

Cronfa Bensiynau Clwyd
Clwyd Pension Fund



FLINTSHIRE COUNTY COUNCIL

**Administering Authority for
Clwyd Pension Fund**

2015 FUNDING STRATEGY STATEMENT

May 2015

2015 FUNDING STRATEGY STATEMENT (FSS)

This Statement has been prepared by Flintshire County Council (the Administering Authority) to set out the funding strategy for the Clwyd Pension Fund (the CPF), in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (as amended) and the guidance paper issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.

Introduction

The Local Government Pension Scheme Regulations 2013 (as amended) (“the 2013 Regulations”) and the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014 (“the 2014 Transitional Regulations”) (collectively; “the Regulations”) provide the statutory framework from which the Administering Authority is required to prepare a FSS. The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Fund, the Administering Authority will prepare and publish their funding strategy.
- In preparing the FSS, the Administering Authority must have regard to :-
 - the guidance issued by CIPFA for this purpose; and
 - the Statement of Investment Principles (SIP) for the CPF published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended);
- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

Benefits payable under the CPF are guaranteed by statute and thereby the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.

The Scheme is a defined benefit arrangement with principally final salary related benefits from contributing members up to 1 April 2014 and Career Averaged Revalued Earnings (“CARE”) benefits earned thereafter. There is also a “50:50 Scheme Option”, where members can elect to accrue 50% of the full scheme benefits and pay 50% of the normal member contribution.

The benefits provided by the CPF are specified in the governing legislation contained in the 2013 Regulations and the 2014 Transitional Regulations. The required levels of employee contributions from 1 April 2014 are also specified in the 2013 Regulations.

Employer contributions are determined in accordance with the 2013 Regulations which require that an actuarial valuation is completed every three years by the actuary, including the provision of a rates and adjustments certificate. Contributions to the CPF should be set so as to “secure its solvency”, whilst the actuary must also have regard to the desirability

of maintaining as nearly constant a common rate of contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

Purpose of the FSS in policy terms

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority, acting on the professional advice provided by the actuary.

The purpose of this Funding Strategy Statement is:

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

The intention is for this strategy to be both cohesive and comprehensive for the CPF as a whole, recognising that there will be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the statement, it must remain a single strategy for the Administering Authority to implement and maintain.

Aims and purpose of the CPF

The aims of the Fund are to:

- Achieve and maintain assets equal to 100% of liabilities within an 18 year average timeframe, within reasonable risk parameters
- Determine employer contribution requirements, recognising the constraints on affordability and strength of employer covenant, with the aim being to maintain as predictable an employer contribution requirement as possible
- Recognising the constraints on affordability for employers, aim for sufficient excess investment returns relative to the growth of liabilities
- Strike the appropriate balance between long-term consistent investment performance and the funding objectives
- Manage employers' liabilities effectively through the adoption of employer specific funding objectives
- Ensure net cash outgoings can be met as/when required
- Minimise unrecoverable debt on employer termination.

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income,
- and pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses as defined in the 2013 Regulations, the 2014 Transitional Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

Responsibilities of the key parties

The Administering Authority should:

- collect employer and employee contributions
- invest surplus monies in accordance with the Regulations
- ensure that cash is available to meet liabilities as and when they fall due
- manage the valuation process in consultation with the CPF's actuary
- prepare and maintain an FSS and a SIP, both after due consultation with interested parties
- monitor all aspects of the CPF's performance and funding and amend FSS/SIP,
- with effect from 1 April 2015, establish, support and monitor a Local Pension Board ("LPB") in accordance with the requirements set down in the Public Service Pensions Act 2013, the Regulations and the Pensions Regulator's relevant Code of Practice.

The Individual Employer should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- exercise discretions within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain
- notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding, and
- have regard to the Regulator's focus on data quality and comply with any requirement set by the Administering Authority in this context.

The Fund actuary should:

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters,
- advise on funding strategy, the preparation of the FSS, and the inter-relationship between the FSS and the SIP.

Solvency issues and target funding levels

Funding Objective

To meet the requirements of the Regulations the Administering Authority's long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the "*funding target*") assessed on an ongoing past service basis including allowance for projected final pay where appropriate. In the long term, the employer rate would ultimately revert to the Future Service Rate.

