# Complete Agenda

**Democratic Service**
Swyddfa'r Cygor
CAERNARFON
Gwynedd
LL55 1SH

Meeting

**PENSIONS COMMITTEE**

Date and Time

**2.00 pm, THURSDAY, 16TH MARCH, 2017**

Location

**Ystafell Gwyrfai, Council Offices,**

**Caernarfon, Gwynedd. LL55 1SH**

Contact Point

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(DISTRIBUTED 09/03/17)

# PENSIONS COMMITTEE

## MEMBERSHIP (7)

## Plaid Cymru (3)

Councillors

Peredur Jenkins | W. Tudor Owen | Simon Glyn

## Independent (2)

Councillors

Trevor Edwards | John Pughe Roberts

## Labour (1)

Councillor
Glyn Thomas

## Liberal Democrats (1)

Councillor
Stephen W. Churchman

## Co-opted Members

| | |
|---|---|
| Hywel Eifion Jones | Anglesey County Council |
| Margaret Lyon | Conwy County Borough Council |

## Aelodau Ex-officio / Ex-officio Members

Chairman and Vice-Chairman of the Council

# A G E N D A

**PENSIONS COMMITTEE 19.01.2017**

**Present:** Councillors: Stephen Churchman (Chair), Simon Glyn, Peredur Jenkins, H. Eifion Jones (Anglesey County Council Representative) and Glyn Thomas

Officers: Dafydd Edwards (Head of Finance Department), Caroline Roberts (Investment Manager), Nicholas Hopkins (Pensions Manager), Iwan Evans (Head of Legal Service) and Lowri Haf Evans (Member Support Officer).

**1. APOLOGIES**

Apologies were received from Councillors Trevor Edwards, Margaret Lyon (Conwy County Borough Council Representative), John P. Roberts and Tudor Owen.

**2. DECLARATION OF PERSONAL INTEREST**

None to note

**3. URGENT ITEMS**

None to note

**4. MINUTES**

The Chair signed the minutes of the previous meeting of this committee, held on 20 October and 10 November 2016, as a true record.

**5. FUNDING STRATEGY STATEMENT 2017/18 – 2019/20**

Following the Actuarial Valuation in November 2016, the Investment Manager highlighted the fact that it was required for the Council to review and publish a triennial Funding Strategy Statement (FSS) by 31 March 2017 (it was noted that the current Gwynedd FSS had been approved by the Pensions Committee on 17 March 2014). A (draft) report was submitted by the Investment Manager who was willing to share it for a consultation period with the employers that were part of the scheme, the actuary and the fund's consultant.

In response to a question regarding submitting the strategy, it was noted that the strategy was to formalise the discussions held on 10 November 2017 - summarising the decisions made with the employers. It was reported that although the document was a technical and substantial one, it had been prepared in consultation with the support of Hymans.

**RESOLVED TO ACCEPT THE REPORT AND THE PRESUMPTIONS AND POLICIES OUTLINED IN THE REPORT WERE CONFIRMED TO BE CONSULTED APPROPRIATELY**

**6. INVESTMENT STRATEGY STATEMENT**

A report was submitted by the Investment Manager, asking the Committee to approve the Investment Strategy Statement (draft) (that is taking place, in name only, the Statement of Investment Principles - in accordance with the requirements of the new legislation) for consultation with all interested parties by 31 March 2017.

It was reported that the strategy was based on investment arrangements and what needed to be done to deal with Investment Managers. Should the investment arrangements need to be changed, this strategy would need to be revised.

In response to a question regarding Britain leaving the European Union, and the need to adapt investment methods, it was highlighted with worldwide portfolios that there would be no need to adapt investment methods because it would be the companies being affected directly.

In response to a question regarding ethical investments, it was highlighted that the administrator's main responsibility and aim was to ensure the best returns to the fund and definite and strong reasons would be needed to follow a 'political' investment strategy that could endanger this.

In response to a question regarding investing in local infrastructure, it was noted that exciting regional opportunities did not offer themselves to North Wales and that investing in infrastructure that did not offer itself, was a risk in terms of gains. In considering Wales Investment Pools, the possibility of encouraging discussions and conveying opinions on investing in infrastructure was suggested, giving full consideration to possible enterprises in North Wales. It was suggested that the Wales Pool possibly had the flexibility of investing in a more local infrastructure as the size enabled a more direct investment in infrastructure.

It was noted, should the need arise to review the Fund's investments, that there would be a need to amend agreements with Investment Managers. The logical step would be to offer observations to representatives of the Wales Investment Pool. It was suggested to hold a discussion at the investment panel before offering anything formal.

A suggestion was also made that the investment managers should respect the need to keep investments legal, and act responsibly. It was noted that their actions could be challenged to ensure that they were wise enough not to invest in anything suspicious.

**RESOLVED TO ACCEPT THE REPORT AND THE DRAFT STATEMENT FOR THE CONSULTATION PERIOD WAS APPROVED.**

**7. WALES INVESTMENT POOL**

Submitted – the report of the Head of Finance Department updating the Committee Members on the progress made to the development in the Wales Investment Pool to manage the investment assests of eight Local Government Pension Schemes (LGPS) in Wales on a co-operative basis; and to seek the Committee's approval on Inter-Authority Agreements to be recommended to the full Council to approve, in order to commit to establishing an All Wales Pool and govern the relevant Joint-committee.

It was noted that the Burges Salmon company drew up the Inter-Authority Agreement with a contribution from the finance officers and legal officers of the eight funds. The agreement reflected what had been discussed over the past months.

It was highlighted that the document was not final, but the members were asked to delegate the right to the Head of Finance Department, in consultation with the Head of Legal Department and the Chair to agree on any changes to the Inter-Authority Agreement before submitting it to the full Council for approval on 2 March 2017. It was noted that minor amendments needed to be done before submitting it, but that the agreement, in terms of form, was quite accurate.

During the ensuing discussion the following points were highlighted by individual Members:

- It should be aimed to ensure that the Welsh language was central to the Pool's work
- The host authority would need to arrange that documents were available bilingually and formal, public meetings would be held bilingually
- That a suitable location was needed for the Pool's Joint-committee meetings

In response to the observations, it was noted that the language matters had been highlighted at a meeting of the Pool's Chairs on 11/1/2017 and had been 'accepted as an understanding.' The Solicitor highlighted that it was possible to add this to the agreement. It was acknowledged that language provision standards varied across Wales.

Proposed and seconded - to ensure that official formal meetings of the Pool's Joint-committee followed the full bilingual procedure, and appropriate clauses should be included in the agreement.

In expressing gratitude for the work done in drawing up the agreement, an application was made to the officers to note, if they were uncomfortable with any situation, that they report back to the Committee.

In response to the comments, the Solicitor noted, by establishing Partnerships, it was essential not to set strict elements. It was highlighted that a high level of key matters continued on local levels and that this was part of the agreement. It was also noted that the joint-committee would adopt local rules.

In response to a comment made regarding differences in council regulations in committee membership, and specifically the Chairmanship period, it was noted that Gwynedd arrangements would be adapted to comply with rules and arrangements of other Councils.

In response to an observation regarding Gwynedd offering themselves as a host authority, it was accepted that the observation was a discussion matter and that it was possible to offer this to the Joint-committee should that be the Committee's desire. The Solicitor highlighted that Gwynedd led on a number of projects, therefore it would be necessary to ensure that resources were in place before venturing - the scope of the work to meet the requirements. It was explained that the host resource would be funded by the eight funds and therefore the observation could be considered as a response to an opportunity.

**RESOLVED:**

i. **That the Committee notes the progress to the development of the Wales Investment Pool and supports the commitment to the Pool.**

ii. **That the Committee approves the draft Inter-Authority Contract, and supports its recommendation to the full Council on 2 March 2017.**

iii. **That the Committee recommends establishing an All Wales Joint-Committee in accordance with the Agreement and that the Joint-committee's official meetings follow the full bilingual procedure.**

iv. **That the Committee delegates the right to the Head of Finance Department in consultation with the Head of Legal Department and the Chair to decide on any changes to the Inter-Authority Agreement before submitting it to the Council for approval.**

The meeting commenced at 2pm and concluded at 3:20pm

| | |
|---|---|
| MEETING: | **PENSIONS COMMITTEE** |
| DATE: | **16 MARCH 2017** |
| TITLE: | **TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2017/18** |
| PURPOSE: | **To ask the pensions committee to adopt the strategies** |
| RECOMMENDATION: | **RECEIVE THE REPORT FOR INFORMATION** |
| AUTHOR: | **DAFYDD L EDWARDS, HEAD OF FINANCE** |

## 1. THE PENSION FUND'S INVESTMENT STRATEGY

In accordance with the Welsh Assembly Government's Statutory Guidance on Local Government Investments, which requires an authority to produce an Annual Investment Strategy, it is considered best practice for the Gwynedd Pension Fund (the "Fund") to adopt Gwynedd Council's Treasury Management Strategy Statement (TMSS) for 2017/18, as amended for the purpose of the Pension Fund (which is attached as Appendix A). Gwynedd Council's TMSS for 2017/18 was approved by the Full Council on 2 March 2017.

## 2. CIPFA GUIDANCE

The Fund will also have regard to the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes.

## 3. THE PENSION FUND'S CASHFLOW

The Fund has net inflows from its dealings with its members, so in any month, the income from contributions and transfers-in significantly exceed the pensions, transfers out and costs paid out. Once there is sufficient surplus cash it is transferred to one or more of the Fund's investment managers. Normally up to around £5 million is held back for cashflow purposes, in particular in respect of pension payments and funding calls from the private equity funds. However in the past, due to known commitments, there have been times when the surplus cash held in the Fund's bank accounts with Gwynedd Council has been over £20 million.

## 4. POOLING IN ORDER TO MAXIMISE RETURNS

Currently all the Fund's surplus cash is pooled with the cash balances of Gwynedd Council and invested with counterparties in accordance with Gwynedd Council's Treasury Management Strategy Statement. At the end of the financial year, Gwynedd Council pays interest over to the Pension Fund based on the Fund's daily balances over the year. This can continue if the Pensions Committee requests that the pension fund's surplus cash balances are pooled with the Council's cash balances. It is apparent that by pooling the fund can take advantage of economies of scale, and as a result can attract better interest rates, reduce bank costs and avoid the duplication of work within the

Council. The report approved by the Full Council on 2nd March 2017 included agreement to continue the pooling arrangement with the Pension Fund following any request from Pensions Committee.

