



# Complete Agenda

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

Meeting

**PENSIONS COMMITTEE**

Date and Time

**2.00 pm, WEDNESDAY, 18TH MARCH, 2020**

Location

**Siambr Hywel Dda - Swyddfeydd y Cyngor, Caernarfon**

Contact Point

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(DISTRIBUTED 11/03/20)

## **PENSIONS COMMITTEE**

### **MEMBERSHIP (7)**

#### **Plaid Cymru (4)**

Councillors

Aled Wyn Jones  
Ioan Thomas

Peredur Jenkins

Peter Read

#### **Independent (2)**

Councillors

John Brynmor Hughes

John Pughe Roberts

#### **Individual Member (1)**

Councillor

Stephen W. Churchman

#### **Co-opted Members**

Councillor David Cowans    Conwy Borough County Council

Councillor Robin Williams    Isle of Anglesey County Council

#### **Ex-officio Members**

Chair and Vice-Chair of the Council

# **A G E N D A**

**1. APOLOGIES**

To receive any apologies for absence

**2. DECLARATION OF PERSONAL INTEREST**

To receive any declaration of personal interest

**3. URGENT ITEMS**

To note any items which are urgent business in the opinion of the Chairman so that they may be considered

**4. MINUTES**

4 - 6

The Chairman shall propose that the minutes of the meeting of this committee held on 16<sup>th</sup> of January 2020 to be signed as a true record

**5. INVESTING SURPLUS CASH- 2020/21**

7 - 26

To consider the report of the Investment Manager

**6. FUNDING STRATEGY STATEMENT 2020/21-2023/24**

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To consider the report of the Investment Manager

**7. WALES PENSION PARTNERSHIP UPDATE**

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To consider the report of the Investment Manager

# Agenda Item 4

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## PENSIONS COMMITTEE 16.01.2020

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**Present:** Councillors: John Pughe Roberts (Chair), Stephen Churchman, John Brynmor Hughes, Peredur Jenkins, Peter Read, Ioan Thomas and Robin Williams (Isle of Anglesey Council)

**Officers:-** Dafydd Edwards (Head of Finance), Delyth Wyn Jones-Thomas (Investment Manager), Meirion Jones (Pensions Manager) and Lowri Haf Evans (Democracy Services Officer).

Others invited: Osian Richards (observing – Chair of Pensions Board)

### 1. APOLOGIES

Apologies was received from Councillors David Cowans (Conwy Borough Council) and Aled Wyn Jones

### 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 29 July 2019, as a true record.

### 5. MINUTES OF THE PENSION FUND'S ANNUAL MEETING

Submitted, for information, the minutes of the Pension Fund's annual meeting held on 24 October 2019

### 6. APPROVING THE 2020 / 2021 BUDGET

Submitted, a report by the Investment Manager relating to a request for the Committee to approve the budget for the 2020-2021 financial year, for the Pension Administration Unit and the Investment Unit.

Attention was drawn to some amendments to the budget, along with a request for an increase in the training budget and software costs for the Pensions Administration Unit. Budget amendments of £140,940 were approved and this brought the total budget for the Pensions Administration Unit to £1,015,700 for the 2020/21 financial year. Similarly, attention was drawn to a request to amend the working hours and salary scales of officers who divided their hours between the Gwynedd Pension Fund and Gwynedd Council within the Investment Unit. Budget amendments of £21,240 were approved and

this brought the total budget for the Investment Unit funded by the Pension Fund to £110,460 for the 2020/21 financial year.

In response to a question regarding whether the amendments justified commitments from the fund, it was noted that they were being included as an 'additional resource'.

**RESOLVED to approve the budget for the 2020/21 financial year for the Pension Administration Unit and Investment Unit, including the additional resources.**

## **7. 2019/20 TREASURY MANAGEMENT – MID YEAR REVIEW**

Submitted, for information, a report highlighting the Council's actual Treasury Management activity during the current financial year. It was highlighted that, during the six months between 1 April and 30 September 2019, the Council's borrowing activity had remained within the restrictions originally placed and there were no banks where the Council had deposited money that had failed to repay. It was reiterated that it was estimated that the Council's investment income exceeded the expected income in the 2019/20 budget.

It was explained that a few of the Council's investments were in property and strategic combined equity funds that were externally managed where security and short-term liquidity was less of a consideration. Consequently, the objectives were realised through regular revenue income and long-term price stability.

**RESOLVED to accept the information.**

## **8. CONSULTATION ON THE FUNDING STRATEGY STATEMENT 2020/21 - 2023-24**

The Investment Manager submitted a report requesting the Committee to confirm the assumptions and policies in the draft Funding Strategy Statement before consulting with all employers. The Committee was informed that there was a statutory requirement to review and publish a triennial Funding Strategy Statement by 31.3.2020. As part of the review, the administrative authority must consult with all employers who are a part of the plan, with the fund's actuary and advisers, and with any other persons deemed suitable.

It was explained that the Fund's triennial actuary valuation was in the process of being prepared and the Actuary, Hymans Robertson gave a presentation on the process and results to the Employers at a meeting in Caernarfon on 24/10/2019. It was highlighted that the presumptions had been agreed and the deficit recovery periods for various categories of employers were prudent and consistent with the previous valuation (2016).

The Draft Funding Strategy Statement (prepared by Hymans) was discussed and attention was drawn to some matters - specific reference was made to section 3 of the report.

- Asset share accounts - it was highlighted that the Fund had adopted a cash flow method for tracking the assets of individual employers. It was reiterated that there was a need to submit the information every month and that considerations to this additional requirement had been included in the Unit's budget.
- Equity Risk Premium - it was highlighted that as the assumed difference between the expected yields increased, the risk increased and the funding basis became less prudent. It was noted that the anticipated surplus yield from the equity assumptions for 2019 was 1.7%.
- Deficit Recovery Periods had been introduced for the 2019 valuation.