Determination of the Funding Target and Recovery Period

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

Underlying these assumptions are the following two tenets:

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

This allows us to take a longer term view when assessing the contribution requirements for certain employers. As part of the valuation when looking to potentially stabilise contribution requirements we will consider whether we can build into the funding plan the following:-

- some allowance for interest rates and bond yields to revert to higher levels over the medium to long term; and
- whether some allowance for increased investment return can be built into the funding plan over the agreed recovery period.

In considering this the Administering Authority, based on the advice of the Actuary, will consider if this results in a reasonable likelihood that the funding plan will be successful taking into account any changes in funding after the valuation date up to the finalisation of the valuation.

As part of each valuation separate employer contribution rates are assessed by the actuary for each participating employer or group of employers. These rates are assessed taking into account the experience and circumstances of each employer, following a principle of no cross-subsidy between the distinct employers in the Scheme. In attributing the overall investment performance obtained on the assets of the Scheme 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 Scheme as a whole.

The Administering Authority, following consultation with the participating employers, has adopted the following objectives for setting the individual employer contribution rates arising from the 2013 actuarial valuation:

- In the current circumstances, as a general rule, the Fund does not believe it appropriate for deficit contribution reductions to apply compared to the 2010 funding plan where substantial deficits remain.

- In addition, a maximum deficit recovery period of 20 years will apply. Employers will have the freedom to adopt a recovery plan on the basis of a shorter period if they so wish. A shorter period may be applied in respect of particular employers where the Administering Authority considers this to be warranted (see Deficit Recovery Plan below). This has resulted in an average recovery period of 18 years being adopted across all employers.
- For any employers assessed to be in surplus, their individual contribution requirements will be adjusted to such an extent that any surplus is used (ie run-off) over a 20 year period (if surpluses are sufficiently large, contribution requirements will be set to a minimum nil total amount). The current level of contributions will be phased down as appropriate.
- The employer contributions will be expressed and certified as two separate elements:
 - a percentage of pensionable payroll in respect of the future accrual of benefit
 - a schedule of lump sum amounts over 2014/17 in respect of the past service deficit subject to review from April 2017 based on the results of the 2016 actuarial valuation.
- Where increases in employer contributions are required from 1 April 2014, following completion of the 2013 actuarial valuation, the increase from the rates of contribution payable in the year 2013/14 may be implemented in steps, over a maximum period of 3 years.
- On the cessation of an employer's participation in the Scheme, the actuary will be asked to make a termination assessment. Any deficit in the Scheme in respect of the employer will be due to the Scheme 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 Scheme to another participating employer. The full termination policy is set out in Appendix 3.

In determining the above objectives the Administering Authority has had regard to:

- the responses made to the consultation with employers on the FSS principles
- relevant guidance issued by the CIPFA Pensions Panel
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose, and
- the Administering Authority's views on the strength of the participating employers' covenants in achieving the objective.

Deficit Recovery Plan

If the assets of the scheme relating to an employer are less than the funding target at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall.

Additional contributions will be expressed as annual monetary lump sums, subject to review based on the results of each actuarial valuation.

In determining the actual recovery period to apply for any particular employer to 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;
- length of expected period of participation in the Fund; and
- changes in the funding position after the valuation date which is deemed reasonable.

In certain instances, and in particular for Fund employers which are considered by the Administering Authority to provide a high level of financial covenant, an allowance may be made as part of the Recovery Plan for investment performance at a higher level than that assumed for assessment of the funding target. It is envisaged that this option will only be afforded to eligible employers where an increase in contributions is required (compared to the 2013/14 level of contribution) when adopting the maximum 20 year recovery period. This higher level of return assumed will, in particular reflect the actual investment strategy of the Fund, on the basis that this is to be maintained over the entire recovery period. The assumptions to be used in these Recovery Plan calculations are set out in Appendix 2.

It is acknowledged by the Administering Authority that, whilst posing a relatively low risk to the Fund as a whole, a number of smaller employers may be faced with significant contribution increases that could seriously affect their ability to function in the future. The Administering Authority therefore, after specific agreement has been obtained by Fund Officers from the Clwyd Pension Fund Committee, would be willing to use its discretion to negotiate an *evidence based* affordable level of contributions for the organisation for the three years 2014/17. Any application of this option is at the ultimate discretion of the Administering Authority and will only be considered after the provision of the appropriate evidence.

The Normal Cost of the Scheme (Future Service Contribution Rate)

In addition to any contributions required to rectify a shortfall of assets below the funding target, contributions will be required to meet the cost of future accrual of benefits for

members after the valuation date (the “normal cost”). The method and assumptions for assessing these contributions are also set out in Appendix 1.