## 5. COUNTERPARTIES

The Council Treasury Management Policy Statement and practice papers include a risk matrix which will be used to define the instruments and counterparties to be used for investment purposes rather than a defined list each year.

## 6. SCOPE

The proposed strategy will not deal with the cash held by the Fund's investment Managers for settlements.

## 7. RECOMMENDATIONS

7.1 The Pensions Committee is asked to approve the attached Treasury Management Strategy Statement and the Annual Investment Strategy for 2017/18, as amended for the Gwynedd Pension Fund (Appendix A).

7.2 The Pensions Committee is also asked to make a request to the Council (even though it is not a separate body) to allow the Pension Fund's surplus cash balances to be pooled with the Council's general cashflow from 1 April 2017 onwards.

**APPENDIX A**

**Treasury Management Strategy Statement 2017/18**

## 1. Introduction

1.1 In March 2011 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

1.2 In addition, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in April 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

1.3 This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

1.4 The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

1.5 In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of its investment balance.

## 2. External Context

### 2.1 Economic background

The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation (CPI) will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of a leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

2.2 **Credit outlook**

Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

2.3 **Interest rate forecast**

The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive, but although a low probability, this cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

2.4 A more detailed economic and interest rate forecast provided by Arlingclose is attached at ***Appendix 1.***

2.5 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.25%, and that no new long-term loans will be required.

## 3. Local Context (Net Borrowing Position) – Not applicable to the Pension Fund

## 4. Borrowing Strategy – Not applicable to the Pension Fund

## 5. Investment Strategy

5.1 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £38 and £87 million, and similar levels are expected to be maintained in the forthcoming year.

This includes the cash balances of Gwynedd Pension Fund which are pooled with the Council's funds for investment purposes. The Pension Fund requests this annually as the returns received are improved and the risks reduced by combining the cash with the Council's funds. The Pensions Committee will approve the relevant elements of this Strategy Statement and request the continuation of the pooling arrangements for 2017/18 at its meeting on 16 March 2017.

### 5.2 Objectives

Both the CIPFA Code and the WG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

## 5.3 **Negative Interest Rates**

If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

## 5.4 **Strategy**

Given the increasing risk and falling returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2017/18. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will represent a continuation of the strategy adopted in 2015/16.

## 5.5 **Approved Counterparties**

The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and time limits shown.

**Table 2: Approved Investment Counterparties**

| Credit Rating | Banks Unsecured | Banks Secured | Government | Corporates | Registered Providers |
|---|---|---|---|---|---|
| UK Govt | n/a | n/a | £ Unlimited<br>50 years | n/a | n/a |
| AAA | 5%<br>5 years | 10%<br>20 years | 10%<br>50 years | 5%<br>20 years | 5%<br>20 years |
| AA+ | 5%<br>5 years | 10%<br>10 years | 10%<br>25 years | 5%<br>10 years | 5%<br>10 years |
| AA | 5%<br>4 years | 10%<br>5 years | 10%<br>15 years | 5%<br>5 years | 5%<br>10 years |
| AA- | 5%<br>3 years | 10%<br>4 years | 10%<br>10 years | 5%<br>4 years | 5%<br>10 years |
| A+ | 5%<br>2 years | 10%<br>3 years | 5%<br>5 years | 5%<br>3 years | 5%<br>5 years |
| A | 5%<br>13 months | 10%<br>2 years | 5%<br>5 years | 5%<br>2 years | 5%<br>5 years |
| A- | 5%<br>6 months | 10%<br>13 months | 5%<br>5 years | 5%<br>13 months | 5%<br>5 years |
| BBB+ | 2.5%<br>100 days | 5%<br>6 months | 2.5%<br>2 years | 2.5%<br>6 months | 2.5%<br>2 years |
| None | £1m<br>6 months | n/a | 10%<br>25 years | £50,000<br>5 years | 5%<br>5 years |
| Pooled funds | 10% per fund | | | | |
| Business loans to local companies* | | | £3m in total<br>10 years | | |

This table must be read in conjunction with the notes below.

* Advancement of these loans will be approved by the procedure detailed in paragraph 5.9 below. Evaluation of the Business Loans is not part of the advice or services from the Council's treasury advisor.

## 5.6 **Credit Rating**

Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

5.7 **Banks Unsecured**

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB are restricted to overnight deposits at the Authority's current account bank Barclays Bank plc.

5.8 **Banks Secured**

Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

5.9 **Government**

Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

5.10 **Corporates**

Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

5.11 **Registered Providers**

Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

5.12 **Pooled Funds**

Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

5.13 **Local Loans Fund**

The Council has set up a Local Loans Fund which will make loans to local businesses. These investments are included in the Non-Specific Investments table above and will be for a maximum period of 10 years. The total value of the fund for such investments is £3million. Applications for loans under this scheme will not be part of the usual credit assessment for treasury management investment purposes but will be assessed by appointed consultants and any decision to lend will be made by the Investment Panel for the scheme.

5.14 **Risk Assessment and Credit Ratings**

Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.15 **Other Information on the Security of Investments**

The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

5.16 **Specified Investments**

The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

## 5.17 Non-specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement; those that are defined as capital expenditure by legislation, such as shares in money market funds and other pooled funds; and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

**Table 3: Non-Specified Investment Limits**

| | **Cash limit** |
|---|---|
| Total long-term investments | £40m |
| Total shares in Money Market funds | £40m |
| Total shares in other pooled funds | £8m |
| Total investments without credit ratings or rated below [A-] | £8m |
| Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [AA+] | £8m |
| Total non-specified investments | £80m |

## 5.18 Investment Limits

The Authority's revenue reserves and Pension Fund cash available to cover investment losses are forecast to be £56 million on 31st March 2017. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £8 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

**Table 4: Investment Limits**

| | **Cash limit** |
|---|---|
| Any single organisation, except the UK Central Government | £8m each |
| UK Central Government | unlimited |
| Any group of organisations under the same ownership | £8m per group |
| Any group of pooled funds under the same management | £20m per manager |
| Negotiable instruments held in a broker’s nominee account | £40m per broker |
| Foreign countries | £8m per country |
| Registered Providers | £20m in total |
| Unsecured investments with Building Societies | £8m in total |
| Loans to unrated corporates | £8m in total |
| Money Market Funds | £ £40m in total |

5.19 **Liquidity management**

The Authority uses prudent cash flow forecasting techniques to determine the maximum period for which funds may prudently be committed.

## 6. Treasury Management Indicators – Not applicable to the Pension Fund

## 7. Other Items

7.1 There are a number of additional items that the Authority is obliged by CIPFA or WG to include in its Treasury Management Strategy.

7.2 **Policy on Use of Financial Derivatives**

In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

7.3 **Investment Training**

The needs of the Authority's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.

7.4 **Investment Advisers**

The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is monitored by the Head of Finance and the Investment Manager on a regular basis.

7.5 **Investment of Money Borrowed in Advance of Need**

The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £195 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

## 8. Financial Implications

The budget for investment income in 2017/18 is £0.17 million, based on an average investment portfolio of £69.1 million at an interest rate of 0.25%. The budget for debt interest paid in 2017/18 is £6.0 million, based on an average debt portfolio of £106.6 million at an average interest rate of 5.62%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

## 9. Other Options Considered

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance, having consulted the Cabinet Member for Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

| Alternative | Impact on income and expenditure | Impact on risk management |
|---|---|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses will be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses will be smaller |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain |
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income<br><br>High premia for early redemption of debt may outweigh any savings | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain |

**Appendix 1**

**Arlingclose Economic & Interest Rate Forecast January 2017**

**Underlying assumptions:**

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump’s victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends.
- Financial markets currently have priced in stronger global growth following significant global fiscal and monetary stimulus; the short term outlook for the global economy is indeed brighter than early 2016. US fiscal stimulus is also a possibility following Trump's victory. The potential rise in protectionism could, however, dampen growth prospects.
- Economic data have presented a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending. On the downside, the currency-led rise in CPI inflation (currently 1.6% a year/year) will continue, breaching the target in 2017.
- Over the coming years the rise in inflation will reduce household spending growth, while economic and political uncertainty will dampen investment intentions, prompting lower activity levels.
- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The usual negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.
- Given the pressure on household spending and business investment, the rise in inflation is unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.
- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods, particularly if this feeds through to wage growth. Given this view and the current inflation outlook, further monetary loosening looks less likely.

**Forecast:**

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short/medium term than previously expected.
- The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.
- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

| | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| Arlingclose Central Case | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** |
| Downside risk | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| | | | | | | | | | | | | | |
| 3-month LIBID rate | | | | | | | | | | | | | |
| Upside risk | 0.05 | 0.10 | 0.10 | 0.10 | 0.15 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| Arlingclose Central Case | **0.25** | **0.25** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** |
| Downside risk | 0.25 | 0.25 | 0.25 | 0.30 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| | | | | | | | | | | | | | |
| 1-yr LIBID rate | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.15 | 0.15 | 0.15 | 0.20 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| Arlingclose Central Case | **0.50** | **0.50** | **0.50** | **0.50** | **0.50** | **0.50** | **0.60** | **0.70** | **0.85** | **0.90** | **0.90** | **0.90** | **0.95** |
| Downside risk | 0.15 | 0.15 | 0.15 | 0.20 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| | | | | | | | | | | | | | |
| 5-yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| Arlingclose Central Case | **0.60** | **0.50** | **0.45** | **0.45** | **0.50** | **0.50** | **0.50** | **0.55** | **0.60** | **0.65** | **0.70** | **0.75** | **0.80** |
| Downside risk | 0.45 | 0.45 | 0.45 | 0.45 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| | | | | | | | | | | | | | |
| 10-yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| Arlingclose Central Case | **1.10** | **1.05** | **0.95** | **0.95** | **0.95** | **0.95** | **0.95** | **1.00** | **1.05** | **1.10** | **1.15** | **1.20** | **1.25** |
| Downside risk | 0.45 | 0.45 | 0.45 | 0.45 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| | | | | | | | | | | | | | |
| 20-yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| Arlingclose Central Case | **1.65** | **1.55** | **1.50** | **1.50** | **1.50** | **1.50** | **1.50** | **1.55** | **1.60** | **1.65** | **1.70** | **1.75** | **1.80** |
| Downside risk | 0.55 | 0.55 | 0.55 | 0.55 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 |
| | | | | | | | | | | | | | |
| 50-yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| Arlingclose Central Case | **1.55** | **1.45** | **1.40** | **1.40** | **1.40** | **1.40** | **1.40** | **1.45** | **1.50** | **1.55** | **1.60** | **1.65** | **1.70** |
| Downside risk | 0.55 | 0.55 | 0.55 | 0.55 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 |

| | |
|---|---|
| **MEETING** | **PENSIONS COMMITTEE** |
| **DATE** | **16 MARCH 2017** |
| **TITLE** | **EMPLOYERS RESPONSE TO THE CONSULTATION ON THE FUNDING STRATEGY STATEMENT** |
| **AUTHOR** | **CAROLINE ROBERTS, INVESTMENT MANAGER** |

## 1. INTRODUCTION

**1.1** As reported to this Committee's meeting on 19 January 2017, we are required to review and publish a Funding Strategy Statement (FSS) by 31 March 2017. As part of this review the administering authority has to consult with each scheme employer, the fund actuary and advisers and any other persons they consider appropriate.