- Deficit Collection - the deficit would be collected as a salary percentage, rather than as an annual share (which was being paid in 12 monthly part-payments)
- Established Employer - every established employer had to pay a basic rate as a minimum over the next three years. Potential variations had been noted in the report.
- Non-established Employers - the contribution rates for employers, that are closed to newcomers, and aim towards cessation, are set equal to employers' basic rates.
- Gradual Period of Contribution Increases - the regulations would allow all employers to increase their contributions gradually - for the 2019 valuation, the increase could be divided across three years

## **RESOLVED**

- **to accept the presumptions and Policies**
- **following the consultation process, to accept the final Funding Strategy Statement (FSS) for adoption by 31 March 2020.**

## **9. EXCLUSION OF PRESS AND PUBLIC**

**RESOLVED** to exclude the press and public from the meeting during the discussion on the following item due to the likely disclosure of exempt information as defined in paragraph 12, Section 4, Schedule 12A, Local Government Act 1972. Although there is public interest in having an understanding of how the pension fund operates, this report regarding proposed rates is shared as a prior warning with the Employers of the Scheme. This information has not been shared within the managerial systems of each of these Employers, and its publication at this point may have an impact on the Employers' interests by undermining their reporting arrangements and financial preparations. On balance, the Monitoring Officer was satisfied that there was no public interest to support the publication of this report.

## **10. PENSION FUND VALUATION RESULTS**

Submitted - the report of the Pensions Manager highlighting the Pension Fund valuation results. It was noted that there had been an improvement in the Fund's position with the budget level increasing from 91% on 31 March 2016 to 108% on 31 March 2019. It was noted that this was very good news.

Attention was drawn to the appendix which contained details of employer contributions. It was noted that all employers who were part of the fund were aware of their individual results and that discussions had taken place with them. It was expressed that the situation was very encouraging.

In response to a question regarding employers' rights to challenge contributions / presumptions, it was noted that the employers had a right to challenge the principles of the Fund as part of the consultation, but it was the fund, with advice and support from the Actuary, Hymans Robertson, that made a decision on the final contributions.

It was proposed that a press statement should be released, when timely to do so, drawing attention to the news.

**RESOLVED to accept the information.**

The meeting commenced at 1.00pm and concluded at 1.35pm.

MEETING: **PENSIONS COMMITTEE**

DATE: **18 MARCH 2020**

TITLE: **INVESTING SURPLUS CASH- 2020/21**

PURPOSE: **To pool the Fund's surplus cash with the cash flow of the Council and to approve the Funding Strategy for this purpose**

AUTHOR: **DELYTH JONES-THOMAS, INVESTMENT MANAGER**

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## **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 for 2020/21, as amended for the purpose of the Pension Fund (which is attached as Appendix A). Gwynedd Council's Statement for 2020 was approved by the full Council on 5<sup>th</sup> March 2020.

## **2. 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.

## **3. 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 the relevant 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 5<sup>th</sup> March 2020 included agreement to continue the pooling arrangement with the Pension Fund, following any request from Pensions Committee.

#### **4. RECOMMENDATIONS**

- 4.1 For this purpose, the Pensions Committee is 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 2020 onwards.
- 4.2 The Pensions Committee is asked to adopt the attached Treasury Management Strategy Statement for 2020/21, as amended for the Gwynedd Pension Fund (Appendix A).



## Treasury Management Strategy Statement 2020/21

### 1. Introduction

- 1.1** Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council 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 financial risk are therefore central to the Council's prudent financial management.
- 1.2** Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Council to approve an investment strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.
- 1.3** In accordance with the WG Guidance, the Council 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, change in the Council's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

### 2. External Context

#### 2.1 Economic background

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate increased to 3.9% while the employment rate was 75.9%, just below recent record-

breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

## 2.2 Credit outlook

Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

## 2.3 Interest rate forecast

The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

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

- 2.4 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 2.00%, and that the Council will not need any new long-term loans in 2020/21.

3. **Local Context – not relevant to the Pension Fund**

4. **Liability benchmark – not relevant to the Pension Fund**

## **5. Borrowing Strategy – not relevant to the Pension Fund**

## **6. Treasury Investment Strategy**

- 6.1** The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £30.9 and £71.2 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 2020/21 at its meeting on 12 March 2020.

Loans to organisation providing local public services and purchases of investment property are not normally considered to be treasury investments, and therefore these are covered separately in Appendix 3.

### **6.2 Objectives**

Both the CIPFA Code and the WG Guidance require the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council'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 Council 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.

### **6.3 Negative interest rates**

If the UK enters into a recession in 2020/21, 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.

## **6.4 Strategy**

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £10m that is available for longer-term investment. The majority of the Council'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.

## **6.5 Business models**

Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

## 6.6 Approved counterparties

The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

**Table 3: Approved investment counterparties and limits**

<b>Credit rating</b>	<b>Banks unsecured</b>	<b>Banks secured</b>	<b>Government</b>	<b>Corporates</b>	<b>Registered Providers</b>
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	5% / £4m 5 years	10% / £8m 20 years	10% / £8m 50 years	5% / £4m 20 years	5% / £4m 20 years
AA+	5% / £4m 5 years	10% / £8m 10 years	10% / £8m 25 years	5% / £4m 10 years	5% / £4m 10 years
AA	5% / £4m 4 years	10% / £8m 5 years	10% / £8m 15 years	5% / £4m 5 years	5% / £4m 10 years
AA-	5% / £4m 3 years	10% / £8m 4 years	10% / £8m 10 years	5% / £4m 4 years	5% / £4m 10 years
A+	5% / £4m 2 years	10% / £8m 3 years	5% / £4m 5 years	5% / £4m 3 years	5% / £4m 5 years
A	5% / £4m 13 months	10% / £8m 2 years	5% / £4m 5 years	5% / £4m 2 years	5% / £4m 5 years
A-	5% / £4m 6 months	10% / £8m 13 months	5% / £4m 5 years	5% / £4m 13 months	5% / £4m 5 years
None	£1m 6 months	n/a	10% / £8m 25 years	£0.5m 5 years	5% / £4m 5 years
<b>Pooled funds and real estate investment trusts</b>		10% / £8m per fund or trust			

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

## 6.7 Credit rating

Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. 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.

## **6.8 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. See below for arrangements relating to operational bank accounts.

## **6.9 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.

## **6.10 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 generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

## **6.11 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 either following an external credit assessment or to a maximum of £1 million per company as part of a diversified pool in order to spread the risk widely.

## **6.12 Registered providers**

Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh

Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

### **6.13 Pooled funds**

Shares or units 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 Council 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 Council's investment objectives will be monitored regularly.

### **6.14 Operational bank accounts**

The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £900,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

### **6.15 Risk assessment and credit ratings**

Credit ratings are obtained and monitored by the Council'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.

#### **6.16 Other information on the security of investments**

The Council 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, reports in the quality financial press and analysis and advice from the Council’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above 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 Council 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 Council’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.