Link to investment policy set out in the Statement of Investment Principles (See Appendix 2)

The results of the 2013 valuation show the liabilities at 31 March 2013 to be 68% covered by the current assets, with the funding deficit of 32% being covered by future deficit contributions.

In assessing the value of the CPF’s liabilities in the valuation, allowance has been made for asset out-performance as described in Appendix 1, taking into account the investment strategy adopted by the CPF, as set out in the SIP.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts. Investment of the CPF’s assets in line with the least risk portfolio would minimise fluctuations in the CPF’s ongoing funding level between successive actuarial valuations. Departure from a least risk investment strategy, in particular to include equity type investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The current benchmark investment strategy, as set out in the SIP, is:

<i>Asset Class</i>	<i>Initial Strategic allocation (%)</i>	<i>Strategic range (%)</i>	<i>Conditional range (%) **</i>	<i>Expected return above Government Bonds p.a.***</i>
Developed Global Equity	8.0	5.0 – 10.0	0 – 30	+4.0%
Emerging Market Equity	6.5	5.0 – 7.5	0 – 15	+5.0%
Frontier Market Equity	2.5	1.0 – 4.0	0 – 5	+6.0%
Multi-Asset Credit	15.0	12.5 – 17.5		+2.0%
<i>Government Bonds</i>			0 – 30	+0.0%
<i>Corporate Bonds</i>			0 – 30	+1.0%
<i>Overseas Government Bonds</i>			0 – 30	+1.0%
<i>Emerging Market Debt</i>			0 – 30	+2.1%
<i>High Yield Debt</i>			0 – 30	+2.1%
Property	7.0	5.0 – 10.0	5 – 15	+3.0%
Infrastructure	4.0	2.0 – 7.0	2 – 10	+3.1%
Private Equity	10.0	8.0 – 12.0	8 – 12	+5.1%
Tactical Allocation Portfolio *	19.0	15.0 – 25.0	10 – 30	+2.0%
<i>Commodities</i>			0 – 10	+2.2%
Managed Account	9.0	7.0 – 11.0		
<i>Managed Futures</i>			0 – 15	+4.0%
<i>Hedge Funds</i>			0 – 10	+3.0%
Cash	-	0.0 – 5.0	0 – 30	+0.0%
Liability Hedging****	19.0	10.0 - 30.0	10 - 30	+4.0%

* The Tactical Portfolio can be invested in any asset class permitted by the regulations. The objective of the Tactical Allocation Portfolio is to add value to the overall Clwyd Pension Fund return.

** The Conditional ranges are at a total fund level, including the Tactical Allocation Portfolio but excluding the Liability Hedging mandate.

*** Expected return is expressed as an excess long-term return over UK government bonds of an appropriate duration or the "premium over gilts" to reflect the extra risk being taken, excluding active management. This is based on JLT Market Forecast as at the date of the 2014 strategic review. Gilts are used as the basis for expected returns as they are a proxy for valuing the liabilities.

**** The Liability Hedging Portfolio is a combination of Liability Driven Investment (LDI) and an equity overlay which will be managed as part of a de-risking approach. As the funding level improves, the equity exposure will be reduced and the LDI hedge ratio increased in a pre-determined way. Given the nature of this mandate i.e. protection against liability changes it is not intended to rebalance the allocation which can lead to a movement away from the initial strategic benchmark allocation of 19% at inception of the mandate.

The funding strategy adopted for the 2013 valuation is based on an assumed average asset out-performance of 1.4% per annum.

Identification of risks and counter measures

The funding of defined benefits is by its nature uncertain. Funding of the CPF is based on both financial and demographic assumptions. These assumptions are specified in the Appendices and the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the actuary that the greatest risk to the CPF's funding is the investment risk inherent in the predominantly equity (or return seeking) based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the overall out performance assumed in the long term.

What are the Key Risks?

Financial

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Asset re-allocations in volatile markets may lock in past losses
- Pay and price inflation significantly more or less than anticipated
- Effect of possible increase in employer's contribution rate on service delivery and admitted/scheduled bodies

Demographic

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)
- The level of take-up of the 50:50 option at a higher or lower level than built into the actuarial assumptions.

Insurance of certain benefits

The contributions for any employer may be varied as agreed by the Actuary and Administering Authority to reflect any changes in contribution requirements as a result of any benefit costs being insured with a third party or internally within the Fund.