**1.2** At the meeting on the 19 January 2017, the Pensions Committee agreed the following policies:

- Due to the fact that bond rates, which are used to calculate future liabilities, were at a historically low level at 31 March 2013 but have improved since that date and are expected to increase in the future, the anticipated excess return from equities has been set at 1.7%. This will smooth the employer contributions over an exceptional period and will be reviewed at the next valuation with the aim of reducing back to 1.4% when the return from gilts improves.

- In the 2010 and 2013 valuations the administering authority continued with the following deficit recovery periods:
    - Statutory bodies – 20 years
    - Grwp Landrillo Menai – 15 years
    - All other employers – future working lifetime.

  These periods have also been used for the 2016 valuation.

- Major bodies with tax raising powers will continue to pay the same contribution rate as their 2016/17 rate.

- For the 2016 valuation increases may be spread over 6 years. Employers who have a reduction in their contribution rate will move immediately to that rate at 1 April 2017.

- Employers who are in deficit pay additional employer contributions in order to recover the deficit. The policy adopted for the 2013 valuation was that deficit payments would be expressed as an annual lump sum to be paid in 12 monthly instalments as part of their employer contributions. This policy will continue following the 2016 valuation.

**1.3** On 20 January 2017, the draft Funding Strategy Statement was sent out to all the scheme's employers, the Fund's actuary and adviser and to representatives of Unison, TGWU and the GMB, consulting on the policies noted in 1.2 above. They were asked to respond with their comments or observations by 28 February 2017.

## 2. The Response

**2.1** One response was received agreeing with their individual proposed employer contribution rate for the next three years.

## 3. Proposed Funding Strategy Statement

**3.1** A copy of the proposed FSS is attached at Appendix 1. There are no changes from the version which was presented to this committee on 19 January 2017 and sent to employers as explained in section 1.3 above.

## 4. Recommendation

**4.1** That the proposed Funding Strategy Statement (in Appendix A) is adopted.

**APPENDIX 1**

# Gwynedd Pension Fund

# Funding Strategy Statement

## 1 Introduction

### 1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the Gwynedd Pension Fund ("the Fund"), which is administered by Gwynedd Council, ("the Administering Authority").

It has been prepared by the Administering Authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and investment adviser. It will be effective from 26 March 2017

### 1.2 What is the Gwynedd Pension Fund?

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK. The Administering Authority runs the Gwynedd Pension Fund, in effect the LGPS for the Gwynedd area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth; and
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

### 1.3 Why does the Fund need a Funding Strategy Statement?

Employees' benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees' contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in Appendix A.

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the LGPS Regulations;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- the Fund's policies on admissions, cessations and bulk transfers;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Statement of Investment Principles / Investment Strategy Statement (see Section 4)

### 1.4 How does the Fund and this FSS affect me?

This depends on who you are:

- a member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;
- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, and in what circumstances you might need to pay more. Note that the FSS applies to all employers participating in the Fund;
- an Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- a Council Tax payer: your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

### 1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;

- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (**NB** this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

### 1.6 How do I find my way around this document?

In Section 2 there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In Section 3 we outline how the Fund calculates the contributions payable by different employers in different situations.

In Section 4 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail if you are interested:

A. the regulatory background, including how and when the FSS is reviewed,

B. who is responsible for what,

C. what issues the Fund needs to monitor, and how it manages its risks,

D. some more details about the actuarial calculations required,

E. the assumptions which the Fund actuary currently makes about the future,

F. a glossary explaining the technical terms occasionally used here.

If you have any other queries please contact Caroline Roberts, Investment Manager in the first instance at her e-mail address carolinelesleyroberts@gwynedd.llyw.cymru.

## 2 Basic Funding issues

(More detailed and extensive descriptions are given in Appendix D).

### 2.1 How does the actuary measure the required contribution rate?

In essence this is a three-step process:

1. Calculate the ultimate funding target for that employer, i.e. the ideal amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;
2. Determine the time horizon over which the employer should aim to achieve that funding target. See the table in 3.3 and Note (c) for more details;
3. Calculate the employer contribution rate such that it has at least a given probability of achieving that funding target over that time horizon, allowing for different likelihoods of various possible economic outcomes over that time horizon. See 2.3 below, and the table in 3.3 Note (e) for more details.

### 2.2 What is each employer's contribution rate?

This is described in more detail in Appendix D. Employer contributions are normally made up of two elements:

a) the estimated cost of benefits being built up each year, after deducting the members' own contributions and including administration expenses. This is referred to as the "*Primary rate*", and is expressed as a percentage of members' pensionable pay; plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, payment of the Secondary rate will aim to return the employer to full funding over an appropriate period (the "time horizon"). The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of any higher rate will be taken by the Fund actuary at subsequent valuations, i.e. will be reflected as a credit when next calculating the employer's contributions.

### 2.3 What different types of employer participate in the Fund?

Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate.

In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: academy schools, contractors, housing associations, charities, etc.

The LGPS Regulations define various types of employer as follows:

**Scheduled bodies** - councils, and other specified employers such as academies and further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

**Designating employers** - employers such as town and parish councils are able to participate in the LGPS via resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

Other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer – **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer – **transferee admission bodies** ("TAB"). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund's admissions policy are not met. (NB The terminology CAB and TAB has been dropped from recent LGPS Regulations, which instead combine both under the single term 'admission bodies'; however, we have retained the old terminology here as we consider it to be helpful in setting funding strategies for these different employers).

### 2.4 How does the measured contribution rate vary for different employers?

All three steps above are considered when setting contributions (more details are given in Section 3 and Appendix D).

1. The **funding target** is based on a set of assumptions about the future, (e.g. investment returns, inflation, pensioners' life expectancies). However, if an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation;

2. The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and

3. The **probability of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

Any costs of non ill-health early retirements must be paid by the employer, see 3.6.

Costs of ill-health early retirements are covered in 3.7 and 3.8.

.

### 2.5 How is a deficit (or surplus) calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see Appendix D, section D5, for further details of how this is calculated), to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

It is important to note that the deficit/surplus and funding level are only measurements at a particular point in time, on a particular set of assumptions about the future. Whilst we recognise that various parties will take an interest in these measures, for most employers the key issue is how likely it is that their contributions will be sufficient to pay for their members' benefits (when added to their existing asset share and anticipated investment returns).

In short, deficits and funding levels are short term measures, whereas contribution-setting is a longer term issue.

### 2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher Pension Fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;
- Other employers will provide various services to the local community, perhaps through housing associations, charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services at a reasonable cost.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;

- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible. However, a recent shift in regulatory focus means that solvency within each generation is considered by the Government to be a higher priority than stability of contribution rates;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result;
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see 3.1). In deciding which of these techniques to apply to any given employer, the Administering Authority takes a view on the financial standing of the employer, i.e. its ability to meet its funding commitments and the relevant time horizon.

The Administering Authority will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc.

For instance, where the Administering Authority has reasonable confidence that an employer will be able to meet its funding commitments, then the Fund will permit options such as stabilisation (see 3.3 Note (b)), a longer time horizon relative to other employers, and/or a lower probability of achieving their funding target. Such options will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, where there is doubt that an employer will be able to meet its funding commitments or withstand a significant change in its commitments, then a higher funding target, and/or a shorter deficit recovery period relative to other employers, and/or a higher probability of achieving the target may be required.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see Appendix A.

## 3 Calculating contributions for individual Employers

### 3.1 General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, the Fund's three-step process identifies the key issues:

1. What is a suitably (but not overly) prudent funding target?
2. How long should the employer be permitted to reach that target? This should be realistic but not so long that the funding target is in danger of never actually being achieved.
3. What probability is required to reach that funding target? This will always be less than 100% as we cannot be certain of future market movements. Higher probability "bars" can be used for employers where the Fund wishes to reduce the risk that the employer ceases leaving a deficit to be picked up by other employers.

These and associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

### 3.2 The effect of paying lower contributions

In limited circumstances the Administering Authority may permit employers to pay contributions at a lower level than is assessed for the employer using the three step process above. At their absolute discretion the Administering Authority may:

- extend the time horizon for targeting full funding;
- adjust the required probability of meeting the funding target;
- permit an employer to participate in the Fund's stabilisation mechanisms;
- permit extended phasing in of contribution rises or reductions;
- pool contributions amongst employers with similar characteristics; and/or
- accept some form of security or guarantee in lieu of a higher contribution rate than would otherwise be the case.

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than required to meet their funding target, over the appropriate time horizon with the required likelihood of success. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the pace of paying contributions;
- lower contributions in the short term will be assumed to incur a greater loss of investment returns on the deficit. Thus, deferring a certain amount of contribution may lead to higher contributions in the long-term; and

- it may take longer to reach their funding target, all other things being equal.

Overleaf (3.3) is a summary of how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.
Section 3.4 onwards deals with various other funding issues which apply to all employers.

