

## FUNDING STRATEGY STATEMENT

### Report of the Director of Finance and Public Value

---

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

---

#### **1) Recommendation**

That the Committee be asked to:

- (a) Note the responses to the consultation with employers and the comments from the Pension Board.
- (b) Approve the revised Funding Strategy Statement set out at Appendix 1 to this report.

#### **2) Introduction**

- 2.1 The Local Government Pension Scheme (LGPS) Regulations 2013 require all LGPS Administering Authorities to prepare a Funding Strategy Statement (FSS) in consultation with all employers participating in their respective Fund.
- 2.2 Following completion of the 2022 Actuarial Valuation, a revised FSS has been drafted in conjunction with the Fund Actuary (Barnett Waddingham). The document is set out at Appendix 1. The document has been revised in order to reflect updated regulations, practice and actuarial assumptions.

#### **3) Revised Funding Strategy Statement**

- 3.1 The purpose of the FSS is to explain the funding objectives of the Fund and how the cost of the benefits provided under the Local Government Pension Scheme are met through the Fund. It also defines the objectives in setting employer contribution rates and the funding strategy that is adopted to meet these objectives.
- 3.2 The FSS sets out the assumptions used by the Actuary in the actuarial assessment, and how the Devon Fund plans to achieve long term cost efficiency while aiming to maintain contribution rates as stable as possible. It also analyses the risks to the funding strategy and how those risks are managed. It should be read in conjunction with the Investment Strategy Statement. These assumptions have been updated to reflect the 2022 Actuarial Valuation. This includes updating the assumed inflation rates, the discount rate used, the demographic assumptions and the maximum recovery period.

3.3. The other main changes in the revised FSS are set out below:

- A revised policy in relation to cessation valuations. Where an employer becomes inactive with no other employer within the Fund responsible for taking over any residual liabilities a cessation valuation is carried out, taking into account the higher risk being borne by the Fund. In the past the calculation has been carried out using a discount rate based on gilt yields. With the recent increases in yields using a discount rate based on gilts would no longer reflect the level of risk facing the Fund. Therefore, the revised FSS adopts a policy of using the same discount rate as for an ongoing valuation of liabilities but including an additional prudence reduction with the aim of targeting a 90% success probability that an exiting employer's assets plus the calculated exit payment/credit will be sufficient to meet the residual liabilities.
- Further clarification around the approach to town and parish councils where the last active member of the Fund leaves, but there may be an intention to offer the LGPS to a future new employee. Where an exit payment is not required, the council concerned will need to continue to make deficit payments to the Fund.
- Updated wording around the impact of the McCloud age discrimination case and the proposed remedies to be applied.
- A new section setting out the potential climate change risks that may impact on the funding strategy.

#### 4) Consultation

4.1 A draft of the revised Funding Strategy Statement was sent out to employers for consultation on 26<sup>th</sup> January with a deadline for responses of 17<sup>th</sup> February. We have received one detailed response from the University of Plymouth. The key issues raised by the University of Plymouth are outlined in the table below, together with comment

| Issue Raised   | Fund Response  |
|--|--|
| The FSS should provide greater transparency of assumptions used in the Triennial Valuation   | The FSS provides the framework within which assumptions are set. The detailed basis of the assumptions used will be set out in the Valuation Report which will be published towards the end of March.  |
| Stability of contributions should not prevent significant reductions in contribution rates, where long-term "solvency" is supported by a very strong ongoing funding position. | The Fund Actuary will consider offsetting primary contribution rates where the employer is more than 110% funded, providing a cushion above 100% to guard against future volatility in funding levels. |
| The Fund should allow for post-valuation experience in setting contribution rates.   | The Fund has a long term outlook, with liabilities stretching many years into the future. The Fund therefore uses long-  |

| Issue Raised  | Fund Response   |
|---|---|
|   | term assumptions, rather than basing assumptions on short term market volatility.   |
| Has the Fund taking sufficient account of current high levels of inflation and salary increases?  | The Fund has a long term outlook, with liabilities stretching many years into the future. The assumed level of inflation and salary growth has taken account of short term inflation but this has been averaged out over 20 years.  |
| Basis of mortality assumptions  | Mortality assumptions are based on tables produced by the CMI (Continuous Mortality Investigation), adjusted based on an analysis of Devon mortality data undertaken as part of the Triennial Valuation.  |
| Why have recovery periods been reduced by more than 3 years?  | Section 13 of the Public Sector Pensions Act 2013, requires Pension Funds to look to reach a 100% funding level over a reasonable period of time in order to avoid putting the burden on future generations. At the last Section 13 Review conducted by the Government Actuary's Department, the Devon Fund had one of the longer timeframes to reach a 100% funding position. Reducing the funding period by more than 3 years at this Valuation will avoid the Fund being red-flagged when the next Section 13 review is undertaken. (It should be noted that the University of Plymouth is over 100% funded so does not have a recovery period.) |
| The University of Plymouth does not agree with the Fund Actuary's view that the gilt yield approach to conducting cessation valuations is no longer sufficiently robust and low-risk. | The previous methodology of calculating an exit payment based on gilt yields broadly replicates what happens in the private sector, when a defined benefit scheme wishes to "buy out" its liabilities and pass them on to an insurer. That insurer will typically look to the gilt market to calculate the premium for accepting these liabilities (with some loading for profit and expenses), the theory being that they can use the premium to purchase gilts and receive a near guaranteed return from the government.  |