Regulatory

- Further changes to Regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees
- Changes to national pension requirements and/or HMRC rules

Governance

- Administering Authority unaware of structural changes in employer's membership (e.g. large fall in employee numbers, large number of retirements)
- Administering Authority not advised of an employer closing to new entrants
- An employer ceasing to exist with insufficient funding or adequacy of a bond.
- Changes in Committee membership.

The Fund has restructured their governance arrangements with the implementation of the Advisory Panel. The Advisory Panel is made up of Fund officers, an investment advisor, an independent advisor and the Fund Actuary.

Full details of the risks and the controls in place are set out on the CPF risk register.

Monitoring

Flightpath - De-risking strategy

In the context of managing various aspects of the Fund's financial risks, the Administering Authority has implemented a "Flightpath" risk management investment strategy with effect from 1 April 2014. A Liability Driven Investments (LDI) mandate has also been implemented.

The principal aim of this risk management strategy is to effectively control and limit interest and inflation risks being run by the Fund (as these factors can lead to significant changes to liability values). At the outset, its aim was to achieve a 'base level' of interest rate and inflation hedging of 10%. The intention is that the hedging ratio will be at 40% by no later than April 2019 and will achieve a hedge ratio of 80% in the long term. The overall funding flightpath strategy is to consider and structure the investment strategy to determine a balance between return-seeking and risk-hedging assets. More detail is included in the Fund's Statement of Investment Principles (SIP).

Flightpath – Monitoring/trigger review

A summary report is provided to the Fund (on a monthly and quarterly basis) which includes a "traffic light" analysis of the key components of the Flightpath and hedging mandate. The "traffic light" indicates whether the Flightpath and hedging mandate are operating in line with expectations or if any actions are required.

There are funding level triggers in place which will result in the disinvestment of growth assets as the funding level improves over time. This is summarised in the table below:

	Funding level	Impact on strategic asset allocation	Change to the hedge ratio
Funding level Trigger 1	80%	Reduce the Insight equity exposure by 50%	Increase hedge ratio to 40%
Funding level Trigger 2	85%	Remove the Insight equity exposure	Increase hedge ratio to 50%
Funding level Trigger 3	90%	Increase Insight allocation from 19% of assets to 25%	Increase hedge ratio to 60%
Funding level Trigger 4	95%	Increase Insight allocation from 25% of assets to 30%	Increase hedge ratio to 70%
Funding level Trigger 5	100%	Increase Insight allocation from 30% of assets to 35%	Increase hedge ratio to 80%

In addition, a separate fund-wide mechanism has been introduced, such that if the funding level falls more than 5% below the “expected” funding level (based on valuation assumptions), then discussions will follow at the Advisory Panel level as to the continued appropriateness of the funding strategy.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations as part of the Flightpath monitoring detailed above and detailed funding reviews. If considered appropriate, the funding and flightpath strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy
- if there have been significant changes to the CPF membership, or LGPS benefits
- if there have been changes to the circumstances of any of the employing authorities to such an extent that they impact on or warrant a change in the funding strategy e.g. closure to new entrants
- if there have been any significant special contributions paid into the CPF

Approval, Review and Consultation

The funding strategy of the Clwyd Pension Fund was reviewed to coincide with the actuarial valuation as at 31 March 2013. The Administering Authority has taken advice from the actuary in reviewing the strategy, and has also consulted with employing organisations.

This Funding Strategy Statement was approved at the Clwyd Pension Fund Committee on 21 May 2015. A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of then current economic conditions and will also reflect any legislative changes.

Further Information

If you require further information about anything in or related to this Funding Strategy Statement, please contact:

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ACTUARIAL VALUATION AS AT 31 MARCH 2013

Method and assumptions used in calculating the funding target

Method

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

Financial assumptions

Investment return (discount rate)

A yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") 1.4% per annum.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date.

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities, but subject to the following two adjustments:

- an allowance for supply/demand distortions in the bond market is incorporated, and
- an adjustment due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index

The overall reduction to RPI inflation at the valuation date is 1.0% per annum.

Salary increases

The assumption for real salary increases (salary increases in excess of price inflation) will be determined by an allowance of 1.5% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In addition to the long term salary increase assumption allowance has been made for expected short term pay restraint for some employers as budgeted in their financial plan. This results in a total salary increase of 1% per annum for 3 years.