## 3.3 The different approaches used for different employers

| **Type of employer** | **Scheduled Bodies** | | **Community Admission Bodies and Designating Employers** | | **Transferee Admission Bodies** |
|---|---|---|---|---|---|
| **Sub-type** | **Local Authorities, Police and Parc Cenedlaethol Eryri** | **All other Scheduled Bodies (Town and Parish Councils)** | **Open to new entrants** | **Closed to new entrants** | **(all)** |
| **Funding Target Basis used** | Ongoing, assumes long-term Fund participation (see Appendix E) | | Ongoing, but may move to "gilts basis" - see Note (a) | | Ongoing, assumes fixed contract term in the Fund (see Appendix E) |
| **Primary rate approach** | (see Appendix D – D.2) | | | | |
| **Stabilised contribution rate?** | Yes - see Note (b) | No | No | No | No |
| **Maximum time horizon – Note (c)** | 20 years | 20 years | Future working lifetime + 33% | Future working lifetime + 33% | Outstanding contract term |
| **Secondary rate – Note (d)** | Monetary amount | Monetary amount | Monetary amount | Monetary amount | Monetary amount |
| **Treatment of surplus** | Covered by stabilisation arrangement | Reduce contributions through a negative secondary rate | Reduce contributions through a negative secondary rate | | Reduce contributions by spreading the surplus over the remaining contract term |
| **Probability of achieving target – Note (e)** | 66% | 70% | 70% or 75% depending on employer risk | 75% | 66% |
| **Phasing of contribution changes** | Covered by stabilisation arrangement | Phasing over 3 years may be permitted | Phasing over 3 years may be permitted | Phasing over 3 years may be permitted | None |
| **Review of rates – Note (f)** | Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations | | | | Particularly reviewed in last 3 years of contract |
| **New employer** | n/a | n/a | Note (g) | | Notes (g) & (h) |
| **Cessation of participation: cessation debt payable** | Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt principles applied would be as per Note (i). | | Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (i). | | Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising. |

**Note (a) (Basis for CABs and Designating Employers closed to new entrants)**

In the circumstances where:

- the employer is a Designating Employer, or an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may set a higher funding target (e.g. using a discount rate set equal to gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Designating Employers and Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease or the Designating Employer alters its designation.

**Note (b) (Stabilisation)**

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" (and may therefore be paying less than their theoretical contribution rate) should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority (see below) and;
- there are no material events which cause the employer to become ineligible, e.g. significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring), or changes in the security of the employer.

On the basis of extensive modelling carried out for the 2016 valuation exercise (see Section 4), the stabilised details are as follows:

| Type of employer | Councils, Police and Parc Cenedlaethol Eryri |
|---|---|
| **Max cont increase** | 0% of pay (contributions are fixed for three years), followed by 1% of pay thereafter |
| **Max cont decrease** | 0% of pay (contributions are fixed for three years), followed by 1% of pay thereafter |

The stabilisation criteria and limits will be reviewed at the 31 March 2019 valuation, to take effect from 1 April 2020. However the Administering Authority reserves the right to review the stabilisation criteria and limits at any time before then, on the basis of membership and/or employer changes as described above.

**Note (c) (Maximum time horizon)**

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2017 for the 2016 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative time horizons, for example where there were no new entrants.

**Note (d) (Secondary rate)**

The secondary rate will be set as a monetary amount for all employers where the secondary rate is positive.

Where the secondary rate is negative, i.e. where an employer is in surplus, the secondary rate will be set as a percentage of salaries.

**Note (e) (Probability of achieving funding target)**

Each employer has its funding target calculated, and a relevant time horizon over which to reach that target. Contributions are set such that, combined with the employer's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum probability. A higher required probability bar will give rise to higher required contributions, and vice versa.

The way in which contributions are set using these three steps, and relevant economic projections, is described in further detail in Appendix D.

Different probabilities are set for different employers depending on their nature and circumstances: in broad terms, a higher probability will apply due to one or more of the following:

- the Fund believes the employer poses a greater funding risk than other employers,
- the employer does not have tax-raising powers;
- the employer does not have a guarantor or other sufficient security backing its funding position; and/or

- the employer is likely to cease participation in the Fund in the short or medium term.

**Note (f) (Regular Reviews)**

Such reviews may be triggered by significant events including but not limited to: significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

**Note (g) (New Admission Bodies)**

With effect from 1 October 2012, the LGPS 2012 Miscellaneous Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date. Under these Regulations, all new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit.

Transferee Admission Bodies: For all TABs, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis. See also Note (i) below.

Community Admission Bodies: The Administering Authority will only consider requests from CABs (or other similar bodies, such as section 75 NHS partnerships) to join the Fund if they are sponsored by a Scheduled Body with tax raising powers, guaranteeing their liabilities and also providing a form of security as above.

The above approaches reduce the risk, to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

**Note (h) (New Transferee Admission Bodies)**

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council or academy) to another organisation (a “contractor”). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees’ Fund benefits. The quid pro quo is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see Note (i).

Employers which “outsource” have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) Pooling

Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which may be under a stabilisation approach.

ii) Letting employer retains pre-contract risks

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor’s contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) Fixed contribution rate agreed

Under this option the contractor pays a fixed contribution rate and does not pay any cessation deficit.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from:

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above; and
- redundancy and early retirement decisions.

**Note (i) (Admission Bodies Ceasing)**

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund (NB recent LGPS Regulation changes mean that the Administering Authority has the discretion to defer taking action for up to three years, so that if the employer acquires one or more active Fund members during that period then cessation is not triggered. The current Fund policy is that this is left as a discretion and may or may not be applied in any given case);
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

(a) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

(b) Where there is a guarantor for future deficits and contributions, the details of the guarantee will be considered prior to the cessation valuation being carried out. In some cases the guarantor is simply guarantor of last resort and therefore the cessation valuation will be carried out consistently with the approach taken had there been no guarantor in place. Alternatively, where the guarantor is not simply guarantor of last resort, the cessation may be calculated using the ongoing basis as described in Appendix E;

(c) Again, depending on the nature of the guarantee, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee.

Under (a) and (b), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund would spread the payment subject to there being some security in place for the employer such as a bond indemnity or guarantee.

In the event that the Fund is not able to recover the required payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

### 3.4 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended time horizon, or permission to join a pool with another body (e.g. the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan; and
- whether the admission agreement is likely to be open or closed to new entrants.

### 3.5 Non ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). (**NB** the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014). Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

With the agreement of the Administering Authority the payment can be spread as follows:

| | |
|---|---|
| Major Employing bodies | - up to 5 years |
| Community Admission Bodies and Designating Employers | - up to 3 years |
| Transferee Admission Bodies | - payable immediately. |

### 3.6 Ill health early retirement costs

In the event of a member's early retirement on the grounds of ill-health, a funding strain will usually arise, which can be very large. The Fund has an ill-health insurance policy covering smaller employers in the Fund. This will pay a sum to the Fund that is broadly equal to the funding strain in the event of a successful claim. For all other employers that are not covered by the external insurance policy, any funding strain in excess of the allowance made in the funding basis would be met through an increase to ongoing contributions.

### 3.7 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis (see 3.3, Note (i)) and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:

a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;

b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the remaining assets would be apportioned pro-rata by the Fund's actuary to the other Fund employers.

In exceptional circumstances the Fund may permit an employer with no remaining active members to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases, as the employer would have no contributing members.

### 3.8 Policies on bulk transfers

The Fund has a separate written policy which covers bulk transfer payments into, out of and within the Fund. Each case will be treated on its own merits, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities; and
- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer’s Fund contributions to increase between valuations.

## 4. Funding strategy and links to investment strategy

### 4.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles (being replaced by an Investment Strategy Statement under new LGPS Regulations), which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out as part of each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

### 4.2 What is the link between funding strategy and investment strategy?

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 and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa

Therefore, the funding and investment strategies are inextricably linked.

### 4.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The asset outperformance assumption contained in the discount rate (see Appendix E3) is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government (see Appendix A1).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

### 4.4 How does this differ for a large stable employer?

The Actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

Prudence - the Fund should have a reasonable expectation of being fully funded in the long term;

Affordability – how much can employers afford;

Stewardship – the assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position; and

Stability – employers should not see significant moves in their contribution rates from one year to the next, to help provide a more stable budgeting environment.

The key problem is that the key objectives often conflict. For example, minimising the long term cost of the scheme (i.e. keeping employer rates affordable) is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down fairly frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

Therefore, a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling: this is a set of calculation techniques applied by the Fund's actuary to model the range of potential future solvency levels and contribution rates.

The Actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach (see 3.3 Note (b)). The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes as described in 3.3 Note (b), struck an appropriate balance between the above objectives. In particular the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Fund.

Whilst the current stabilisation mechanism is to remain in place until 2020, it should be noted that this will need to be reviewed following the 2019 valuation.

## 5. Statutory reporting and comparison to other LGPS Funds

### 5.1 Purpose

Under Section 13(4)(c) of the Public Service Pensions Act 2013 ("Section 13"), the Government Actuary's Department must, following each triennial actuarial valuation, report to the Department of Communities & Local Government (DCLG) on each of the LGPS Funds in England & Wales. This report will cover whether, for each Fund, the rate of employer contributions are set at an appropriate level to ensure both the solvency and the long term cost efficiency of the Fund.

This additional DCLG oversight may have an impact on the strategy for setting contribution rates at future valuations.

### 5.2 Solvency

For the purposes of Section 13, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

(a) the rate of employer contributions is set to target a funding level for the Fund of 100%, over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds); and either

(b) employers collectively have the financial capacity to increase employer contributions, and/or the Fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or

(c) there is an appropriate plan in place should there be, or if there is expected in future to be, a material reduction in the capacity of fund employers to increase contributions as might be needed.

### 5.3 Long Term Cost Efficiency

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long term cost efficiency if:

i. the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual,

ii. with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, DCLG may have regard to various absolute and relative considerations. A relative consideration is primarily concerned with comparing LGPS pension funds with other LGPS pension funds. An absolute consideration is primarily concerned with comparing Funds with a given objective benchmark.

Relative considerations include:

1. the implied deficit recovery period; and
2. the investment return required to achieve full funding after 20 years.

Absolute considerations include:

1. the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;
2. how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy;
3. the extent to which contributions actually paid have been in line with the expected contributions based on the extant rates and adjustment certificate; and
4. the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual Fund experience.

DCLG may assess and compare these metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

## Appendix A – Regulatory framework

### A1 Why does the Fund need an FSS?

The Department for Communities and Local Government (DCLG) has stated that the purpose of the FSS is:

*"to establish a **clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;*

*to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*

*to take a **prudent longer-term view** of funding those liabilities."*

These objectives are desirable individually, but may be mutually conflicting.