| Issue Raised   | Fund Response  |
|--|--|
|  | <p>The suggestion that we should retain a gilts based approach to cessation valuations would also advocate that the Fund should then buy gilts to cover the orphan liabilities, as described above. However, the Fund does not provide individual investment strategies for different employers and there is no current provision for LGPS liabilities to be bought out in this way. In effect the remaining employers in the Fund act as insurers for those who have ceased, and the existing investment strategy, which does not include an allocation to gilts, would need to provide sufficient return to cover the liabilities.</p> <p>As set out above, the revised policy would use a discount rate based on the current investment strategy with an additional level of prudence to target a 90% probability of achieving the required return. Therefore, notwithstanding the consultation response, it is proposed that the revised policy be adopted within the FSS.</p> |
| Investment Strategy – the Fund should look to de-risk and/or offer a range of alternative investment strategies to different employers | <p>The Fund has a long term outlook, with liabilities stretching many years into the future. Therefore, it can withstand short term volatility. In general terms lower risk means lower return. A lower return implies a lower discount rate and would therefore result in higher contribution rates for employers.</p> <p>The Fund is not resourced to provide a range of different investment strategies. The Investment Strategy was reviewed in early 2022 and is deemed to be fit for the Fund's employers, the majority of which have a long-term secure covenant.</p>   |

- 4.2 The revised FSS has also been considered by the Pension Board who were supportive of the revised FSS at their meeting on 7<sup>th</sup> February. The Board queried the link between the Fund's fiduciary duty and managing climate change related

risks. The wording of that section of the FSS has been tweaked slightly to provide greater clarity but without significantly changing the substance of the policy.

## **5) Conclusion**

- 5.1 The Committee are asked to approve the revised Funding Strategy Statement, noting the responses to the consultation. Following the 2022 Actuarial Valuation, the Fund is required to publish the Valuation Report and Rates and Adjustments Certificate that sets out employer contributions for the next 3 years by 31 March 2023. Approval of the revised Funding Strategy Statement will ensure that the Valuation Report and Rates and Adjustments Certificate are consistent with the funding policy.
- 5.2 Officers will have further dialogue with the University of Plymouth regarding their concerns.

**Angie Sinclair**

Director of Finance and Public Value

**Electoral Divisions:** All

## **Local Government Act 1972: List of background papers**

Nil

### **Contact for enquiries:**

Name: Mark Gayler

Telephone: 01392 383621

Address: Room 196 County Hall

# **Devon County Council Pension Fund Funding Strategy Statement**

**Draft Revision presented to the Investment and Pension Fund Committee  
3 March 2023**

## **1. Introduction**

This is the Funding Strategy Statement for the Devon County Council Pension Fund. It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013 (the Regulations) and describes Devon County Council's strategy, in its capacity as administering authority, for the funding of the Devon County Council Pension Fund (the Fund).

The Fund Actuary, Barnett Waddingham LLP, has been consulted on the contents of this Statement.

This statement should be read in conjunction with the Fund's Investment Strategy Statement (ISS) and has been prepared with regard to the guidance (Preparing and Maintaining a funding strategy statement in the LGPS 2016 edition) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

## **2. Purpose of the Funding Strategy Statement**

The purpose of this Funding Strategy Statement (FSS) is to:

- Establish a clear and transparent fund-specific strategy that will identify how employers' pension liabilities are best met going forward;
- Support the desirability of maintaining as nearly constant a primary contribution rate (as defined in Regulation 62(5) of the Regulations) as possible;
- Ensure that the regulatory requirements to set contributions to meet the future liability to provide scheme member benefits in a way that ensures the solvency and long-term cost efficiency of the fund are met; and
- Take a prudent longer-term view of funding those liabilities.

## **3. Aims and purposes of the Fund**

The aims of the Fund are to:

- Manage employers' liabilities effectively and ensure that sufficient resources are available to meet all liabilities as they fall due;
- Enable primary contribution rates to be kept as nearly constant as possible and (subject to the administering authority not taking undue risks) at reasonable cost to all relevant parties (such as the taxpayers, scheduled, resolution and admitted bodies), while achieving and maintaining fund solvency and long-term cost efficiency, which should be assessed in light of the risk profile of the fund and employers, and the risk appetite of the administering authority and employers alike; and
- Seek returns on investment within reasonable risk parameters.

The purposes of the Fund are to:

- Pay pensions, lump sums and other benefits to Scheme members as provided for under the Regulations;

- Meet the costs associated in administering the Fund; and
- Receive and invest contributions, transfer values and investment income.

## **4. Funding objectives**

Contributions are paid to the Fund by Scheme members and the employing bodies to provide for the benefits which will become payable to Scheme members when they fall due.

The funding objectives are to:

- Ensure that pension benefits can be met as and when they fall due over the lifetime of the Fund;
- Ensure the solvency of the Fund;
- Set levels of employer contribution to target a 100% funding level over an appropriate time period and using appropriate actuarial assumptions;
- Build up the required assets in such a way that employer contribution rates are kept as stable as possible, with consideration of the long-term cost efficiency objective; and
- Adopt appropriate measures and approaches to reduce the risk, as far as possible, to the Fund, other employers and ultimately the taxpayer from an employer defaulting on its pension obligations.

In developing the funding strategy, the administering authority should also have regard to the likely outcomes of the review carried out under Section 13(4)(c) of the Public Service Pensions Act 2013. Section 13(4)(c) requires an independent review of the actuarial valuations of the LGPS funds; this involves reporting on whether the rate of employer contributions set as part of the actuarial valuations are set at an appropriate level to ensure the solvency of the Fund and the long-term cost efficiency of the Scheme so far as relating to the pension fund. The review also looks at compliance and consistency of the actuarial valuations.