#### **6.17 Investment limits**

The Council’s revenue reserves available to cover investment losses are forecast to be £50 million on 31<sup>st</sup> March 2020. In order that no more than 16% 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**

	<b>Cash limit</b>
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 and registered social landlords	£20m in total
Unsecured investments with building societies	£8m in total
Loans to unrated corporates	£8m in total
Money market funds	£40m in total
Real estate investment trusts	£20m in total

## **6.18 Liquidity management**

The Council uses prudent cash flow forecasting techniques to determine the maximum period for which funds may prudently be committed. The forecast is compiled on the basis that short-term borrowing is used to cover its financial commitments if required. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

## **7. Treasury Management Indicators- not relevant to the Pension Fund**

## **8. Related Matters**

**8.1** The CIPFA Code requires the Council to include the following in its Treasury Management Strategy.

### **8.2 Financial Derivatives**

In the absence of any explicit legal power to do so, the Council 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.

### **8.3 Markets in Financial Instruments Directive**

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Head of Finance believes this to be the most appropriate status.

### **9. Welsh Government Guidance**

Further matter required by the Welsh Government Guidance are included in Appendix 3.

### **10. Financial Implications**

**10.1** The budget for investment income in 2020/21 is £0.6 million based on an average investment portfolio of £30 million at an interest rate of 2.0%. The budget for debt interest paid in 2020/21 is £5.8 million, based on an average debt portfolio of £104.2 million at an average interest rate of 5.54%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

### **11. Other Options Considered**

**11.1** 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 Finance, 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.

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
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 may 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 may 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 may 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 may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

## Appendix 1 – Arlingclose Economic & Interest Rate Forecast November 2019

### Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.
- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.
- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitional period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.
- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.
- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.
- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.
- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

## Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
<b>Official Bank Rate</b>														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.21
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
<b>3-month money market rate</b>														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
<b>1yr money market rate</b>														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.60
<b>5yr gilt yield</b>														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	0.37
Arlingclose Central Case	0.50	0.50	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.57
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.56
<b>10yr gilt yield</b>														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.00	0.88
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.45
<b>20yr gilt yield</b>														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45
<b>50yr gilt yield</b>														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%

PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

## Appendix 2- Existing Investment & Debt Portfolio Position

	31.12.2019 Actual Portfolio £m	31.12.2019 Average Rate %
<b>External Borrowing:</b>		
Public Works Loan Board	88.2	5.91
Other loans	16.2	4.22
<b>Total external borrowing</b>	<b>104.4</b>	<b>5.65</b>
<b>Other long- term liabilities:</b>		
Leases	1.7	0.0
<b>Total other long-term liabilities</b>	<b>1.7</b>	<b>0.0</b>
<b>Total gross external debt</b>	<b>106.1</b>	<b>5.65</b>
<b>Treasury investments:</b>		
Banks and Building societies (unsecured)	7.3	0.77
Government (incl. Local authorities)	5.5	0.82
Money Market Fund	21.5	0.72
Pooled funds	10.0	3.46
<b>Total treasure investments</b>	<b>44.3</b>	<b>1.36</b>
<b>Net debt</b>	<b>61.8</b>	

## Appendix 3 – Additional requirements of Welsh Government Investment Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this Council's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

**Contribution:** The Council's investments contribute to its service delivery objectives and/or to promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans to local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the Council, and
- investment property provides a net financial surplus that is reinvested into local public services.

**Climate change:** The Council's investment decisions consider long-term climate risks to support a low carbon economy to the extent that if a low carbon investment equivalent is available with the same return, then the low carbon investment would be preferred by the Council.

**Specified investments:** The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- 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 Council defines "high credit quality" organisations and securities 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.

**Loans: Not relevant to the Pension Fund**

**Non-specified investments:** Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in table 3b; the Council confirms that its current non-specified investments remain within these limits.



Table 3b: Non-specified investment limits

	Cash limit
Units in pooled funds without credit ratings or rated below A-	£20m
Shares in real estate investment trusts	£10m
Total non-specified investments	£30m

**Non-financial investments:** This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. On an assessment as at 31<sup>st</sup> March 2019, the Council consider that the scale of its non- financial investments as not significant.

**Liquidity:** For financial investments that are not treasury management investments, or loans, the Council has procedures in place to ensure that the funds are prudently committed for a maximum period of time.

**Investment advisers:** The Council 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.

**Borrow in advance of need: Not relevant to the Pension Fund**

**Commercial deals:** In the event of a commercial deal, the individuals making the deal are aware of the core principles of the prudential framework and of the regulatory regime within which the Council operates.

**Capacity, skills and corporate governance:** Elected members and officers were invited to a presentation by Arlingclose on 15<sup>th</sup> January 2020. The information and discussion at the presentation ensures that the members have the appropriate skills and information to enable them to:

- Take informed decisions as to whether to enter into a specific investment.
- To assess individual assessments in the context of the strategic objectives and risk profile of the Council
- Understand how the quantum of these decisions have changed the overall risk exposure of the local authority

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



MEETING:	<b>PENSION COMMITTEE</b>
DATE:	<b>18 MARCH 2020</b>
TITLE:	<b>FUNDING STRATEGY STATEMENT 2020/21-2023/24</b>
PURPOSE:	<b>To adopt the Funding Strategy Statement following consultation</b>
RECOMMENDATION:	<b>ADOPT THE STATEMENT</b>
AUTHOR:	<b>DELYTH JONES-THOMAS, INVESTMENT MANAGER</b>

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## **1. INTRODUCTION**

As reported to the Committee meeting on 16 January 2020, the Fund is required to issue a Funding Strategy Statement. This was presented and agreed at the January committee and was sent out for consultation with interested parties.

## **2. RESPONSE**

All participating employers, the actuary and fund advisers have been consulted.

No formal response to the consultation was received, but we understand that the employers of the Fund are satisfied with the strategy and their contributions level further to this.

## **3. FINAL FUNDING STRATEGY STATEMENT**

The final Funding Strategy Statement is attached as Appendix A. There are no changes from the version that was submitted to the Committee on 16 January 2020.

## **4. RECOMMENDATION**

The Committee is asked to adopt the Funding Strategy Statement .

## **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 12<sup>th</sup> March 2020.

##### **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 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, in what circumstances you might need to pay more and what happens if you cease to be an employer in the Fund. 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 Delyth Jones-Thomas, Investment Manager in the first instance at her e-mail address [delythwynjonesthomas@gwynedd.llyw.cymru](mailto:delythwynjonesthomas@gwynedd.llyw.cymru).