The requirement to maintain and publish a FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2016) and to its Statement of Investment Principles / Investment Strategy Statement.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

### A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to "consultation with such persons as the authority considers appropriate", and should include "a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers".

In practice, for the Fund, the consultation process for this FSS was as follows:

a) A draft version of the FSS was issued to all participating employers in January 2017 for comment;

b) Comments were requested within 30 days;

c) There was an Employers Forum on 10 November 2016 at which questions regarding funding strategies could be raised and answered;

d) Following the end of the consultation period the FSS was updated where required and then published, in March.

### A3 How is the FSS published?

The FSS is made available through the following routes:

Published on the website, at cronfawww.gwyneddpensionfund.org;

A copy sent by e-mail to each participating employer in the Fund;

A copy sent to employee representatives;

A summary issued to all Fund members;

A full copy linked from the annual report and accounts of the Fund;

Copies sent to investment managers and independent advisers;

Copies made available on request.

**A4 How often is the FSS reviewed?**

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2019.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Pensions Committee and would be included in the relevant Committee Meeting minutes.

**A5 How does the FSS fit into other Fund documents?**

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Statement of Investment Principles/Investment Strategy Statement, Governance Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web at www.gwyneddpensionfund.org

## Appendix B – Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to each play their part.

### B1 The Administering Authority should:-

1. operate the Fund as per the LGPS Regulations;
2. effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
3. collect employer and employee contributions, and investment income and other amounts due to the Fund;
4. ensure that cash is available to meet benefit payments as and when they fall due;
5. pay from the Fund the relevant benefits and entitlements that are due;
6. invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles/Investment Strategy Statement (SIP/ISS) and LGPS Regulations;
7. communicate appropriately with employers so that they fully understand their obligations to the Fund;
8. take appropriate measures to safeguard the Fund against the consequences of employer default;
9. manage the valuation process in consultation with the Fund's actuary;
10. provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
11. prepare and maintain a FSS and a SIP/ISS, after consultation;
12. notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
13. monitor all aspects of the fund's performance and funding and amend the FSS and SIP/ISS as necessary and appropriate.

### B2 The Individual Employer should:-

1. deduct contributions from employees' pay correctly;
2. pay all contributions, including their own as determined by the actuary, promptly by the due date;
3. have a policy and exercise discretions within the regulatory framework;
4. make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
5. notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

### B3 The Fund Actuary should:-

1. prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;

2. provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
3. provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);
4. prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
5. assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
6. advise on the termination of employers' participation in the Fund; and
7. fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

**B4 Other parties:-**

1. investment advisers (either internal or external) should ensure the Fund's SIP/ISS remains appropriate, and consistent with this FSS;
2. investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the SIP/ISS;
3. auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
4. governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
5. legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures;
6. the Department for Communities and Local Government (assisted by the Government Actuary's Department) and the Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

**Appendix C – Key risks and controls**

**C1 Types of risk**

The Administering Authority has an active risk management programme in place. The measures that it has in place to control key risks are summarised below under the following headings:

financial;

demographic;

regulatory; and

governance.

**C2 Financial risks**

| **Risk** | **Summary of Control Mechanisms** |
|---|---|
| Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities over the long-term. | Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing.<br><br>Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.<br><br>Analyse progress at three yearly valuations for all employers.<br><br>Inter-valuation roll-forward of liabilities between valuations at whole Fund level. |
| Inappropriate long-term investment strategy. | Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes.<br><br>Chosen option considered to provide the best balance. |
| Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities. | Stabilisation modelling at whole Fund level allows for the probability of this within a longer term context.<br><br>Inter-valuation monitoring, as above.<br><br>Some investment in bonds helps to mitigate this risk. |
| Active investment manager under-performance relative to benchmark. | Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark. |
| Pay and price inflation significantly more | The focus of the actuarial valuation process is |

| Risk | Summary of Control Mechanisms |
|---|---|
| than anticipated. | on real returns on assets, net of price and pay increases.<br><br>Inter-valuation monitoring, as above, gives early warning.<br><br>Some investment in bonds also helps to mitigate this risk.<br><br>Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees. |
| Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies | An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions. |
| Orphaned employers give rise to added costs for the Fund | The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.<br><br>If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 3.9). |

**C3 Demographic risks**

| Risk | Summary of Control Mechanisms |
|---|---|
| Pensioners living longer, thus increasing cost to Fund. | Set mortality assumptions with some allowance for future increases in life expectancy.<br><br>The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation. |
| Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees. | Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies. |
| Deteriorating patterns of early retirements | Employers are charged the extra cost of non ill-health retirements following each individual |

| Risk | Summary of Control Mechanisms |
|---|---|
| | decision.<br><br>Employer ill health retirement experience is monitored, and an ill-health insurance policy is in place for smaller employers. |
| Reductions in payroll causing insufficient deficit recovery payments | In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:<br><br>Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see Note (b) to 3.3).<br><br>For other employers, review of contributions is permitted in general between valuations (see Note (f) to 3.3). The Fund ensures that all deficit contributions are paid as fixed monetary amounts rather than as a percentage of payroll. |

**C4 Regulatory risks**

| Risk | Summary of Control Mechanisms |
|---|---|
| Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform. | The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.<br><br>The results of the most recent reforms were built into the 2013 valuation. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions. |
| Time, cost and/or reputational risks associated with any DCLG intervention triggered by the Section 13 analysis (see Section 5). | Take advice from Fund Actuary on position of Fund as at prior valuation, and consideration of proposed valuation approach relative to anticipated Section 13 analysis. |

| | |
|---|---|
| Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies. | The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.<br><br>Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate. |

**C5 Governance risks**

| Risk | Summary of Control Mechanisms |
|---|---|
| Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants. | The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.<br><br>The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions between triennial valuations<br><br>Deficit contributions may be expressed as monetary amounts. |
| Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way | The Administering Authority maintains close contact with its specialist advisers.<br><br>Advice is delivered via formal meetings involving Elected Members, and recorded appropriately.<br><br>Actuarial advice is subject to professional requirements such as peer review. |
| Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body. | The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.<br><br>Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken. |
| An employer ceasing to exist with insufficient funding or adequacy of a bond. | The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.<br><br>The risk is mitigated by:<br><br>Seeking a funding guarantee from another scheme employer, or external body, wherever |

| Risk | Summary of Control Mechanisms |
|---|---|
| | possible (see Notes (h) and (i) to 3.3).<br><br>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.<br><br>Vetting prospective employers before admission.<br><br>Where permitted under the regulations requiring a bond to protect the Fund from various risks.<br><br>Requiring new Community Admission Bodies to have a guarantor.<br><br>Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to 3.3).<br><br>Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to 3.3). |

## Appendix D – The calculation of Employer contributions

In Section 2 there was a broad description of the way in which contribution rates are calculated.  This Appendix considers these calculations in much more detail.

All three steps above are considered when setting contributions (more details are given in Section 3 and Appendix D:

1. The **funding target** is based on a set of assumptions about the future, eg investment returns, inflation, pensioners' life expectancies. However, if an employer is approaching the end of its participation in the Fund then it's funding target may be set on a more prudent basis, so that it's liabilities are less likely to be spread among other employers after it's cessation of participation;

2. The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform;

3. The required **probability of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

### D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

a) the estimated cost of ongoing benefits being accrued,  referred to as the "Primary contribution rate" (see D2 below); plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "Secondary contribution rate" (see D3 below).

The contribution rate for each employer is measured as above, appropriate for each employer's funding position and membership. The whole Fund position, including that used in reporting to DCLG (see section 5), is calculated in effect as the sum of all the individual employer rates. DCLG currently only regulates at whole Fund level, without monitoring individual employer positions.

### D2 How is the Primary contribution rate calculated?

The Primary element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members' **future** service in the Fund. This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

The Primary rate is calculated separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. The Primary rate is calculated such that it is projected to:

1. meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets,
2. within the determined time horizon (see note 3.3 Note (c) for further details),
3. with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

* The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The projections are carried out using an economic modeller developed by the Fund's actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (by the end of the time horizon) is equal to the required probability.

The approach includes expenses of administration to the extent that they are borne by the Fund, and includes allowances for benefits payable on death in service and on ill health retirement.

### D3 How is the Secondary contribution rate calculated?

The combined Primary and Secondary rates aim to achieve the employer's funding target, within the appropriate time horizon, with the relevant degree of probability.

For the funding target, the Fund actuary agrees the assumptions to be used with the Administering Authority – see Appendix E. These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer's current and former employees, based on pensionable service to the valuation date only (i.e. ignoring further benefits to be built up in the future).

The Fund operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see Section 3).

The Secondary rate is calculated as the balance over and above the Primary rate, such that the total is projected to:

1. meet the required funding target relating to combined past and future service benefit accrual, including accrued asset share (see D5 below)
2. within the determined time horizon (see 3.3 Note (c) for further details)
3. with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

The projections are carried out using an economic modeller developed by the Fund Actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes with at least 100% solvency (by the end of the time horizon) is equal to the required probability.

## D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

1. past contributions relative to the cost of accruals of benefits;
2. different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
3. the effect of any differences in the funding target, i.e. the valuation basis used to value the employer's liabilities;
4. any different time horizons;
5. the difference between actual and assumed rises in pensionable pay;
6. the difference between actual and assumed increases to pensions in payment and deferred pensions;
7. the difference between actual and assumed retirements on grounds of ill-health from active status;
8. the difference between actual and assumed amounts of pension ceasing on death;
9. the additional costs of any non ill-health retirements relative to any extra payments made; and/or
10. differences in the required probability of achieving the funding target.

## D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus".

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers, to the extent that employers in effect share the same investment strategy. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

1. the actual timing of employer contributions within any financial year;
2. the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification but not to audit standard.  The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

**Appendix E – Actuarial assumptions**

**E1 What are the actuarial assumptions?**

These are expectations of future experience used to place a value on future benefit payments ("the liabilities"). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

Changes in assumptions will affect the measured funding target. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower funding targets and lower employer costs. A more prudent basis will give higher funding targets and higher employer costs.

**E2 What basis is used by the Fund?**

The Fund's standard funding basis is described as the "ongoing basis", which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term, a more prudent basis applies: see Note (a) to 3.3.