## **5. Key parties**

The key parties involved in the funding process and their responsibilities are as follows:

### **The administering authority**

The administering authority for the Fund is Devon County Council. The main responsibilities of the administering authority are to:

- Operate the Fund in accordance with the LGPS Regulations;
- Collect employee and employer contributions, investment income and other amounts due to the Fund as stipulated in the Regulations;
- Invest the Fund's assets in accordance with the Fund's Investment Strategy Statement (ISS);
- Pay the benefits due to Scheme members as stipulated in the Regulations;

- Ensure that cash is available to meet liabilities as and when they fall due;
- Take measures as set out in the Regulations to safeguard the Fund against the consequences of employer default;
- Manage the actuarial valuation process in conjunction with the Fund Actuary;
- Prepare and maintain this FSS and also the ISS after consultation with other interested parties;
- Monitor all aspects of the Fund's performance;
- Effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme Employer; and
- Enable the Local Pension Board to review the valuation process as they see fit.

### **Scheme employers**

In addition to the administering authority, a number of other Scheme employers, including admission bodies, participate in the Fund.

The responsibilities of each Scheme employer that participates in the Fund, including the administering authority, are to:

- Collect employee contributions and pay these together with their own employer contributions as certified by the Fund Actuary to the administering authority within the statutory timescales;
- Notify the administering authority of any new Scheme members and any other membership changes promptly;
- Develop a policy on certain discretions and exercise those discretions as permitted under the Regulations;
- Meet the costs of any augmentations or other additional costs in accordance with agreed policies and procedures; and
- Pay any exit payments due on ceasing participation on the Fund.

### **Scheme members**

Active scheme members are required to make contributions into the Fund as set by the Department for Levelling Up, Housing and Communities (DLUHC).

### **Fund Actuary**

The Fund Actuary for the Fund is Barnett Waddingham LLP. The main responsibilities of the Fund Actuary are to:

- Prepare valuations including the setting of employers' contribution rates at a level to ensure Fund solvency and long-term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and the Regulations;
- Prepare advice and calculations in connection with bulk transfers and the funding aspects of individual benefit-related matters such as pension strain costs, ill health retirement costs, compensatory added years costs, etc;
- Provide advice and valuations on the exiting of employers from the Fund;

- Provide advice to the administering authority on bonds or other forms of security against the financial effect on the Fund of employer default;
- Assist the administering authority in assessing whether employer contributions need to be revised between valuations as permitted or required by the Regulations;
- Ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the Fund; and
- Advise on other actuarial matters affecting the financial position of the Fund.

## **6. Funding strategy**

The factors affecting the Fund's finances are constantly changing, so it is necessary for its financial position and the contributions payable to be reviewed from time to time by means of an actuarial valuation to check that the funding objectives are being met.

The most recent actuarial valuation of the Fund was carried out as at 31 March 2022. A summary of the methods and assumptions adopted is set out in the sections below.

The actuarial valuation involves a projection of future cashflows to and from the Fund. The main purpose of the valuation is to determine the level of employers' contributions that should be paid to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund.

### **Funding method**

The key objective in determining employers' contribution rates is to establish a funding target and then set levels of employer contribution to meet that target over an agreed period.

The funding target is to have sufficient assets in the Fund to meet the accrued liabilities for each employer in the Fund.

For all employers, the method adopted is to consider separately the benefits accrued before the valuation date (past service) and benefits expected to be accrued after the valuation date (future service). These are evaluated as follows:

- The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service. It makes allowance for future increases to members' pay for pensions in payment. A funding level in excess of 100% indicates a surplus of assets over liabilities; while a funding level of less than 100% indicates a deficit; and
- The future service funding rate (also referred to as primary rate as defined in Regulation 62(5) of the Regulations) which is the level of contributions required from the individual employers which, in combination with employee contributions is expected to support the cost of benefits accruing in future.

The adjustment required to the primary rate to calculate an employer's total contribution rate is referred to as the secondary rate, as defined in Regulation 62(7).

Further details of how the secondary rate is calculated for employers is given further below.

The approach to the primary rate will depend on specific employer circumstances and in particular, may depend on whether an employer is an “open” employer – one which allows new recruits access to the Fund, or a “closed” employer which no longer permits new staff access to the Fund. The expected period of participation by an employer in the Fund may also affect the total contribution rate.

For open employers, the actuarial funding method that is adopted is known as the Projected Unit Method. The key feature of this method is that, in assessing the future service cost, the primary contribution rate represents the cost of one year’s benefit accrual only.

For closed employers, the actuarial funding method adopted is known as the Attained Age Method. The key difference between this method and the Projected Unit Method is that the Attained Age Method assesses the average cost of the benefits that will accrue over a specific period, such as the length of a contract or the remaining expected working lifetime of active members.

The approach by employer may vary to reflect an employer’s specific circumstance, however, in general the closed employers in the Fund are admission bodies who have joined the Fund as part of an outsourcing contract and therefore the Attained Age Method is used in setting their contributions. All other employers (for example councils, higher education bodies and academies) are generally open employers and therefore the Projected Unit Method is used. The administering authority holds details of the open or closed status of each employer.

## **7. Valuation assumptions and funding model**

In completing the actuarial valuation, it is necessary to formulate assumptions about the factors affecting the Fund's future finances such as inflation, pay increases, investment returns, rates of mortality, early retirement and staff turnover etc.