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the RPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

Demographic assumptions

Mortality

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the scheme. The mortality tables used are set out below, with a loading reflecting CPF specific experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. Current members who retire on the grounds of ill health are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 4 years older whereas for existing ill health retirees we assume this is at an age 3 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 1.5% per annum.

The mortality before retirement has also been adjusted based on LGPS wide experience.

Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. 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 p.a. of pension given up.

Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the incidence of retirement in normal health and in ill health and the proportions married/civil partnership assumption have been modified from the last valuation. In addition, allowing for take-up of the 50:50 option will be made up to a maximum of 5% of current and future members for certain employers (who have sufficient size of current contributing members). Other assumptions are as per the last valuation.

Expenses

Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by adding 0.5% of pensionable pay to the contributions as required from participating employers. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

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

Method and assumptions used in calculating the cost of future accrual

The cost of future accrual (normal cost) will be calculated using the same actuarial method and assumptions as used to calculate the funding target except that the financial assumptions adopted will be as described below.

The financial assumptions for assessing the future service contribution rate should take account of the following points:

- contributions will be invested in market conditions applying at future dates, which are unknown at the effective date of the valuation, and which are not directly linked to market conditions at the valuation date; and
- the future service liabilities for which these contributions will be paid have a longer average duration than the past service liabilities.

The financial assumptions in relation to future service (i.e. the normal cost) are not specifically linked to investment conditions as at the valuation date itself, and are based on an overall assumed real return (i.e. return in excess of price inflation) of 3.0% per annum, with a long term average assumption for consumer price inflation of 2.6% per annum. These two assumptions give rise to an overall discount rate of 5.6% p.a (i.e. 3.0% plus 2.6%).

Adopting this approach the future service rate is not subject to variation solely due to different market conditions applying at each successive valuation, which reflects the requirement in the Regulations for stability in the "Primary Rate" of contributions. In market conditions at the effective date of the 2013 valuation this approach gives rise to a slightly more optimistic stance (i.e. allows for a higher AOA) in relation to the cost of accrual of future benefits compared to the market related basis used for the assessment of the funding target.

At each valuation the cost of the benefits accrued since the previous valuation will become a past service liability. At that time any mismatch against gilt yields and the asset out-performance assumptions used for the funding target is fully taken into account in assessing the funding position.

Summary of key whole Fund assumptions used for calculating funding target and cost of future accrual (the “normal cost”) for the 2013 actuarial valuation

Long-term gilt yields	
Fixed interest	3.2% p.a.
Index linked	-0.4% p.a.
Past service Funding Target financial assumptions	
Investment return/Discount Rate	4.6% p.a.
CPI price inflation	2.6% p.a.
Long Term Salary increases	4.1% p.a.
Pension increases/indexation of CARE benefits	2.6% p.a.
Future service accrual financial assumptions	
Investment return	5.6% p.a.
CPI price inflation	2.6% p.a.
Long Term Salary increases	4.1% p.a.
Pension increases/indexation of CARE benefits	2.6% p.a.

Demographic assumptions

The post retirement mortality tables adopted for this valuation are as follows:

Life expectancy at 65 in 2013		Base table	Adjustment	Improvement model	Long term rate
CURRENT ANNUITANTS	Normal health	S1PxA	94% / 93%	CMI_2012	1.5%
	Ill health	S1PxA	Normal health + 3 years	CMI_2012	1.5%
	Dependants	S1PMA/S1DFA	156% / 106%	CMI_2012	1.5%
	Future dependants	S1PMA/S1DFA	106% / 98%	CMI_2012	1.5%
CURRENT ACTIVES / DEFERREDS	Actives normal health	S1PxA	87% / 82%	CMI_2012	1.5%
	Actives ill health	S1PxA	Normal health + 4 years	CMI_2012	1.5%
	Deferreds	S1PxA	114% / 102%	CMI_2012	1.5%
	Future dependants	S1PMA/S1DFA	99% / 93%	CMI_2012	1.5%

Other demographic assumptions are noted below:

Withdrawal	As for 2010 valuation
Other demographics	Based on LG scheme specific experience.
50:50 Option	Up to 5% take-up for certain employers

Assumptions used in calculating contributions payable under the recovery plan

The contributions payable under the recovery plan are calculated using the same assumptions as those used to calculate the funding target, with the exception that, for certain employers which are considered by the Administering Authority to provide a high level of financial covenant and are required to increase contributions (compared to 2013/14 levels) when adopting the maximum recovery period of 20 years, an allowance may be made as part of the recovery plan for investment performance at a higher level than that assumed for assessment of the funding target. Therefore the required contributions are adjusted to allow for the following variation in assumptions during the period of the recovery plan:

Investment return on existing assets and future contributions

A maximum overall return effective as at the valuation date of 6.0% p.a. (i.e. a return of 2.8% p.a. in excess of gilts) reflecting the underlying investment strategy of the scheme and, in particular, including the assets of the scheme that underlie the pensioner as well as the non-pensioner liabilities.