**E3 What assumptions are made in the ongoing basis?**

**a) Investment return / discount rate**

The key financial assumption is the anticipated return on the Fund's investments. This "discount rate" assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds ("gilts"). There is, however, no guarantee that Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2016 and setting contribution rates effective from 1 April 2017, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.7% per annum greater than gilt yields at the time of the valuation (this is the same as that used at the 2013 valuation). In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

**b) Salary growth**

Pay for public sector employees is currently subject to restriction by the UK Government until 2020. Although this "pay freeze" does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards. Based on long term historical analysis of the membership in LGPS funds, and continued austerity measures, the salary increase assumption at the 2016 valuation has been set to be a blended rate combined of:

1. 1% p.a. until 31 March 2020, followed by
2. 0.5% above the Consumer Prices Index (CPI) per annum p.a. thereafter.

This is equivalent to a single salary increase assumption of CPI.

This is a change from the previous valuation, which assumed an assumption of 1% p.a. for three years, and RPI plus 1% p.a. thereafter. The change has led to a reduction in the funding target (all other things being equal).

**c) Pension increases**

Since 2011 CPI, rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the "formula effect" of the difference between RPI and CPI. At this valuation, we have used a reduction of 1.0% per annum. This is a larger reduction than at 2013, which will serve to reduce the funding target (all other things being equal). (Note that the reduction is applied in a geometric, not arithmetic, basis).

**d) Life expectancy**

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the Club Vita's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with the 2013 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.25% per annum minimum underpin to future reductions in mortality rates. This is a similar allowance for future improvements than was made in 2013.

The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members' benefits.

**e) General**

The same financial assumptions are adopted for most employers, in deriving the funding target underpinning the Primary and Secondary rates: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

**Appendix F – Glossary**

| | |
|---|---|
| **Actuarial assumptions/basis** | The combined set of assumptions made by the actuary, regarding the future, to calculate the value of **the funding target**. The main assumptions will relate to the **discount rate**, salary growth, pension increases and longevity. More prudent assumptions will give a higher target value, whereas more optimistic assumptions will give a lower value. |
| **Administering Authority** | The council with statutory responsibility for running the Fund, in effect the Fund's "trustees". |
| **Admission Bodies** | Employers where there is an Admission Agreement setting out the employer's obligations. These can be Community Admission Bodies or Transferee Admission Bodies. For more details (see 2.3). |
| **Covenant** | The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term. |
| **Designating Employer** | Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund. |
| **Discount rate** | The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day. This is necessary to provide a **funding target** which is consistent with the present day value of the assets. A lower discount rate gives a higher target value, and vice versa. It is used in the calculation of the **Primary and Secondary rates**. |
| **Employer** | An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **funding target** values for each employer are individually tracked, together with its **Primary rate** at each **valuation**. |
| **Funding target** | The actuarially calculated present value of all pension entitlements of all **members** of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the **deficit**. It is calculated on a chosen set of **actuarial assumptions**. |
| **Gilt** | A UK Government bond, ie a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective |

measure of solvency.

| | |
|---|---|
| **Guarantee / guarantor** | A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's. |
| **Letting employer** | An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority, but can sometimes be another type of employer such as an Academy. |
| **LGPS** | The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 101 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers. |
| **Maturity** | A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy. |
| **Members** | The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees). |
| **Primary contribution rate** | The employer contribution rate required to pay for ongoing accrual of active members' benefits (including an allowance for administrative expenses). See Appendix D for further details. |
| **Profile** | The profile of an employer's membership or liability reflects various measurements of that employer's **members**, ie current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also. |
| **Rates and Adjustments** | A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal **valuation**. This is completed by the actuary and confirms the |

| | |
|---|---|
| **Certificate** | contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed. |
| **Scheduled Bodies** | Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers, university lecturers). |
| **Secondary contribution rate** | The difference between the employer's actual and **Primary contribution rates**. In broad terms, this relates to the shortfall of its asset share to its **funding target**. See Appendix D for further details. |
| **Stabilisation** | Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these. |
| **Valuation** | An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is normally carried out in full every three years (last done as at 31 March 2016), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date also. |

## Appendix 2 – Employers' Contributions, Spreading and Phasing Periods

Following the 2016 valuation, the minimum employer contributions shown in the Rates and Adjustment certificate attached to the 2016 valuation report are based on the deficit recovery periods and phasing periods shown in the table below. The table also shows the individual adjustments under Regulation 77(6) to each employer's contributions from the 'Common Contribution Rate'.

| | | Proposed Maximum Deficit | | Contribution Rates and Sums for the year ending | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Recovery Period | Phasing Period | FSR 31.03.18 | Deficit 31.03.18 | FSR 31.03.19 | Deficit 31.03.19 | FSR 31.03.20 | Deficit 31.03.20 |
| CODE | Employer Name or Pool | (In years) | (In years) | % | £'000 | % | £'000 | % | £'000 |
| | Major Scheduled Bodies | | | | | | | | |
| 100 | **Gwynedd** | 20 | S | 18.3 | 3,045 | 18.3 | 3,045 | 18.3 | 3,045 |
| 200 | **Isle of Anglesey** | 20 | S | 18.6 | 1,294 | 18.6 | 1,294 | 18.6 | 1,294 |
| Pool | **Conwy Pool** | | | | | | | | |
| 300 | **- Conwy County Borough Council** | 20 | S | 19.1 | 1,347 | 19.1 | 1,347 | 19.1 | 1,347 |
| 55 | **- Ysgol Emrys ap Iwan** | 20 | S | 19.1 | | 19.1 | | 19.1 | |
| 56 | **- Eirias High School** | 20 | S | 19.1 | | 19.1 | | 19.1 | |
| 57 | **- Ysgol Bryn Elian** | 20 | S | 19.1 | | 19.1 | | 19.1 | |
| 58 | **- Ysgol Pen y Bryn** | 20 | S | 19.1 | | 19.1 | | 19.1 | |
| | Major Admission Bodies | | | | | | | | |
| 37 | **Careers Wales** | FWL | 0 | 23.1 | 0 | 23.1 | 0 | 23.1 | 0 |
| 38 | **Cwmni Cynnal** | FWL | 0 | 24.0 | 0 | 24.0 | 0 | 24.0 | 0 |
| 43 | **Snowdonia National Park** | 20 | S | 19.5 | 71 | 19.5 | 71 | 19.5 | 71 |
| 76 | **Cartrefi Conwy** | FWL | 0 | 10.1 | 0 | 10.1 | 0 | 10.1 | 0 |
| 77 | **Cartrefi Cymunedol Gwynedd** | FWL | 0 | 17.0 | 0 | 17.0 | 0 | 17.0 | 0 |
| 78 | **Grwp Llandrillo Menai** | 15 | 0 | 21.1 | 0 | 21.1 | 0 | 21.1 | 0 |
| 81 | **Police and Crime Commissioner North Wales** | 20 | S | 16.3 | 844 | 16.3 | 844 | 16.3 | 844 |
| | Other Scheduled Bodies | | | | | | | | |
| 13 | **Caernarfon T.C.** | 20 | 0 | 18.4 | 0 | 18.4 | 0 | 18.4 | 0 |
| 14 | **Menai Bridge T.C.** | 20 | 0 | 19.8 | 0 | 19.8 | 0 | 19.8 | 0 |
| 16 | **Bangor C.C.** | 20 | 3 | 21.2 | 3.0 | 21.2 | 5.0 | 21.2 | 7.0 |
| 17 | **Llangefni T.C.** | 20 | 3 | 21.0 | 0.4 | 20.7 | 0 | 19.7 | 0 |
| 22 | **Beaumaris T.C.** | 20 | 3 | 16.6 | 2.5 | 16.6 | 1.7 | 16.6 | 0.9 |
| 27 | **Holyhead T.C.** | 20 | 0 | 16.4 | 0 | 16.4 | 0 | 16.3 | 0 |

| | | Proposed Maximum Deficit | | Contribution Rates and Sums for the year ending | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| CODE | Employer Name or Pool | Recovery Period (In years) | Phasing Period (In years) | FSR 31.03.15 % | Deficit 31.03.15 £'000 | FSR 31.03.16 % | Deficit 31.03.16 £'000 | FSR 31.03.17 % | Deficit 31.03.17 £'000 |
| 28 | **Llandudno T.C.** | 20 | 0 | 20.0 | 0 | 20.0 | 0 | 20.0 | 0 |
| 66 | **Tywyn T.C.** | 20 | 3 | 20.5 | 1.5 | 20.5 | 0.7 | 20.2 | 0 |
| 68 | **Llanllyfni C.C.** | 20 | 3 | 19.8 | 0.3 | 19.8 | 0.4 | 19.8 | 0.5 |
| 70 | **Towyn a Kinmel Bay T.C.** | 20 | 0 | 18.1 | 0 | 18.1 | 0 | 18.1 | 0 |
| 72 | **Abergele T.C.** | 20 | 3 | 21.5 | 0 | 22.2 | 0.0 | 22.6 | 0.3 |
| 73 | **Colwyn Bay T.C.** | 20 | 0 | 19.5 | 0 | 19.5 | 0 | 19.5 | 0 |
| 74 | **Blaenau Ffestiniog T.C.** | 20 | 3 | 19.7 | 0.7 | 19.7 | 0.4 | 19.7 | 0.1 |
| 83 | **Conwy T.C.** | 20 | 3 | 21.2 | 0 | 21.8 | 0 | 21.8 | 0 |
| | Small Admission Bodies | | | | | | | | |
| 11 | **North Wales Society for the Blind** | FWL | 3 | 26.1 | 0 | 26.5 | 2.0 | 26.5 | 6.0 |
| 25 | **Cyd-Bwyllgor Claddu Caergybi** | FWL | 3 | 28.1 | 3.0 | 28.1 | 7.0 | 28.1 | 11.0 |
| 34 | **Coleg Harlech** | FWL | 3 | 24.7 | 32.0 | 24.7 | 33.0 | 24.7 | 33.0 |
| 41 | **Cwmni'r Fran Wen*** | FWL | 3 | 22.4 | 0 | 22.4 | 0 | 22.4 | 0 |
| 61 | **Conwy Voluntary Services** | FWL | 3 | 25.6 | 0 | 27.7 | 0 | 29.4 | 1.0 |
| 62 | **Medrwn Môn** | FWL | 3 | 25.8 | 0 | 26.0 | 2.0 | 26.0 | 4.0 |
| 63 | **Mantell Gwynedd** | FWL | 0 | 27.9 | 0 | 27.9 | 0 | 27.9 | 0 |
| 64 | **Canolfan Cynghori Ynys Môn Citizens Advice Bureau** | FWL | 3 | 32.4 | 1.0 | 32.4 | 3.0 | 32.4 | 4.0 |
| 67 | **Menter Môn** | FWL | 0 | 23.3 | 0 | 23.3 | 0 | 23.3 | 0 |
| 69 | **Conwy Citizens Advice Bureau** | FWL | 3 | 32.6 | 0 | 33.2 | 2.0 | 33.2 | 2.0 |
| 71 | **CAIS** | FWL | 3 | 29.7 | 5.0 | 29.7 | 8.0 | 29.7 | 11.0 |
| 80 | **Jewsons Ltd** | FWL | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 |
| 84 | **Caterlink Ltd** | FWL | 3 | 27.0 | 38.0 | 27.0 | 39.0 | 27.0 | 40.0 |
| 87 | **Antur Teifi** | FWL | 0 | 25.4 | 0 | 25.4 | 0 | 25.4 | 0 |