The assumptions adopted at the valuation can therefore be considered as:

- The demographic (or statistical) assumptions which are essentially estimates of the likelihood or timing of benefits and contributions being paid, and
- The financial assumptions which will determine the estimates of the amount of benefits and contributions payable and their current (or present) value.

### **Future price inflation**

The base assumption in any valuation is the future level of price inflation over a period commensurate with the duration of the liabilities, as measured by the Retail Price Index (RPI). This is derived using the 20 year point on the Bank of England implied Retail Price Index (RPI) inflation curve, with consideration of the market conditions over the six months straddling the valuation date. The 20 year point on the curve is taken as 20 years is consistent with the average duration of an LGPS Fund. A deduction of 0.3% p.a.

is applied to the yield at the 20 year point to reflect the shape of the yield curve. A further deduction of 0.4% p.a. is applied to reflect the view that investors are willing to pay a premium for inflation-linked products in return for protection against unexpected inflation.

#### **Future pay inflation**

As some of the benefits are linked to pay levels at retirement, it is necessary to make an assumption as to future levels of pay inflation. Historically, there has been a close link between price and pay inflation with pay inflation exceeding price inflation in the longer term. The long-term pay increase assumption adopted as at 31 March 2022 was CPI plus 1.0% p.a. which includes allowance for promotional increases.

#### **Future pension increases**

Pension increases are linked to changes in the level of the Consumer Price Index (CPI). Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods. However, RPI is due to be aligned with CPIH (CPI but with allowance for housing costs) from 2030.

Therefore, reflecting the anticipated amendment to RPI from 2030 and therefore the relative difference between RPI and CPI, a deduction of 0.35% p.a. is made to the RPI assumption to derive the CPI assumption. The CPI assumption adopted as at 31 March 2022 was 2.9% p.a.

#### **Future investment returns/discount rate**

To determine the value of accrued liabilities and derive future contribution requirements it is necessary to discount future payments to and from the Fund to present day values.

The discount rate that is adopted will depend on the funding target adopted for each Scheme employer.

For open employers, the discount rate that is applied to all projected liabilities reflects a prudent estimate of the rate of investment return that is expected to be earned from the underlying investment strategy by considering average market yields in the six months straddling the valuation date. The discount rate so determined may be referred to as the “ongoing” discount rate. The discount rate adopted for the 31 March 2022 valuation was 4.7% p.a.

For closed employers, an adjustment may be made to the discount rate in relation to the remaining liabilities, once all active members are assumed to have retired if at that time (the projected “termination date”), the employer becomes an exiting employer under Regulation 64.

The Fund Actuary will incorporate such an adjustment after consultation with the administering authority.

The adjustment to the discount rate for closed employers may be set to a higher funding target at the projected termination date, so that there are sufficient assets to fund the

remaining liabilities on a “minimum risk” rather than on an ongoing basis if the Fund does not believe that there is another Scheme employer to take on the responsibility of the liabilities after the employer has exited the Fund. The aim is to minimise the risk of deficits arising after the termination date. More information on the minimum risk approach is provided in the cessation valuation section.

A summary of the financial assumptions adopted for the 2022 valuation is set out in the table below:

| Financial assumptions as at 31 March 2022               |                            |
|---|----------------------------|
| CPI inflation   | 2.9% p.a.                  |
| Pension/deferred pension increases and CARE revaluation | In line with CPI inflation |
| Pay increases   | CPI inflation + 1.0% p.a.  |
| Discount rate   | 4.7% p.a.                  |

### **Asset valuation**

For the purposes of the valuation, the asset value used is the market value of the accumulated Fund at the valuation date adjusted to reflect average market conditions during the six months straddling the valuation date. This is referred to as the smoothed asset value and is calculated as a consistent approach to the valuation of the liabilities.

The Fund’s assets are notionally allocated to employers at an individual level by allowing for actual Fund returns achieved on the assets and cashflows paid into and out of the Fund in respect of each employer (e.g. contributions received and benefits paid).

### **Demographic (Statistical) assumptions**

The demographic assumptions incorporated into the valuation, such as future mortality rates, are based on Fund-specific experience and national statistics. These are adjusted as appropriate to reflect the individual circumstances of the Fund and/or individual employers.

Further details of all of the assumptions adopted are included in the latest actuarial valuation report.

### **2022 valuation results**

As at 31 March 2022, as calculated at the 2022 valuation, the Fund was 98% funded, corresponding to a deficit of £89m.

The primary rate required to cover the employer cost of future benefit accrual was 19.2% of payroll p.a.

### **McCloud/Sargeant judgments**

When the Government reformed public service pension schemes in 2014 and 2015 they introduced protections for older members. In December 2018, the Court of Appeal ruled that younger members of the Judges' and Firefighters' Pension schemes have been discriminated against because the protections do not apply to them. The Government has confirmed that there will be changes to all public sector schemes, including the LGPS, to remove this age discrimination. A consultation has been run in relation to the changes proposed for the LGPS and legislation is now being drafted to bring forward these changes. We understand the updated Regulations are to be consulted on over the course of 2023 with revised Regulations effective from October 2023.