The investment return assumed for the contributions under the recovery plan is taken to apply throughout the recovery period. As a result, any change in investment strategy which would act to reduce the expected future investment returns could invalidate these assumptions and therefore the funding strategy.

As indicated above, this variation to the assumptions in relation to the recovery plan can only be applied for those employers which the Administering Authority deems to be of sufficiently high financial covenant to support the anticipation of investment returns, based on the current investment strategy, over the entire duration of the recovery period. No such variation in the assumptions will apply in any case to any employer which does not have a funding deficit at the valuation (and therefore for which no recovery plan is applicable). Where a funding deficit exists the additional return over and above that built into the funding target assumptions will be limited so that the total employer contributions emerging from the valuation will be no less than the current level of contributions payable by the employer or the Future Service Contribution Rate.

Clwyd Pension Fund

Policy on Termination Funding for Employers (“Termination Policy”)

1. Introduction

- 1.1. This document details the Clwyd Pension Fund’s (CPF) policy on the methodology for assessment of ongoing contribution requirements and termination payments in the event of the cessation of an employer’s participation in the Fund. This document also covers CPF’s policy on admissions into the Fund and sets out the considerations for current and former *admission bodies*. It supplements the general policy of the Fund as set out in the Funding Strategy Statement (FSS).
- 1.2. *Admission bodies* are required to have an “*admission agreement*” with the Fund. In conjunction with the Regulations, the *admission agreement* sets out the conditions of participation of the *admission body* including which employees (or categories of employees) are eligible to be members of the Fund.
- 1.3. *Scheme Employers* have a statutory right to participate in the LGPS and their staff therefore can become members of the LGPS at any time, although some organisations (*Part 2 Scheme Employers*) do need to designate eligibility for its staff.
- 1.4. A list of all current *employing bodies* participating in the CPF is kept as a live document and will be updated by the *Administering Authority* as bodies are admitted to, or leave the CPF.
- 1.5. Please see the glossary for an explanation of the terms used (in italics) throughout this Appendix.

2. Principles

Termination of an employer’s participation

- 2.1. When an *employing body* terminates 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.
- 2.2. 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 there is a complete transfer of responsibility to another Fund with a different *Administering Authority*.

- 2.3. In the event that unfunded liabilities arise that cannot be recovered from the *employing body*, these will normally fall to be met by the Fund as a whole (i.e. all employers) unless there is a guarantor or successor body within the Fund.
- 2.4. The CPF's policy is that a termination assessment will be made based on a *least risk funding basis*, unless the *employing body* has a guarantor within the Fund or a successor body exists to take over the *employing body's* liabilities (including those for former employees). This is to protect the other employers in the Fund as, at termination, the *employing body's* liabilities will become *orphan liabilities* within the Fund, and there will be no recourse to it if a shortfall emerges in the future (after participation has terminated).
- 2.5. If, instead, the *employing body* has a guarantor within the Fund or a successor body exists to take over the *employing body's* liabilities, the CPF's policy is that the *valuation funding basis* will be used for the termination assessment unless the guarantor informs the CPF otherwise. The guarantor or successor body will then, following any termination payment made, subsume the assets and liabilities of the *employing body* within the Fund. (For *Admission Bodies*, this process is sometimes known as the "novation" of the admission agreement.) This may, if agreed by the successor body, constitute a complete amalgamation of assets and liabilities to the successor body, including any funding deficit on closure. In these circumstances no termination payment will be required from the outgoing *employing body* itself, as the deficit would be recovered via the successor body's own deficit recovery plan.
- 2.6. It is possible under certain circumstances that an employer can apply to transfer all assets and current and former members' benefits to another LGPS Fund in England and Wales. In these cases no termination assessment is required as there will no longer be any *orphan liabilities* in the CPF. Therefore, a separate assessment of the assets to be transferred will be required.