## 2 Basic Funding issues

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

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

In essence this is a three-step process:

1. Calculate the funding target for that employer, i.e. the estimated 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 likelihood of achieving that funding target over that time horizon, allowing for 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 an allowance for 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 is in respect of benefits already accrued at the valuation date. 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: 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 calculated 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). 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 the period over which the funding target is achieved. 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 **likelihood 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, then the required likelihood 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 funding level 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 funding level and deficit/surplus 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, funding levels and deficits are short term, high level risk 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 likelihood 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 time horizon relative to other employers, and/or a higher likelihood of achieving the target may be required.

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

## **2.7 What approach has the Fund taken to dealing with uncertainty arising from the McCloud court case and its potential impact on the LGPS benefit structure?**

The LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The courts have ruled that the 'transitional protections' awarded to some members of public service pension schemes when the schemes were reformed (on 1 April 2014 in the case of the LGPS) were unlawful on the grounds of age discrimination. At the time of writing, the Ministry of Housing, Communities and Local Government (MHCLG) has not provided any details of

changes as a result of the case. However it is expected that benefits changes will be required and they will likely increase the value of liabilities. At present, the scale and nature of any increase in liabilities are unknown, which limits the ability of the Fund to make an accurate allowance.

[The LGPS Scheme Advisory Board \(SAB\) issued advice to LGPS funds in May 2019](#). As there was no finalised outcome of the McCloud case by 31 August 2019, the Fund Actuary has acted in line with SAB's advice and valued all member benefits in line with the current LGPS Regulations.

The Fund, in line with the advice in the SAB's note, has considered how to allow for this risk in the setting of employer contribution rates. As the benefit structure changes arising from the McCloud judgement are uncertain, the Fund has elected to make an approximate allowance by increasing the required likelihood of success set for contribution rates for all employers.

Once the outcome of the McCloud case is known, the Fund may revisit the contribution rates set to ensure they remain appropriate.

The Fund has also considered the McCloud judgement in its approach to cessation valuations. Please see note (j) to table 3.3 for further information.

## **2.8 When will the next actuarial valuation be?**

On 8 May 2019 MHCLG issued a [consultation](#) seeking views on (among other things) proposals to amend the LGPS valuation cycle in England and Wales from a three year (triennial) valuation cycle to a four year (quadrennial) valuation cycle.

On 7 October 2019 MHCLG confirmed the next LGPS valuation cycle in England and Wales will be 31 March 2022, regardless of the ongoing consultation. The Fund therefore instructed the Fund Actuary to certify contribution rates for employers for the period 1 April 2020 to 31 March 2023 as part of the 2019 valuation of the Fund.

### **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 likelihood is required to reach that funding target? This will always be less than 100% as we cannot be certain of the future. Higher likelihood "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 reserves the right to 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 likelihood 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 result in a lower level of future investment returns on the employer's asset share. 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		Colleges, Community Admission Bodies and Designating Employers		Transferee Admission Bodies*
Sub-type	Local Authorities, Police and Parc Cenedlaethol Eryri	Town and Parish Councils	Open to new entrants	Closed to new entrants	(all)
Funding Target Basis used	Ongoing participation basis, assumes long-term Fund participation (see Appendix E)		Ongoing participation basis, but may move to "gilts basis" - see Note (a)		Contractor exit basis, 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)	17 years	17 years	14 years	Future working lifetime	Outstanding contract term
Secondary rate – Note (d)	Percentage of pay				
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
Likelihood of achieving target – Note (e)	70%	75%	75%	75%	75%
Phasing of contribution changes**	Reductions will apply in full from 2020/21. Increases will be phased in over 3 years.				
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: exit debt/credit 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).		Colleges aside, can be ceased subject to terms of admission agreement. Exit debt/credit 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/credit calculated on the contractor exit basis, unless the admission agreement is terminated early by the contractor in which case the low risk exit basis would apply. Letting employer is liable for future deficits and contributions arising.

\* Where the Administering Authority recognises a fixed contribution rate agreement between a letting authority and a contractor, the certified employer contribution rate will be derived in line with the methodology specified in the risk sharing agreement. Additionally, in these cases, upon cessation the contractor's assets and liabilities will transfer back to the letting employer with no crystallisation of any deficit or surplus. Further detail on fixed contribution rate agreements is set out in [note \(i\)](#).

\*\* Changes to contribution rates for the non-stabilised open employers (other than Transferee Admission Bodies) are subject to a phasing mechanism. This works by calculating the difference in total rates at 2016 and 2019 before application of the mechanism, and then restricting the subsequent increase or reduction as follows: a) if the difference is 5.0% or less of pay, the rate will change by the full difference, or b) if the difference is more than 5.0% of pay, then the rate will change by 5.0% plus half of the difference above 5.0%. The contribution rates for employers that are closed to new entrants, and are heading towards cessation, have been set equal to the employers' primary rates

### **Note (a) (Gilts exit 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. based on the return for long-term 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 2019 valuation exercise (see [Section 4](#)), it has been agreed all stabilised employers must pay their primary rate as a minimum over the next three years, with the reduction in total rate subject to a limit that depends on the 2019 funding level (i.e. a limit of 1.0% of pay if between 100% and 104%, 1.5% of pay if between 105% and 119%, and 2.0% of pay if 120% or above). The stabilised details thereafter are as follows:

Type of employer	Councils, Police and Parc Cenedlaethol Eryri
Max cont rate increase in each future year	1.0% of pay
Max cont rate decrease in each future year	1.0% of pay

The stabilisation criteria and limits will be reviewed at the next formal valuation. 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 2020 for the 2019 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 percentage of pay for all employers.

**Note (e) (Likelihood 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 likelihood. A higher required likelihood 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 likelihoods are set for different employers depending on their nature and circumstances: in broad terms, a higher likelihood 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 greater than expected rise in liabilities;
- 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 (or entitled to any surplus) 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 throughout its participation in the Fund and does not pay any deficit or receive an exit credit. In other words, the pension risks “pass through” to the letting employer.

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. Alternatively, letting employers and Transferee Admission Bodies may operate any of the above options by entering into a separate Side Agreement. The Administering Authority would not necessarily be a party to this side agreement, but may treat the Admission Agreement as if it incorporates the side agreement terms where this is permitted by legislation or alternatively agreed by all parties.

Any risk sharing 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 following the LGPS (Amendment) Regulations 2018 which came into effect on 14<sup>th</sup> May 2018, this will normally result in an exit credit payment to the Admission Body. If a risk-sharing agreement has been put in place (please see [note \(i\)](#) above) no cessation debt or exit credit may be payable, depending on the terms of the agreement.