For the 2022 valuation, as required by the Department for Levelling Up, Housing & Communities, in calculating the value of members' liabilities it was assumed that:

- The current underpin (which only applies to those members within 10 years of their NPA at 31 March 2012) will be revised and will apply to all members who were active in the Scheme on or before 31 March 2012 and who join the post 1 April 2014 scheme without a disqualifying service gap;
- The period of protection will apply from 1 April 2014 to 31 March 2022 but will cease when a member leaves active service or reaches their final salary scheme normal retirement age (whichever is sooner);
- Where a member remains in active service beyond 31 March 2022 the comparison of their benefits will be based on their final salary when they leave the LGPS or when they reach their final salary scheme normal retirement age (again whichever is sooner);
- Underpin protection will apply to qualifying members who leave active membership of the LGPS with an immediate or deferred entitlement to a pension; and
- The underpin will consider when members take their benefit.

Further details of the McCloud/Sargeant judgment can be found below in the Regulatory risks section.

### **Guaranteed Minimum Pension (GMP) indexation and equalisation**

On 23 March 2021, the Government published the outcome to its Guaranteed Minimum Pension Indexation consultation, concluding that all public service pension schemes, including the LGPS, will be directed to provide full indexation to members with a GMP reaching SPA beyond 5 April 2021. This is a permanent extension of the existing 'interim solution' that has applied to members with a GMP reaching SPA on or after 6 April 2016. Details of the consultation outcome can be found at:  
<https://www.gov.uk/government/consultations/public-service-pensions-guaranteed-minimum-pension-indexation-consultation>.

The 2022 valuation approach for GMP is that the Fund will pay limited increases for members that have reached SPA by 6 April 2016, with the government providing the

remainder of the inflationary increase. For members that reach SPA after this date, the Fund will be required to pay the entire inflationary increase.

## **8. Deficit recovery/surplus amortisation periods**

Whilst one of the funding objectives is to build up sufficient assets to meet the cost of benefits as they accrue, it is recognised that at any particular point in time, the value of the accumulated assets will be different to the value of accrued liabilities, depending on how the actual experience of the Fund differs to the actuarial assumptions. Accordingly, the Fund will normally either be in surplus or in deficit. This theory applies down to an individual employer level; each employer in the Fund has their own share of deficit or surplus attributable to their section of the Fund.

Where the actuarial valuation for an employer discloses a significant surplus or deficit then the level of required employer contribution will include an adjustment to either amortise the surplus or fund the deficit over a period of no more than 15 years. The adjustment may be set either as a percentage of payroll or as a fixed monetary amount.

Deficit contributions required from an employer are expressed as a minimum requirement, with employers able to pay regular contributions at a higher rate, or one-off contributions, to reduce their deficit. Employers should discuss with the Administering Authority and gain agreement from the Administering Authority before making one-off payments. The individual employer contribution rates are set out in the Rates and Adjustments Certificate which forms part of the Fund's 2022 valuation report.

The employers must pay contributions in line with the Rates and Adjustment Certificate, but they may be able to alter the timing of contributions payable and/or pay in additional contributions with agreement from the Administering Authority. The Administering Authority has agreed to allow a discount to employers who pay their deficit contributions up front, as long as the payment is received by the end of April in a particular Scheme year (i.e. the discount for the 2023/24 contributions would only apply if the lump sum payment was made by 30 April 2023). The discounts are 1.3% for an annual payment in advance or 4% for paying three years of contributions in advance. Employers should discuss with and gain agreement from the Administering Authority before making up front payments at the discounted rate.

The Rates and Adjustments Certificate sets out the minimum amounts to be paid by an employer to the Fund. Additional contributions towards deficit over the amounts certified in the Rates and Adjustment Certificate are permissible subject to the agreement of the Administering Authority. The employer must set out in writing to the Administering Authority a request to pay in additional deficit contributions. The employer should demonstrate its ability to fund any significant additional deficit contribution in accordance with accounting regulations. The Administering Authority will consider this request and will notify the Fund Actuary in order to consider the potential impact, including consideration of tracking of the amount paid for any employers participating in a funding pool. The Administering Authority will aim to approve or reject a request to pay additional contribution within 28 days, but this may

vary on a case by case basis. A revised Rates and Adjustments Certificate will be required where appropriate.

The maximum recovery period across the Fund at the 2022 valuation was 15 years. This represents a reduction of six years from the maximum 21 year recovery period set at the 2019 valuation. The ultimate aim is to reach 100% funding, and a reduction of six years in the recovery period since the 2019 valuation demonstrates that the Fund is progressing towards that goal. Please note that recovery periods varied between individual employers.

Where the valuation for an employer discloses a surplus then the level of required employer contribution may include an adjustment to amortise the surplus over a period to be agreed with the Administering Authority and the Fund Actuary.

The period that is adopted for any particular employer will depend on:

- The significance of the surplus or deficit relative to that employer's liabilities;
- The covenant of the individual employer (including any security in place) and any limited period of participation in the Fund;
- The remaining contract length of an employer in the Fund (if applicable); and
- The implications in terms of stability of future levels of employers' contribution.

As part of the 2022 valuation, the Fund commissioned an employer covenant review from Barnett Waddingham LLP based on an analysis of credit risk reports obtained from Dun & Bradstreet (D&B). Where the review highlighted any concerns with regard to the default risk of an employer, particular attention was given to the deficit recovery period adopted for the employer and whether any security for the Fund was in place.

A general summary of the approach used for employers in the Fund is set out in the table below, however, the approach adopted may differ to reflect the situation specific to the employer.

| Type of employer                    | Examples   | Maximum recovery period   |
|-------------------------------------|--|---------------------------|
| Major scheduled bodies              | County and district councils, police and fire bodies | 15 years                  |
| Small scheduled bodies              | Town and parish councils                             | 15 years                  |
| Higher and further education bodies | Colleges, universities                               | 11 years                  |
| Academies                           | Academies, free schools                              | 11 years                  |
| Admission bodies                    | Contractors  | Remaining contract length |
| Other                               | Charities, etc.                                      | 15 years                  |

## **9. Pooling of individual employers**

The policy of the Fund is that each individual employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund.