Funding basis

- 2.7. An *employing body* may choose to pre-fund for termination i.e. 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 least risk basis.
- 2.8. For any *employing bodies* funding on such a *least risk* strategy a notional investment strategy will be assumed as a match to the liabilities. In particular the *employing body's* notional asset share of the Fund will be credited with an investment return in line with the *least risk funding* assumptions adopted rather than the actual investment return generated by the actual asset portfolio of the entire Fund. The Fund reserves the right to modify this approach in any case where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

Administering Authority options relating to Admission Bodies

2.9. Prior to admission to the Fund, an *Admission Body* is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the *Administering Authority*. If the risk assessment and/or bond amount is not to the satisfaction of the *Administering Authority* (as required under the LGPS Regulations) it will consider and determine whether the admission body must pre-fund for termination with contribution requirements assessed using the least risk methodology and assumptions.

2.10. Some aspects that the *Administering Authority* may consider when deciding whether to apply a least risk methodology are:

- Uncertainty over the security of the organisation's funding sources e.g. the *admission body* relies on voluntary or charitable sources of income or has no external funding guarantee/reserves;
- If the *admission body* has an expected limited lifespan of participation in the Fund;
- The average age of employees to be admitted and whether the admission is closed to new joiners.

2.11. In order to protect other Fund employers, where it has been considered undesirable to provide a bond, a guarantee must be sought in line with the LGPS Regulations.

3. Implementation

New admissions (admitted after 1 April 2014)

3.1. With effect from 1 April 2014 the CPF will apply the above principles to the admission of new bodies into the Fund and to the methodology for assessment of a termination payment on the cessation of such an *admission body's* participation in the CPF.

Transferee admission bodies (TABs)

3.2. *Transferee admission bodies* are a category of *admission body* that generally will have a guarantor in the Fund. This is due to the Regulations requiring that, in the event of any unfunded liabilities on the termination of the admission, the contribution rate for the relevant *Scheme Employer* should be revised. Accordingly, in general, the least risk approach to funding and termination will not apply for TABs.

3.3. Any risk sharing arrangements agreed between the *Scheme Employer* and the TAB will be documented in the commercial agreement between the two parties and not the admission agreement.

3.4. On termination of a TAB admission, any *orphan liabilities* in the Fund will be subsumed by the relevant *Scheme Employer*.

- 3.5. The *Admission Body* is required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the *Administering Authority*. This assessment would normally be based on advice in the form of a "risk assessment report" provided by the actuary to the CPF. As the *Scheme Employer* is effectively the ultimate guarantor for these admissions to the CPF it must also be satisfied (along with the *Administering Authority*) over the level (if any) of any bond requirement.
- 3.6. In the absence of any other specific agreement between the parties, deficit recovery periods for TABs will be set in line with the Fund's general policy as set out in the FSS.
- 3.7. An exception to the above policy applies if the guarantor is not a participating employer within the CPF, including if the guarantor is a participating employer within another LGPS Fund. In order to protect other employers within the CPF the *Administering Authority* may in this case treat the *admission body* in accordance with paragraph 2.9.

Community admission bodies (CABs)

- 3.8. Historically, there was no requirement to carry out an assessment of the level of risk on termination of the admission agreement for a CAB until changes were made to the Regulations. For bodies admitted under previous legislation, despite no requirement to do so the *Administering Authority* may nevertheless have decided to carry out such a risk assessment where appropriate. As noted in 3.5, all *Admission Bodies* are now required to carry out an assessment of the level of risk on premature termination of the contract to the satisfaction of the *Administering Authority*.
- 3.9. The CPF's policy is to consider applications on a case-by-case basis, in line with the principles set out above. In general, if any risk assessment or determination of a bond amount is not to the satisfaction of the *Administering Authority*, or if a guarantor (of sufficient standing acceptable to the *Administering Authority*) is not forthcoming, the *admission body* will be required to pre-fund for termination with contribution requirements assessed using a least risk methodology and assumptions as set out in 2.9. Where bond agreements are to the satisfaction of the *Administering Authority*, the level of the bond amount will be subject to review on a regular basis.
- 3.10. Deficit recovery periods will be determined consistent with the policy set out in the FSS. Alternatively, the *Administering Authority* may determine an employer specific deficit recovery period will apply.