As discussed in Section 2.7, the LGPS benefit structure from 1 April 2014 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The Fund has considered how it will reflect the current uncertainty regarding the outcome of this judgement in its approach to cessation valuations. For cessation valuations that are carried out before any changes to the LGPS benefit structure (from 1 April 2014) are confirmed, the Fund's policy is that the actuary will review the profile of the ceasing membership and, if material, may apply a loading to the ceasing employer's post 2014 benefit accrual value, as an estimate of the possible impact of resulting benefit changes.

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 surplus/deficit will normally be calculated using a “gilts exit basis”, which is more prudent than the ongoing participation 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 participation 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 or surplus. 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 may 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 on the gilts exit basis, and would carry out the cessation valuation on the ongoing participation basis: Secondary contributions would be derived from this cessation debt. This approach would be monitored as part of each formal valuation and secondary contributions would be reassessed as required. The Admission Body may terminate the agreement only via payment of the outstanding debt assessed on the gilts exit basis. Furthermore, 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 Admission 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 Administering Authority has arranged for an external insurance policy to cover ill health early retirement strains for smaller employers in the Fund. Each of these employer's contributions to the Fund includes its share of that year's insurance premium. When an active member retires on ill health early retirement, the claim amount received from the insurer will be credited to the respective employer's asset share in the Fund.

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 or receive an exit credit 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 and a cessation deficit 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**

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 Investment Strategy Statement, 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 actuary's assumptions for future investment returns (described further in Appendix E) are based on the current benchmark investment strategy of the Fund. The future investment return assumptions underlying each of the fund's three funding bases include a margin for prudence, and are therefore 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](#)).

In the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility in asset values. However, the actuary takes a long term view when assessing employer contribution rates and the contribution rate setting methodology takes into account this potential variability.

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



## **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 MHCLG 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 MHCLG 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, MHCLG 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.

MHCLG 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 Ministry of Housing, Communities and Local Government (MHCLG) 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 2020 for comment;
- b) Comments were requested within 42 days;
- c) There was an Employers Forum on 24 October 2019 at which the funding strategy was outlined and 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 <https://www.gwynedd-pensionfund.org.uk/en/Investments/Funding-Strategy-Statement.aspx>;
- 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 (which may move to every four years in future – see Section 2.8). This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation.

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 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](http://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 Investment Strategy Statement (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 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 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 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 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. MHCLG (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 and contribution rates over the long-term.	<p>Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing.</p> <p>Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.</p> <p>Analyse progress at three yearly valuations for all employers.</p> <p>Inter-valuation roll-forward of liabilities between valuations at whole Fund level.</p>
Inappropriate long-term investment strategy.	<p>Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes.</p> <p>Chosen option considered to provide the best balance.</p>
Active investment manager under-performance relative to benchmark.	<p>Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.</p>
Pay and price inflation significantly more than anticipated.	<p>The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.</p> <p>Inter-valuation monitoring, as above, gives early warning.</p> <p>Some investment in bonds also helps to mitigate this risk.</p>

<b>Risk</b>	<b>Summary of Control Mechanisms</b>
	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.  If it occurs, the Actuary calculates the added cost spread pro-rata among all employers.
Effect of possible asset underperformance as a result of climate change	The Fund invests its assets in line with Responsible Investment beliefs and guidelines.

### **C3 Demographic risks**

<b>Risk</b>	<b>Summary of Control Mechanisms</b>
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy.  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 decision.  Employer ill health retirement experience is monitored, and an ill-health insurance policy is in place for smaller employers.



Risk	Summary of Control Mechanisms
<p>Reductions in payroll causing insufficient deficit recovery payments</p>	<p>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:</p> <p>Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases (see <u>Note (b) to 3.3</u>).</p> <p>For other employers, review of contributions is permitted in general between valuations (see <u>Note (f) to 3.3</u>).</p>

#### C4 Regulatory risks

Risk	Summary of Control Mechanisms
<p>Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform.</p>	<p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>The Administering Authority is monitoring the progress on the McCloud court case and will consider an interim valuation or other appropriate action once more information is known.</p> <p>The government's long term preferred solution to GMP indexation and equalisation - conversion of GMPs to scheme benefits - was built into the 2019 valuation.</p>
<p>Time, cost and/or reputational risks associated with any MHCLG intervention triggered by the Section 13 analysis (see <u>Section 5</u>).</p>	<p>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.</p>
<p>Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies.</p>	<p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.</p>

## C5 Governance risks

Risk	Summary of Control Mechanisms
<p>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.</p>	<p>The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.</p> <p>The Actuary may revise the rates and Adjustments certificate to increase an employer's contributions between triennial valuations</p> <p>Deficit contributions may be expressed as monetary amounts.</p>
<p>Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way</p>	<p>The Administering Authority maintains close contact with its specialist advisers.</p> <p>Advice is delivered via formal meetings involving Elected Members, and recorded appropriately.</p> <p>Actuarial advice is subject to professional requirements such as peer review.</p>
<p>Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.</p>	<p>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.</p> <p>Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.</p>
<p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p>	<p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.</p> <p>The risk is mitigated by:</p> <p>Seeking a funding guarantee from another scheme employer, or external body, wherever possible (see <u>Notes (h) and (i) to 3.3</u>).</p> <p>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</p> <p>Vetting prospective employers before admission.</p>

Risk	Summary of Control Mechanisms
	<p>Where permitted under the regulations requiring a bond to protect the Fund from various risks.</p> <p>Requiring new Community Admission Bodies to have a guarantor.</p> <p>Reviewing bond or guarantor arrangements at regular intervals (see <u>Note (f) to 3.3</u>).</p> <p>Reviewing contributions well ahead of cessation if thought appropriate (see <u>Note (a) to 3.3</u>).</p>
<p>An employer ceasing to exist resulting in an exit credit being payable</p>	<p>The Administering Authority regularly monitors admission bodies coming up to cessation</p> <p>The Administering Authority invests in liquid assets to ensure that exit credits can be paid when required.</p>

## 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.

As discussed in Section 2, the actuary calculates the required contribution rate for each employer using a three-step process:

- Calculate the funding target for that employer, i.e. the estimated 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;
- 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;
- Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon, allowing for various possible economic outcomes over that time horizon. See the table in 3.3 and Note (e) for more details.

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 assets, liabilities and membership. The whole Fund position, including that used in reporting to MHCLG (see section 5), is calculated in effect as the sum of all the individual employer rates. MHCLG 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 likelihood, 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 (the "Economic Scenario Service") 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. Further information about this model is included in [Appendix E](#). The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

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 Fund aims for the employer to have assets sufficient to meet 100% of its accrued liabilities at the end of its funding time horizon based on the employer's funding target assumptions (see [Appendix E](#)).