Accordingly, contribution rates are set for individual employers to reflect their own particular circumstances.

However, certain groups of individual employers are pooled for the purposes of determining contribution rates to recognise common characteristics or where the number of Scheme members is small.

The main purpose of pooling is to produce more stable employer contribution levels in the longer term whilst, recognising that ultimately there will be some level of cross-subsidy of pension cost amongst pooled employers.

### **Forming/disbanding a funding pool**

Where the Fund identifies a group of employers with similar characteristics and potential merits for pooling, it is possible to form a pool for these employers. Advice will be sought from the Fund Actuary to consider the appropriateness and practicalities of forming the funding pool.

Conversely, the Fund may consider it no longer appropriate to pool a group of employers. This could be due to divergence of previously similar characteristics or an employer becoming a dominant party in the pool (such that the results of the pool are largely driven by that dominant employer). Where this scenario arises, advice will be sought from the Fund Actuary.

Funding pools will be monitored on a regular basis, at least at each actuarial valuation, in order to ensure the pooling arrangement remains appropriate.

The funding pools adopted for the Fund at the 2022 valuation are summarised in the table below:

| Pool        | Type of pooling                 | Notes   |
|-------------|---------------------------------|---|
| Police      | Past and future service pooling | Devon and Cornwall Police and the Police and Crime Commissioner pay the same primary contribution rate (Devon and Cornwall Police pays an additional secondary rate) and both have the same funding level |
| North Devon | Past and future service pooling | North Devon District Council and North Devon Joint Crematorium pay the same same total contribution rate and have the same funding level  |

| Pool                   | Type of pooling                 | Notes   |
|------------------------|---------------------------------|---|
| Small scheduled bodies | Past and future service pooling | All town and parish councils in the pool pay the same total contribution rate and have the same funding level |
| Academies              | Past and future service pooling | All academies in the pool pay the same total contribution rate and have the same funding level                |

### **Risk-sharing**

There are employers that participate in the Fund with a risk-sharing arrangement in place with another employer in the Fund.

For example, there are employers participating in the Fund with pass-through provisions: under this arrangement the pass-through employer does not take on the risk of underfunding as this risk remains with the letting authority or relevant guaranteeing employer. When the pass-through employer ceases participation in the Fund, it is not responsible for making any exit payment, nor receiving any exit credit, as any deficit or surplus ultimately falls to the letting authority or relevant guaranteeing employer.

At the 2022 valuation, risk-sharing arrangements were allowed for by allocating any deficit/liabilities covered by the risk-sharing arrangement to the relevant responsible employer.

## **10. New employers joining the Fund**

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

### **Admission bodies**

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

### **Funding at start of contract**

Generally, when a new admission body joins the Fund, they will become responsible for all the pensions risk associated with the benefits accrued by transferring members and the benefits to be accrued over the contract length. This is known as a full risk transfer. In these cases, it may be appropriate that the new admission body is allocated a share of

Fund assets equal to the value of the benefits transferred, i.e. the new admission body starts off on a fully funded basis. This is calculated on the relevant funding basis and the opening position may be different when calculated on an alternative basis (e.g. on an accounting basis).

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

#### Contribution rate

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

Depending on the details of the arrangement, for example if any risk sharing arrangements are in place, then additional adjustments may be made to determine the contribution rate payable by the new admission body. The approach in these cases will be bespoke to the individual arrangement.

#### Security

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

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

#### Risk-sharing

Although a full risk transfer (as set out above) is most common, subject to agreement with the administering authority where required, new admission bodies and the relevant letting authority may make a commercial agreement to deal with the pensions risk differently. For example, it may be agreed that all or part of the pensions risk remains with the letting authority.

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

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

The administering authority may consider risk-sharing arrangements as long as the approach is clearly documented in the admission agreement, the transfer agreement or any other side agreement. The arrangement also should not lead to any undue risk to the other employers in the Fund.

Legal and actuarial advice in relation to risk-sharing arrangements should be sought where required.

#### **New academies**

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

#### **Funding at start**

On conversion to academy status, the new academy will become part of the Academies funding pool and will be allocated assets using the following approach:

1. Transfer assets in respect of the school's liabilities from the relevant local authority to the Academies funding pool. The value of assets is determined by what is called the active cover approach: we take the local authority's assets, apportion that so that the local authority's deferred and pensioner liabilities are fully funded, and so the rest that remains is available to cover the local authority's active liabilities. The percentage calculated by dividing these remaining assets over the active liabilities is the active cover %. We apply this to the school's liabilities to determine the assets to transfer to the Academies funding pool.
2. We then allocate assets to the new academy based on the funding level of the pool.

This active cover will be capped at 100% so that at most the liabilities will be transferred fully funded from the local authority.

#### **Contribution rate**

The contribution rate payable when a new academy joins the Fund will be in line with the contribution rate certified for the Academies funding pool at the 2022 valuation.

Where an academy joins an existing multi-academy trust in the Fund, additional contributions will be certified for the multi-academy trust in respect of the academy.

## **11. Contribution reviews between actuarial valuations**

It is anticipated for most Scheme employers that the contribution rates certified at the formal actuarial valuation will remain payable for the period of the rates and adjustments certificate. However, there may be circumstances where a review of the contribution rates payable by an employer (or a group of employers) under Regulation 64A is deemed appropriate by the administering authority.