**FWL** = Future Working Lifetime
**S** = Statutory tax raising body – no increase in contribution rate
**FSR** = Future Service Rate
***** Under discussion

| | |
|---|---|
| **COMMITTEE** | **PENSIONS COMMITTEE** |
| **DATE** | **19 MARCH 2017** |
| **PURPOSE** | **Adopt the Investment Strategy Statement following consultation** |
| **TITLE** | **INVESTMENT STRATEGY STATEMENT** |
| **AUTHOR** | **CAROLINE ROBERTS, INVESTMENT MANAGER** |

## 1. INTRODUCTION

As reported to this Committee's meeting on 19 January 2017, we are required to publish an Investment Strategy Statement (ISS) which replaces the existing Statement of Investment Principles (SIP). As part of the process a draft ISS was agreed in January by this Committee and it was sent out for consultation with interested parties.

## 2. LIMITS ON INVESTMENTS

Under the requirements for the SIP there were limits on certain types of investment and each fund could opt to increase these amounts if necessary to set an appropriate allocation for its specific requirements. There are no specific limits in the new legislation and therefore no need to formally increase the amounts. However, it is good practice to have some broad limits and these are included in the ISS.

## 3. THE RESPONSE

There were no responses to the consultation.

## 4. PROPOSED INVESTMENT STRATEGY STATEMENT

A copy of the proposed ISS is attached in Appendix A. There are no changes from the version which was presented to this committee on 19 January 2017.

## 5. RECOMMENDATION

That the proposed Investment Strategy Statement is adopted.

**APPENDIX A**

# Investment Strategy Statement

## 1. Introduction and background

This is the Investment Strategy Statement ("ISS") of the Gwynedd Pension Fund ("the Fund"), which is administered by Gwynedd Council, ("the Administering Authority"). The ISS is made in accordance with Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 ("the Regulations").

The ISS has been prepared by the Fund's Pension Committee ("the Committee") having taken advice from the Fund's investment adviser, Hymans Robertson LLP. The Committee acts on the delegated authority of the Administering Authority.

The ISS, which will be approved by the Committee on 16 March 2017, is subject to periodic review at least every three years and without delay after any significant change in investment policy. The Committee has consulted on the contents of the Fund's investment strategy with such persons it considers appropriate.

The Committee seeks to invest in accordance with the ISS, any Fund money that is not needed immediately to make payments from the Fund. The ISS should be read in conjunction with the Fund's Funding Strategy Statement (which is currently being reviewed).

## 2. The suitability of particular investments and types of investments

The primary objective of the Fund is to provide pension and lump sum benefits for members on their retirement and/or benefits on death, before or after retirement, for their dependants, on a defined benefits basis. This funding position will be reviewed at each triennial actuarial valuation, or more frequently as required.

The Committee aims to fund the Fund in such a manner that, in normal market conditions, all accrued benefits are fully covered by the value of the Fund's assets and that an appropriate level of contributions is agreed by the employer to meet the cost of future benefits accruing. For employee members, benefits will be based on service completed but will take account of future salary and/or inflation increases.

The Committee has translated its objectives into a suitable strategic asset allocation benchmark for the Fund. This benchmark is consistent with the Committee's views on the appropriate balance between generating a satisfactory long-term return on investments whilst taking account of market volatility and risk and the nature of the Fund's liabilities.

It is intended that the Fund's investment strategy will be reviewed at least every three years following actuarial valuations of the Fund.

The fund carried out an asset liability modelling exercise in conjunction with the 2016 actuarial valuation. A number of different contribution and investment strategies were modelled and the future evolution of the Fund considered under a wide range of different scenarios. The Committee set a target of having a minimum 67% chance of achieving their long term funding target – returning to a fully funded position within the next 20 years. They also considered the level of downside risk in the various strategies by identifying the low funding levels which might emerge in the event of poor outcomes.

This approach helps to ensure that the investment strategy takes due account of the maturity profile of the Fund (in terms of the relative proportions of liabilities in respect of pensioners, deferred and active members), together with the level of disclosed surplus or deficit (relative to the funding bases used).

In addition, the Committee monitors investment strategy on an ongoing basis, focusing on factors including, but not limited to:

- Suitability given the Fund's level of funding and liability profile
- The level of expected risk
- Outlook for asset returns

The Committee also monitors the Fund's actual allocation on a regular basis to ensure it does not notably deviate from the target allocation.

The long term asset class returns assumed within the modelling exercise were as follows:

| Asset Class | Median expected return 10 years (%pa) | Median expected return 20 years (%pa) |
|---|---|---|
| UK equities | 5.0 | 5.9 |
| Overseas equities | 4.6 | 5.6 |
| Private equity | 5.9 | 7.0 |
| UK Property | 2.8 | 3.7 |
| Absolute Return Bonds | 2.6 | 3.6 |

## 3. Investment of money in a wide variety of investments

### Asset classes

The Fund may invest in quoted and unquoted securities of UK and overseas markets including equities and fixed interest and index linked bonds, cash, property and commodities either directly or through pooled funds. The Fund may also make use of contracts for differences and other derivatives either directly or in pooled funds investing in these products for the purpose of efficient portfolio management or to hedge specific risks.

The Committee reviews the nature of Fund investments on a regular basis, with particular reference to suitability and diversification. The Committee seeks and considers written advice from a suitably qualified person in undertaking such a review. If, at any time, investment in a security or product not previously known to the Committee is proposed, appropriate advice is sought and considered to ensure its suitability and diversification.

The Fund’s target investment strategy is set out below. In line with the Regulations, the authority’s investment strategy does not permit more than 5% of the total value of all investments of fund money to be invested in entities which are connected with that authority within the meaning of section 212 of the Local Government and Public Involvement in Health Act 2007”.

**Table 1: Fund allocation**

| Asset class | Target allocation % |
|---|---|
| UK equities | 19.5 |
| Overseas equities | 53.0 |
| Total equities | 72.5 |
| Property | 10.0 |
| Bonds | 15.0 |
| Infrastructure | 2.5 |
| Total | 100.0 |

**Managers**

The Committee has appointed a number of investment managers all of whom are authorised under the Financial Services and Markets Act 2000 to undertake investment business.

The Committee, after seeking appropriate investment advice, has agreed specific benchmarks with each manager so that, in aggregate, they are consistent with the overall asset allocation for the Fund. The Fund’s investment managers will hold a mix of investments which reflects their views relative to their respective benchmarks. Within each major market and asset class, the managers will maintain diversified portfolios through direct investment or pooled vehicles. The manager of the passive funds in which the Fund invests holds a mix of investments within each pooled fund that reflects that of their respective benchmark indices.

## 4. The approach to risk, including the ways in which risks are to be measured and managed

The Committee is aware that the Fund has a need to take risk (e.g. investing in growth assets) to help it achieve its funding objectives. It has an active risk management programme in place that aims to help it identify the risks being taken and put in place processes to manage, measure, monitor and (where possible) mitigate the risks being taken. One of the Committee’s overarching beliefs is to only to take as much investment risk as is necessary.

The principal risks affecting the Fund are set out below, we also discuss the Fund’s approach to managing these risks and the contingency plans that are in place:

**Funding risks**

- Financial mismatch – The risk that Fund assets fail to grow in line with the developing cost of meeting the liabilities.

- Changing demographics –The risk that longevity improves and other demographic factors change, increasing the cost of Fund benefits.

- Systemic risk - The possibility of an interlinked and simultaneous failure of several asset classes and/or investment managers, possibly compounded by financial 'contagion', resulting in an increase in the cost of meeting the Fund's liabilities.

The Committee measures and manages financial mismatch in two ways. As indicated above, the Committee has set a strategic asset allocation benchmark for the Fund. This benchmark was set taking into account asset liability modelling which focused on probability of success and level of downside risk. The results from the 2016 analysis highlighted that the Fund has a 77% probability of achieving full funding over the period to 2037 and a downside risk measure equivalent to a funding level of 38% at that date in the average of the worst 5% of outcomes. This analysis will be revisited as part of the 2016 valuation process. The Committee assesses risk relative to the strategic benchmark by monitoring the Fund's asset allocation and investment returns relative to the benchmark. The Committee also assesses risk relative to liabilities by monitoring the delivery of benchmark returns relative to liabilities.

The Committee also seeks to understand the assumptions used in any analysis and modelling so they can be compared to their own views and the level of risks associated with these assumptions to be assessed.

The Committee seeks to mitigate systemic risk through a diversified portfolio but it is not possible to make specific provision for all possible eventualities that may arise under this heading.

**Asset risks**

- Concentration - The risk that a significant allocation to any single asset category and its underperformance relative to expectation would result in difficulties in achieving funding objectives.
- Illiquidity - The risk that the Fund cannot meet its immediate liabilities because it has insufficient liquid assets.
- Currency risk – The risk that the currency of the Fund's assets underperforms relative to Sterling (i.e. the currency of the liabilities).
- Environmental, social and governance ("ESG") – The risk that ESG related factors reduce the Fund's ability to generate the long-term returns.
- Manager underperformance - The failure by the fund managers to achieve the rate of investment return assumed in setting their mandates.

The Committee measures and manages asset risks as follows.