The Secondary rate is calculated as the balance over and above the Primary rate, such that the total contribution rate 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. at the end of the determined time horizon (see [3.3 Note \(c\)](#) for further details)
3. with a sufficiently high likelihood, 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 (the "Economic Scenario Service") 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. Further information about this model is included in [Appendix E](#). The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

### **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 at the end of the time horizon;
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 likelihood of achieving the funding target.

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

The Administering Authority does not operate separate bank accounts or investment mandates for each employer. Therefore it cannot account for each employer's assets separately. Instead, the Fund Actuary must apportion the assets of the whole Fund between the individual employers. There are broadly two ways to do this:

- 1) A technique known as "analysis of surplus" in which the Fund actuary estimates the surplus/deficit of an employer at the current valuation date by analysing movements in the surplus/deficit from the previous actuarial valuation date. The estimated surplus/deficit is compared to the employer's liability value to calculate the employer's asset value. The actuary will quantify the impact of investment, membership and other experience to analyse the movement in the surplus/deficit. This technique makes a number of simplifying assumptions due to the unavailability of certain items of information. This leads to a balancing, or miscellaneous, item in the analysis of surplus, which is split between employers in proportion to their asset shares.
- 2) A 'cashflow approach' in which an employer's assets are tracked over time allowing for cashflows paid in (contributions, transfers in etc.), cashflows paid out (benefit payments, transfers out etc.) and investment returns on the employer's assets.

Until 31 March 2016 the Administering Authority used the 'analysis of surplus' approach to apportion the Fund's assets between individual employers.

Since then, the Fund has adopted a cashflow approach for tracking individual employer assets.

The Fund Actuary tracks employer assets on an annual basis. Starting with each employer's assets from the previous year end, cashflows paid in/out and investment returns achieved on the Fund's assets over the course of the year are added to calculate an asset value at the year end. The approach has some simplifying assumptions in that all cashflows and investment returns are assumed to have occurred uniformly over the course of the year. As the actual timing of cashflows and investment returns are not allowed for, the sum of all employers' asset values will deviate from the whole fund asset total over time (the deviation is expected to be minor). The difference is split between employers in proportion to their asset shares at each triennial valuation.

**D6 How does the Fund adjust employer asset shares when an individual member moves from one employer in the Fund to another?**

Under the cashflow approach for tracking employer asset shares, the Fund has allowed for any individual members transferring from one employer in the Fund to another, via the transfer of a sum from the ceding employer's asset share to the receiving employer's asset share. This sum is equal to the member's Cash Equivalent Transfer Value (CETV) as advised by the Fund's administrators.

## **Appendix E – Actuarial assumptions**

### **E1 What are the actuarial assumptions used to calculate employer contribution rates?**

These are expectations of future experience used to place a value on future benefit payments (“the liabilities”) and future asset values. 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.

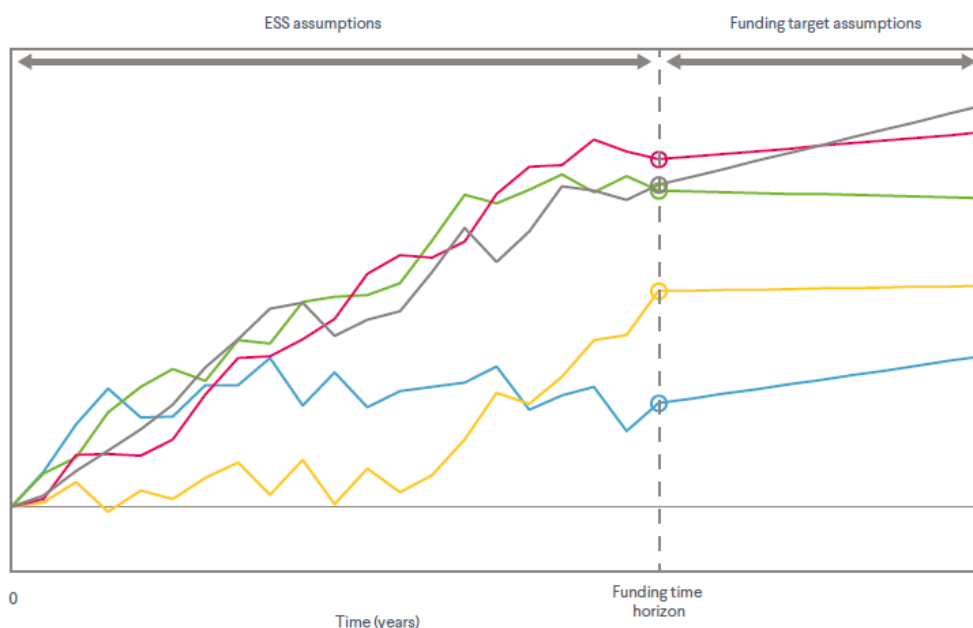
Changes in assumptions will affect the funding target and required contribution rate. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The actuary’s approach to calculating employer contribution rates involves the projection of each employer’s future benefit payments, contributions and investment returns into the future under 5,000 possible economic scenarios. Future inflation (and therefore benefit payments) and investment returns for each asset class (and therefore employer asset values) are variables in the projections. By projecting the evolution of an employer’s assets and benefit payments 5,000 times, a contribution rate can be set that results in a sufficient number of these future projections (determined by the employer’s required likelihood) being successful at the end of the employer’s time horizon. In this context, a successful contribution rate is one which results in the employer having met its funding target at the end of the time horizon.

Setting employer contribution rates therefore requires two types of assumptions to be made about the future:

1. Assumptions to project the employer’s assets, benefits and cashflows to the end of the funding time horizon. For this purpose the actuary uses Hymans Robertson’s proprietary stochastic economic model - the Economic Scenario Service (“ESS”).
2. Assumptions to assess whether, for a given projection, the funding target is satisfied at the end of the time horizon. For this purpose, the Fund has three different funding bases.





Details on the ESS assumptions and funding target assumptions are included below (in E2 and E3 respectively).

## E2 What assumptions are used in the ESS?

The actuary uses Hymans Robertson's ESS model to project a range of possible outcomes for the future behaviour of asset returns and economic variables. With this type of modelling, there is no single figure for an assumption about future inflation or investment returns. Instead, there is a range of what future inflation or returns will be which leads to likelihoods of the assumption being higher or lower than a certain value.