A contribution review may be requested by an employer or be required by the administering authority. The review may only take place if one of the following conditions are met:

- (i). it appears likely to the administering authority that the amount of the liabilities arising or likely to arise has changed significantly since the last valuation;
- (ii). it appears likely to the administering authority that there has been a significant change in the ability of the Scheme employer or employers to meet the obligations of employers in the Scheme; or
- (iii). a Scheme employer or employers have requested a review of Scheme employer contributions and have undertaken to meet the costs of that review. A request under this condition can only be made if there has been a significant change in the liabilities arising or likely to arise and/or there has been a significant change in the ability of the Scheme employer to meet its obligations to the Fund.

Guidance on the administering authority's approach considering the appropriateness of a review and the process in which a review will be conducted is set out the Fund's separate Contribution review policy which can be accessed at

<https://www.devonpensionfund.org.uk/document/contribution-review-policy/>

This includes details of the process that should be followed where an employer would like to request a review.

Once a review of contribution rates has been agreed, unless the impact of amending the contribution rates is deemed immaterial by the Fund Actuary, then the results of the review will be applied with effect from the agreed review date, regardless of the direction of change in the contribution rates.

Note that where a Scheme employer seems likely to exit the Fund before the next actuarial valuation then the administering authority can exercise its powers under Regulation 64(4) to carry out a review of contributions with a view to providing that assets attributable to the Scheme employer are equivalent to the exit payment that will be due from the Scheme employer. These cases do not fall under the separate contribution review policy.

With the exception of any cases falling under Regulation 64(4), the administering authority will not accept a request for a review of contributions where the effective date is within 12 months of the next rates and adjustments certificate.

## **12. Cessation valuations**

When an employer leaves the Scheme and becomes an exiting employer, the Fund Actuary will be asked to make a termination assessment. Any deficit in the Fund in respect of the employer will be due to the Fund as an exit payment, unless it is agreed by the administering authority and the other parties involved that the assets and liabilities relating to the employer will transfer within the Fund to another participating employer, or if an alternative arrangement is agreed.

Any deficit in the Fund in respect of the exiting employer will be due to the Fund as a single lump sum payment, unless it is agreed by the administering authority and the other parties involved that an alternative approach is permissible. For example:

- It may be agreed with the administering authority that the exit payment can be spread over some agreed period;
- the assets and liabilities relating to the employer may transfer within the Fund to another participating employer; or
- the employer's exit may be deferred subject to agreement with the administering authority, for example if it intends to offer Scheme membership to a new employee within the following three years.

Similarly, any surplus in the Fund in respect of the exiting employer may be treated differently to a payment of an exit credit, subject to the agreement between the relevant parties and any legal documentation.

In assessing the financial position on termination, the Fund Actuary may adopt a discount rate based on different assumptions to those used at the previous valuation in order to protect the other employers in the Fund from having to fund any future deficits which may arise from the liabilities that will remain in the Fund.

For example, if the administering authority is satisfied that there is another employer willing to take on responsibility for the liabilities (or that there is some other form of guarantee in place) then the cessation position may be calculated on the ongoing funding basis.

If there is no guarantor in the Fund willing to accept responsibility for the residual liabilities of the exiting employer, then those liabilities may be assessed on a basis more prudent than the ongoing funding basis, known as a full cessation approach. The assumptions adopted will be consistent with the current ongoing funding position, but with additional prudence included in order to take into account potential uncertainties and risk e.g. due to adverse market changes, additional liabilities arising from regulatory or legislative change and political/economic uncertainties. The additional level of prudence on this basis was last reviewed as part of the Fund's 2022 valuation, when a stochastic analysis was used to assess the "success probabilities" of certain levels of prudence, with the aim being to target a 90% success probability that an exiting employer's assets plus the calculated exit payment/credit will be sufficient to meet the residual liabilities. This corresponds to a 3.6% prudence adjustment in the discount rate assumption. This adjustment will be reviewed on a regular basis, and as a minimum as part of each actuarial valuation.

### **Managing exit payments**

Where a cessation valuation reveals a deficit and an exit payment is due, the expectation is that the employer settles this debt immediately through a single cash payment. However, should it not be possible for the employer to settle this amount, providing the employer puts forward sufficient supporting evidence to the administering authority, the administering authority may agree a deferred debt agreement (DDA) with the employer under Regulation 64(7A) or a debt spreading agreement (DSA) under Regulation 64B.

Under a DDA, the exiting employer becomes a deferred employer in the Fund (i.e. they remain as a Scheme employer but with no active members) and remains responsible for paying the secondary rate of contributions to fund their deficit. The secondary rate of contributions will be reviewed at each actuarial valuation until the termination of the agreement.

Under a DSA, the cessation debt is crystallised and spread over a period deemed reasonable by the administering authority having regard to the views of the Fund Actuary.

Whilst a DSA involves crystallising the cessation debt and the employer's only obligation is to settle this set amount, in a DDA the employer remains in the Fund as a Scheme employer and is exposed to the same risks (unless agreed otherwise with the administering authority) as active employers in the Fund (e.g. investment, interest rate, inflation, longevity and regulatory risks) meaning that the deficit will change over time.

Guidance on the administering authority's policy for entering into, monitoring and terminating a DDA or DSA is set out in the Fund's separate DSA and DDA policies document at: <https://www.devonpensionfund.org.uk/document/deferred-debt-and-debt-spreading-agreement-policies/>

This includes details of when a DDA or a DSA may be permitted, and the information required from the employer when putting forward a request for a DDA or DSA.