Future Terminations

- 3.11. In many cases, termination of an employer's participation is an event that can be foreseen, for example, because the organisation's operations may be planned to be discontinued and/or the admission agreement is due to cease. Under the Regulations, in the event of the *Administering Authority* becoming aware of such circumstances, it can amend an employer's minimum contributions such that the value of the assets of the *employing body* is neither materially more nor materially less than its anticipated liabilities at the date it appears to the *Administering*

Authority that it will cease to be a participating employer. In this case, *employing bodies* are encouraged to open a dialogue with the Fund to commence planning for the termination as early as possible. Where termination is disclosed in advance the Fund will operate procedures to reduce the sizeable volatility risks to the debt amount in the run up to actual termination of participation. The Fund will modify the *employing body's* approach in any case, where it might materially affect the finances of the Scheme, or depending on any case specific circumstances.

- 3.12. The Fund's standard policy is to recover termination deficits (including interest and expenses) as a one off payment. However, at the discretion of the Administering Authority, the deficit can be recovered over an agreed period as certified by the Actuary. This period will depend on the Administering Authority's view on the covenant of the outgoing employer.

Least Risk Termination basis

- 3.13. The least risk financial assumptions that applied at the actuarial valuation date (31 March 2013) are set out below in relation to any liability remaining in the Fund. These will be updated on a case-by-case basis, with reference to prevailing market conditions at the relevant *employing body's* cessation date.

Least risk assumptions	31 March 2013
Discount Rate	3.2% p.a.
CPI price inflation	2.9% p.a.
Pension increases/indexation of CARE benefits	2.9% p.a.

All demographic assumptions will be the same as those adopted for the 2013 actuarial valuation, unless modified otherwise.

Glossary

Admission bodies: A specific type of employer under the Local Government Pension Scheme (LGPS) who do not automatically qualify for participation in the Fund but are allowed to join if they satisfy the relevant criteria set out in the Regulations.

Community admission bodies: A subset of, and the traditional type of *admission bodies* – bodies who operate in and/or are connected to local government. They also include *admission bodies* that are not associated to local government, as follows:

- Bodies which provide a public service in the UK otherwise than for the purposes of gain and which have sufficient links with a *Scheme Employer* to be regarded as having a community of interest.
- Bodies which provide a public service in the UK otherwise than for the purposes of gain and which are approved by the Secretary of State to be admitted to the LGPS. Approval may be subject to such conditions as the Secretary of State thinks fit and he may withdraw approval at any time if such conditions are not met.
- Bodies to which any *Scheme Employer* provides funding. Where at the date that the admission agreement is made with such a body the total contribution from any one or more *Scheme Employers* to its contribution income equals 50% or less of the funding contributed by third parties it must be a term of the admission agreement that the *Scheme Employer* who provides funding (and, if more than one, all of them) guarantees the liability of the *admission body* to pay all amounts due from it under the Regulations.

Employing bodies: any organisation that participates in the LGPS, including *admission bodies* and *scheme employers*.

Valuation funding basis: the financial and demographic assumptions used to determine the employer's contribution requirements. The relevant discount rate used for valuing the present value of liabilities is consistent with an expected rate of return of the Fund's investments. This includes an expected out-performance over gilts in the long-term from other asset classes, held by the Fund.

Least risk funding basis: more cautious funding basis than the existing valuation basis. The relevant discount rate used for valuing the present value of liabilities is consistent with that used under the most recent valuation but removing the allowance for asset out-performance.

Orphan liabilities: liabilities in the CPF for which there is no sponsoring employer within the Fund. Ultimately orphan liabilities must be underwritten by all other employers in the Fund.

Part 2 Scheme Employers: employers that have the statutory right to participate in the LGPS, although these bodies (set out in Part 2 of Schedule 2 of the 2013 Regulations) would need to designate an employee, or a class of employees to which he/she belonged, as being eligible for membership of the LGPS.

Scheme Employers: employers that have the statutory right to participate in the LGPS. These organisations (set out in Part 1 of Schedule 2 of the 2013 Regulations) would not need to designate eligibility, unlike the *Part 2 Scheme Employers*.

Administering Authority: Flintshire County Council, as the lead authority of the CPF, responsible for all aspects of its management and operation.

Transferee admission bodies: A subset of *admission bodies* and participates in the Fund for employees involved with delivery of a specific function or service for a *Scheme Employer*. An example is where a local authority outsources a specific service to a private sector employer. In these cases the relevant *Scheme Employer* would be a party to the admission agreement, as well as the *admission body* itself and the *administering authority*.