The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2019. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the simulated yields at that time horizon.

		Annualised total returns							RPI inflation expectation	17 year real govt bond yield	17 year govt bond yield
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Overseas Equity	Property	A rated corporate bonds (medium)			
5 years	16th %'ile	-0.4%	-2.3%	-2.9%	-4.1%	-4.1%	-3.5%	-2.7%	1.9%	-2.5%	0.8%
	50th %'ile	0.7%	0.5%	0.3%	4.0%	4.1%	2.4%	0.8%	3.3%	-1.7%	2.1%
	84th %'ile	2.0%	3.3%	3.4%	12.7%	12.5%	8.8%	4.0%	4.9%	-0.8%	3.6%
10 years	16th %'ile	-0.2%	-1.8%	-1.3%	-1.5%	-1.4%	-1.5%	-0.9%	1.9%	-2.0%	1.2%
	50th %'ile	1.3%	0.0%	0.2%	4.6%	4.7%	3.1%	0.8%	3.3%	-0.8%	2.8%
	84th %'ile	2.9%	1.9%	1.7%	10.9%	10.8%	7.8%	2.5%	4.9%	0.4%	4.8%
20 years	16th %'ile	0.7%	-1.1%	0.1%	1.2%	1.3%	0.6%	0.7%	2.0%	-0.7%	2.2%
	50th %'ile	2.4%	0.3%	1.0%	5.7%	5.8%	4.3%	1.9%	3.2%	0.8%	4.0%
	84th %'ile	4.5%	2.0%	2.0%	10.3%	10.4%	8.1%	3.0%	4.7%	2.2%	6.3%
<b>Volatility (Disp) (1 yr)</b>		1%	7%	10%	17%	17%	14%	11%	1%		

### **E3 What assumptions are used in the funding target?**

At the end of an employer's funding time horizon, an assessment will be made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). Valuing the cost of future benefits requires the actuary to make assumptions about the following financial factors:

- Benefit increases and CARE revaluation
- Salary growth
- Investment returns (the “discount rate”)

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is unlikely to be appropriate for every projection. For example, a high assumed future investment return (discount rate) would not be prudent in projections with a weak outlook for economic growth. Therefore, instead of using a fixed value for each assumption, the actuary references economic indicators to ensure the assumptions remain appropriate for the prevailing economic environment in each projection. The economic indicators the actuary uses are: future inflation expectations and the prevailing risk free rate of return (the yield on long term UK government bonds is used as a proxy for this rate).

The Fund has three funding bases which will apply to different employers depending on their type. Each funding basis has a different assumption for future investment returns when determining the employer's funding target.

### **E4 What other assumptions apply?**

The following assumptions are those of the most significance used in both the projection of the assets, benefits and cashflows and in the funding target.

#### **a) Salary growth**

After discussion with the Fund officers the salary increase assumption at the 2019 valuation has been set to be a blended rate combined of:

1. 2% p.a. until 31 March 2022, 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 + 0.3% p.a.

This is a change from the previous valuation, which assumed an assumption of 1% p.a. 2020, and CPI plus 0.5% p.a. thereafter. This was equivalent to a single assumption of CPI.

The change has led to an increase in the funding target (all other things being equal).

#### **b) 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.

At this valuation, we have used a reduction of 1.0% per annum (Note that the reduction is applied on a geometric, not arithmetic, basis).

**c) 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.

Allowance has been made in the ongoing valuation basis for future improvements in line with the 2018 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 updated allowance for future improvements will generally result in lower life expectancy assumptions and hence a reduced funding target (all other things being equal).

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.

**d) General**

The same financial assumptions are adopted for most employers (on the ongoing participation basis identified above), 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

<b>Funding basis</b>	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of <b>the funding target at the end of the employer’s time horizon</b> . The main assumptions will relate to the <b>level of future investment returns</b> , salary growth, pension increases and longevity. More prudent assumptions will give a higher funding target, whereas more optimistic assumptions will give a lower funding target.
<b>Administering Authority</b>	The council with statutory responsibility for running the Fund, in effect the Fund’s “trustees”.
<b>Admission Bodies</b>	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 <a href="#">2.3</a> ).
<b>Covenant</b>	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.
<b>Designating Employer</b>	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.
<b>Employer</b>	An individual participating body in the Fund, which employs (or used to employ) <b>members</b> of the Fund. Normally the assets and <b>funding target</b> values for each employer are individually tracked, together with its <b>Primary rate</b> at each <b>valuation</b> .
<b>Gilt</b>	A UK Government bond, i.e. 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 are also used in funding as an objective measure of a risk-free rate of return.
<b>Guarantee / guarantor</b>	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 <b>covenant</b> to be as strong as its guarantor’s.
<b>Letting employer</b>	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.

<b>LGPS</b>	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 100 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.
<b>Maturity</b>	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.
<b>Members</b>	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).
<b>Primary contribution rate</b>	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.
<b>Profile</b>	The profile of an employer's membership or liability reflects various measurements of that employer's <b>members</b> , 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 <b>maturity</b> also.
<b>Rates and Adjustments Certificate</b>	A formal document required by the LGPS Regulations, which must be updated at the conclusion of the formal <b>valuation</b> . This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the period until the next valuation is completed.
<b>Scheduled Bodies</b>	Types of employer explicitly defined in the LGPS Regulations, whose employees 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).

<b>Secondary contribution rate</b>	The difference between the employer's actual and <b>Primary contribution rates</b> . See <a href="#">Appendix D</a> for further details.
<b>Stabilisation</b>	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.
<b>Valuation</b>	A risk management exercise to review <b>Primary and Secondary contribution rates</b> , and other statutory information for a Fund, and usually individual employers too.

