, having obtained relevant evidence from the employer to support the request.

In addition, unless in exceptional circumstances at the sole discretion of the Fund, a request for a contribution review will not be permitted within 12 months from the statutory valuation date, during the period when updated membership data and more in depth assessment of the Fund and individual employer liabilities is under review.

Where the review of contributions has been initiated by the Administering Authority, any costs incurred as part of the review in relation to the gathering of evidence to present to the Scheme employer and the actuarial costs to commission the contribution review will be met by the Fund. This is with the exception of any costs incurred as a result of extra information requested by the Scheme employer which is not ordinarily anticipated to be incurred by the Administering Authority as part of the review. These exception costs would be recharged to the Scheme employer.

For the avoidance of doubt, where the contributions review is requested by an employer the expectation would be that responsibility for associated costs are passed onto the employer, unless specifically agreed otherwise and at the discretion of the Fund.

The review of contributions may take up to three months from the date of confirmation to the employer that the review is taking place, in order to collate the necessary information (note in most cases it is expected that there will be a requirement for the employer to supply relevant information and data to support the review).

Process and Potential Outcomes of a Contribution Review

Where review is triggered, the Administering Authority will notify the employer of the intention to review contributions. Ultimately, the decision to review contributions as a result of the above events rests with the Administering Authority after, if necessary, taking advice from their Actuary, legal or a covenant specialist advisors.

This also applies where an employer notifies the Administering Authority of the event and requests a review of the contributions. The employer will be required to confirm payment of the costs associated with the review and outline the rationale and case for the review through a suitable exchange of information prior to consideration by the Administering Authority. The Administering Authority will determine any information it requires from the employer, in addition to the information held or provided with the request for review.

Consideration will be given to the impact of change in an employer's contributions may have on the other employers and on the Fund as a whole, when deciding whether to proceed with a contribution review.

The most recent actuarial valuation data will be used as a starting point for the review, with amendments made where required to reflect any significant changes in the employer's membership profile. The Administering Authority will consider whether it is appropriate to use updated membership data within the review, for example where the level of manual amendments required to the valuation data would require a disproportionate level of work or if there has been a significant change in an employer's membership.

The approach to setting assumptions will be in line with that adopted for the most recent actuarial valuation, and in line with that set out in the Fund's Funding Strategy Statement. The market conditions and demographic assumptions used will be in line with those at the most recent actuarial valuation unless an update is deemed more appropriate by the Fund Actuary.

As well as revisiting the employer's contribution plan, as part of the review it is possible that other parts of the funding strategy will also be reviewed where the covenant of the employer has changed, for example the Fund will consider:

- The Employer Categorisation and in particular whether the employer's risk rating (as outlined on page 25) remains appropriate or whether they should move to a different category.
- As a consequence of the point above, whether the secondary contributions should be adjusted either as a result of the amending the recovery period and/or the volatility reserve for that employer.
- Whether the Primary contribution rate should be adjusted to allow for membership profile change.

Any change to an employer's contributions will be implemented at a date agreed between the employer and the Fund. The Schedule to the Rates and Adjustment Certificate at the last valuation will be updated for any contribution changes.

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