The Fund's strategic asset allocation benchmark invests in a diversified range of asset classes. The Committee has put in place rebalancing arrangements to ensure the Fund's "actual allocation" does not deviate substantially from its target. The Fund invests in a range of investment mandates each of which has a defined objective, performance benchmark and manager process which, taken in aggregate, help reduce the Fund's asset concentration risk. By investing across a range of assets, including liquid quoted equities and bonds, as well as property, the Committee has recognised the need for access to liquidity in the short term.

The Fund invests in a range of overseas markets which provides a diversified approach to currency markets; the Committee also assess the Fund's currency risk during their risk analysis. Details of the Fund's approach to managing ESG risks are set out later in this document.

The Committee has considered the risk of underperformance by any single investment manager and have attempted to reduce this risk by appointing more than one manager and having a significant proportion of the Scheme's assets managed on a passive basis. The Committee assess the Fund's managers' performance on a regular basis, and will take steps, including potentially replacing one or more of their managers, if underperformance persists.

**Other provider risk**

- Transition risk - The risk of incurring unexpected costs in relation to the transition of assets among managers. When carrying out significant transitions, the Committee seeks suitable professional advice.
- Custody risk - The risk of losing economic rights to Fund assets, when held in custody or when being traded.
- Credit default - The possibility of default of a counterparty in meeting its obligations.
- Stock-lending – The possibility of default and loss of economic rights to Fund assets.

The Committee monitors and manages risks in these areas through a process of regular scrutiny of its providers, and audit of the operations it conducts for the Fund, or has delegated such monitoring and management of risk to the appointed investment managers as appropriate (e.g. custody risk in relation to pooled funds). The Committee has the power to replace a provider should serious concerns exist.

A separate schedule of risks that the Fund monitors is set out in the Fund's Funding Strategy Statement.

## 5. The approach to pooling investments, including the use of collective investment vehicles and shared services

The Fund is a participating scheme in the WALES Pool. The proposed structure and basis on which the WALES Pool will operate was set out in the July 2016 submission to Government.

**Assets to be invested in the Pool**

The Fund's intention is to invest its assets through the WALES Pool as and when suitable Pool investment solutions become available. An indicative timetable for investing through the Pool was set out in the July 2016 submission to Government. The key criteria for assessment of Pool solutions will be as follows:

1 That the Pool enables access to an appropriate solution that meets the objectives and benchmark criteria set by the Fund

2 That there is a clear financial benefit to the Fund in investing in the solution offered by the Pool, should a change of provider be necessary.

At the time of preparing this statement the Fund has already invested the following assets via the WALES Pool:

| Asset class | Manager | % of Fund assets | Benchmark and performance objective |
|---|---|---|---|
| Passive Equity | BlackRock | 22.5 | FTSE All-Share and FTSE All-World Indices<br><br>Benchmark Return |

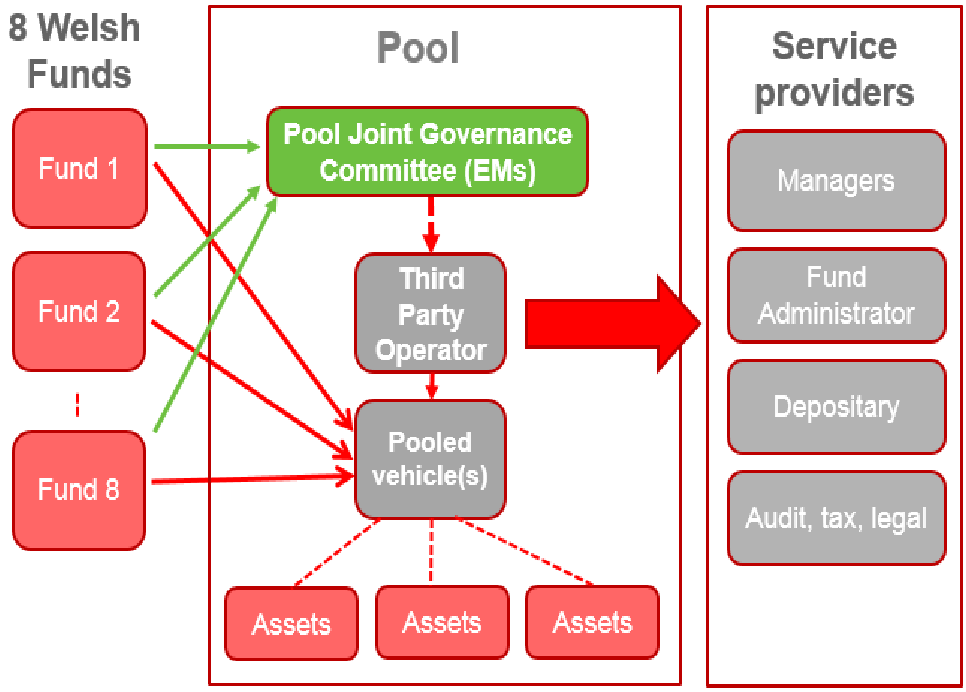
At the time of preparing this statement the Fund has elected not to invest the following assets via the WALES Pool:

| Asset class | Manager | % of Fund assets | Benchmark and performance objectives | Reason for not investing via the WALES Pool |
|---|---|---|---|---|
| Private Equity | Partners | 5.0 | MSCI World Benchmark + 5% per annum | Existing contractual commitments in funds which have a finite life. |
| Infrastructure | Partners | 2.5 | MSCI World Benchmark + 5% per annum | Existing contractual commitments in funds which have a finite life. |

Any assets not currently invested in the Pool will be reviewed at least every three years to determine whether the rationale remains appropriate, and whether it continues to demonstrate value for money. The next such review will take place no later than 2020.

**Structure and governance of the WALES Pool**

The Pool will appoint a third party operator authorised by the FCA to provide a series of investment sub-funds in which the assets of the participating funds will be invested.




A Joint Governance Committee (JGC) will be established to oversee the operator. The Committee will comprise elected members – one from each of the eight participating funds. It is anticipated that this is likely to be the Chairs of the respective Pensions Committees though administering authorities may choose to nominate alternative members if appropriate. This arrangement will provide accountability for the operator back to individual administering authorities.

The Joint Governance Committee (JGC) will be set up formally as a Joint Committee between the participating administering authorities. Each fund will have one elected member on the Committee.It will operate on the basis of 'One Fund, One Vote', though the intention is that any decisions are reached by consensus wherever possible. A formal Terms of Reference for the Committee will be drawn up.

The Committee will be responsible for ensuring where practical that there are an appropriate range of sub-funds available to allow administering authorities to implement their own desired asset allocation. The JGC will be in regular discussions with the operator as to the specific sub-funds which should be set up within the Pool, both at the outset and on an ongoing basis.

Officers from each administering authority will attend JGC meetings (in a non-voting capacity). The officers already work together as the Pensions Sub Group of the SWT (Society of Welsh Treasurers). The formal terms of reference of this officer group will be revised in light of the new pooling arrangements. The officers will advise the JGC on the establishment and monitoring of the various sub-funds as well as liaise directly with the operator on any day-to-day investment matters.

In the first instance, it is anticipated that the fund representatives on the JGC will report back to their respective individual funds' Pensions committees who will be responsible for satisfying themselves as to the effectiveness of the pooling arrangements overall and the operation of the JGC. However, the local Pensions Boards may also seek reassurance on aspects of the management of the funds' investments.

External scrutiny and formal due diligence of the operator and depositary will also be carried out by the FCA in their role as regulator.

The operator will be responsible for selecting and contracting with investment managers for each of the sub-funds as well as appointing other service providers such as depositary asset servicer, and an external valuer as necessary.

We anticipate at this stage that listed bonds and equities are likely to be invested through a UK based Authorised Contractual Scheme (ACS) in order to benefit from the tax transparent nature of the vehicle, though we will discuss this issue with the appointed operator. It may be that alternative vehicles are more appropriate for some other asset classes. As well as considering the options with the operator, we will also take external advice on the final proposed approach from a tax efficiency and legal compliance basis.

Under the proposed structure, the depository will hold legal title to the assets of the Pool. The operator will be responsible for managing and operating the Pool, including entering into the legal contracts with the investment managers.

The appointed operator will provide and operate a range of investment vehicles to allow collective investment by the participating funds.

The operator will be responsible for selecting and contracting with investment managers for the management of the underlying assets. They will also be responsible for administration in relation to the vehicles in terms of unit pricing, valuation, handling cash flows in and out of the various sub-funds, trade processing and reporting on performance.

They will be responsible for due diligence from an audit, legal and tax perspective for the respective sub-funds and also for electing a depositary to the Pool.
The Pool will also procure independent external legal and tax advice as necessary to support them in their relationship with the operator.

**5. How social, environmental or corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments**

It is recognised that ESG factors can influence long term investment performance and the ability to achieve long term sustainable returns. The Committee consider the Fund's approach to responsible investment in two key areas:

- **Sustainable investment / ESG factors** – considering the financial impact of environmental, social and governance (ESG) factors on its investments.

- **Stewardship and governance** – acting as responsible and active investors/owners, through considered voting of shares, and engaging with investee company management as part of the investment process.

At the present time the Committee does not take into account non-financial factors when selecting, retaining, or realising its investments. The Committee understand the Fund is not able to exclude investments in order to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

To date, the Fund's approach to Social investments has largely been to delegate this to their underlying investment managers as part of their overall ESG duties. The Fund's managers report on this matter as part of the Fund's annual ESG review.

The Fund does not hold any assets which it deems to be social investments.

**The exercise of rights (including voting rights) attaching to investments**

**Voting rights**

The Committee has delegated the exercise of voting rights to the investment manager(s) on the basis that voting power will be exercised by them with the objective of preserving and enhancing long term shareholder value. Accordingly, the Fund's managers have produced written guidelines of their process and practice in this regard. The managers are strongly encouraged to vote in line with their guidelines in respect of all resolutions at annual and extraordinary general meetings of companies under Regulation 7(2)(f).

**Stewardship**

The Committee has agreed in principle to become signatories to the Stewardship Code as published by the Financial Reporting Council. The Committee expects both the WALES Pool and any directly appointed fund managers to also comply with the Stewardship Code.

The Fund believes in collective engagement and is a member of the Local Authority Pension Fund Forum (LAPFF), through which it collectively exercises a voice across a range of corporate governance issues.