# Agenda Item 7

MEETING:	<b>PENSIONS COMMITTEE</b>
DATE :	<b>18 MARCH 2020</b>
TITLE:	<b>WALES PENSION PARTNERSHIP UPDATE</b>
PURPOSE:	<b>TO INFORM THE COMMITTEE OF THE WALES PENSION PARTNERSHIP ACTIVITIES</b>
RECOMMENDATION:	<b>NOTE THE INFORMATION</b>
AUTHOR:	<b>DELYTH JONES-THOMAS, INVESTMENT MANAGER</b>

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## 1. Introduction

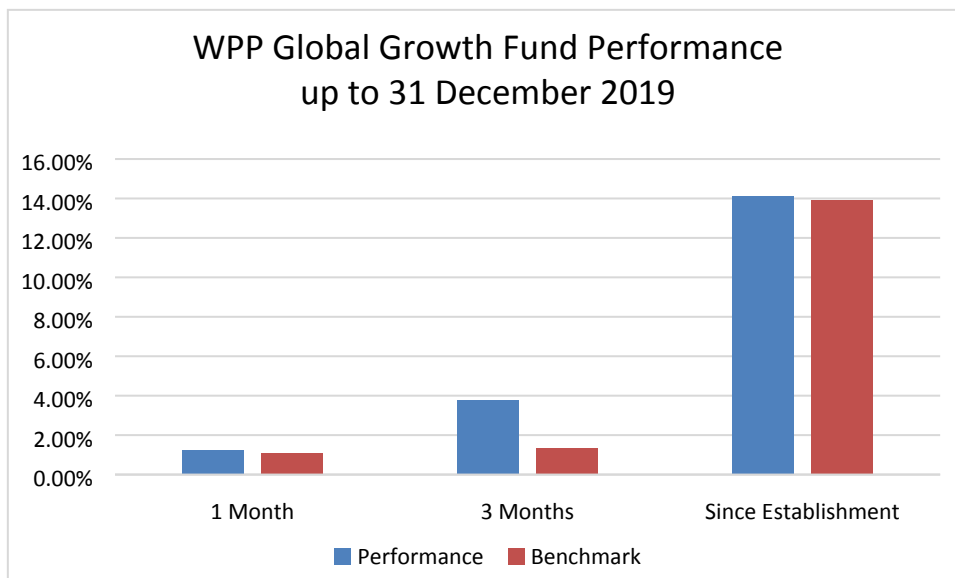
The collaboration has been going from strength to strength since its establishment in 2017 with officers meeting frequently. Performance to date has been at a high standard and a number of developments are underway and therefore, this paper updates the Committee on the situation.

## 2. Performance

£606.2M of equity fund investments was transferred to the WPP in February 2019, with the amount divided equally into the following two funds:

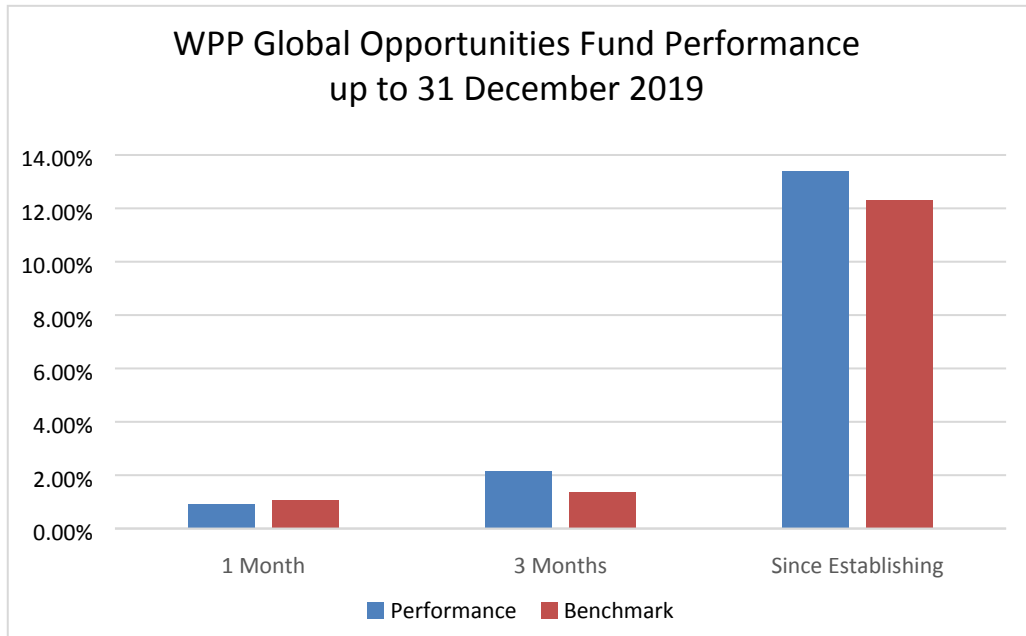
- **Global Growth Fund** (Baillie Gifford, Veritas and Pzena)
- **Global Opportunities Fund** (Morgan Stanley, Numeric, Sanders, Jacobs Levy, SW Mitchell, NWG and Oaktree)

### Global Growth Fund



Performance is 0.23% higher than the benchmark since establishment with a strong performance from Baillie Gifford in particular.

## Global Opportunities Fund



Performance is 1.08% higher than the benchmark with a strong performance from Morgan Stanley, Sanders and SW Mitchel in particular.

### 3. Fixed Income Transfer

In April 2020, our current investment with Fidelity (Global equity) and Insight (Bonds) will be transferred to the following two Fixed Income fund:

- **Multi Asset Credit Fund**

£161.6M (value as at 31/12/19) from Fidelity will be transferred to this fund

- **Absolute Return Fund**

£292.0M (value as at 31/12/19) from Insight will be transferred to this fund

### 4. Developments

#### 4.1 Emerging Markets

Following the Fixed Income transfer in April, the next transfer that will take place is Emerging Markets- work is underway at the moment to determine the ideal investment management structure for this new fund.

The Gwynedd fund will move our Emerging Markets share from Fidelity to this fund.



#### 4.2 Private Markets

A group has been established that looks at the options of pooling assets into this category. The group meets regularly in order to establish the requirements of each fund.

#### 4.3 Low Carbon Investments

Russell Investments is aware of the importance of responsible investments with environmental, social and governmental requirements, and is therefore looking for ways to meet these needs when developing the form and management of PPC funds.

#### 4.4 Representation of Pension Boards on the Joint Partnership Committee

The Joint Governance Committee consists of one elected member nominated by each of the constituent authorities, who is the chair of the pensions committee of that constituent authority. The nominated representatives from the eight pension boards in Wales meet every six months on an engagement day with the host authority (Carmarthenshire County Council), WPP Operator and some officers from the constituent authorities. Two meetings have already been held and the feedback has been very positive and constructive. The next engagement meeting will be on the 2nd of April.

It is expected that the 12th March Joint Governance Committee will examine whether these arrangements are still appropriate and see if it is possible to improve the governance arrangements.

#### 4.5 Joint Governance Committee

The Chairman and Vice Chairman of the Pension Committee, along with the Head of Finance will attend the Joint Governance Committee on 12th March and a verbal update can be given on any developments and decisions.

### **5. Recommendation**

Further to the presentation of Link and Russell's representatives to the previous Gwynedd Pensions Committee meeting, the Committee is asked to note this update.