#### **Regulatory factors**

At the date of drafting this FSS, the Government is currently consulting on potential changes to the Regulations, some of which may affect the timing of future actuarial valuations. This is set out in the *Local government pension scheme: changes to the local valuation cycle and the management of employer risk* consultation document.

Further details of this can be found in the **Error! Reference source not found.** section below.

#### **Town and Parish Councils**

When a Town or Parish Council cease participation in the Fund their cessation valuation will be based on a full cessation approach.

A Town or Parish Council may defer their exit if the last member leaves active service but the Town or Parish Council is intending to offer the scheme to a new employee. This will be in agreement with the Devon Pension Fund and any deficit payments due by the Town or Parish Council must continue to be paid during the suspension period. Any suspension period will be time-limited at the discretion of the Fund but will typically be capped at 3 years. The deficit contributions will be monetary amounts equivalent to the secondary contributions calculated as part of the most recent funding valuation.

During the period of suspension or following a cessation the Town or Parish Council will be removed from the funding pool. If a new member joins the employer during the suspension period they will re-join the pool.

If the last active member leaves a Town or Parish Council and they are not intending to offer the scheme to a new employee, or the suspension period comes to an end, a cessation valuation will be required. The employer may be able to enter a Deferred Debt Agreement (DDA) or Debt Spreading Agreement (DSA) with the Fund to allow them to spread the debt amount over a period of time to help with affordability. Alternatively they will pay any exit payment calculated. As part of a DDA or DSA the employer will be taken out of the funding pool and their full cessation deficit will be spread across the deficit recovery period of the pool. If a new member joins the employer during the DDA period they will re-join the pool.

#### **Exit credits**

The Local Government Pension Scheme (LGPS) (Amendment) Regulations 2018 were introduced in May 2018 which allow administering authorities to make an exit credit payment to exiting employers. This will be reviewed on a case by case basis before any payment is made. Considerations will be based on any previous agreements made and discussions between the Administering Authority, the Exiting Employer and the guaranteeing employer (if relevant).

Having regard to any relevant considerations, the administering authority will take the following approach to the payment of exit credits:

- Any employer who cannot demonstrate that they have been exposed to underfunding risk during their participation in the Fund will not be entitled to an exit credit payment. This will include the majority of “pass-through” arrangements. This is on the basis that these employers would not have not been asked to pay an exit payment had a deficit existed at the time of exit.
- The administering authority does not need to enquire into the precise risk sharing arrangement adopted by an employer but it must be satisfied that the risk sharing arrangement has/not been in place before it will pay out an exit credit. The level of risk that an employer has borne will be taken into account when determining the amount of any exit credit. It is the responsibility of the exiting employer to set out why the arrangements make payment of an exit credit appropriate.
- Any exit credit payable may be subject to a maximum of the actual employer contributions paid into the Fund as certified in the Fund’s rates and adjustments certificates, up to any cap arrangements that may have been in place and excluding any additional payments such as strain payments.
- As detailed above, the Fund Actuary may adopt differing approaches depending on the specific details surrounding the employer’s cessation scenario. The default approach to calculating the cessation position will be on a minimum-risk basis unless it can be shown that there is another employer in the Fund who will take on financial responsibility for the liabilities in the future. If the administering authority is satisfied that there is another employer willing to take on responsibility for the liabilities (or that there is some other form of guarantee in place) then the cessation position may be calculated on the ongoing funding basis.

- The administering authority will pay out any exit credits within six months of the cessation date where possible. A longer time may be agreed between the administering authority and the exiting employer where necessary. For example if the employer does not provide all the relevant information to the administering authority within one month of the cessation date the administering authority will not be able to guarantee payment within six months of the cessation date.

Under the Regulations, the administering authority has the discretion to take into account any other relevant factors in the calculation of any exit credit payable and they will seek legal advice where appropriate.

### **13. Bulk transfers**

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

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

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

#### **Consolidation of Multi Academy Trusts (MATs)**

Where an academy is transferring into or out of the Devon Fund as part of a MAT consolidation exercise, the Fund generally expects that this will proceed through a Direction Order from the Secretary of State. In these situations and subject to the terms agreed between the Fund Actuary to both LGPS Funds, typically all the assets attributable to the academy in the ceding Fund are transferred to the receiving Fund.

Where the academy is transferring out of the Devon Fund, the Fund requires a Direction Order to be sought such that all associated deferred and pensioner liabilities are also transferred out of the Fund.

Where the academy is transferring into the Devon Fund, where appropriate, the academy will become part of the Fund's Academy pool. If the funding level of the transfer into the Devon Fund is substantially lower than the funding level of the academy pool, then the Fund may require additional contributions to be paid by the academy to protect the other academies in the pool from an increased funding cost as a result of the transfer terms. There may be some instances where it is not deemed appropriate for the academy to join the Academy pool, or at least not immediately. For example, if a large number of academies from a MAT transfer into the Devon Fund at

one time, then it may be more appropriate to initiate a separate funding pool for these academies until their funding position is in line with the main Academy pool, at which point it can then be merged into the Academy pool.

## **14. Links with the Investment Strategy Statement (ISS)**

The main link between the Funding Strategy Statement (FSS) and the ISS relates to the discount rate that underlies the funding strategy as set out in the FSS, and the expected rate of investment return which is expected to be achieved by the underlying investment strategy as set out in the ISS.

As explained above, the ongoing discount rate that is adopted in the actuarial valuation is derived by considering the expected return from the underlying investment strategy. This ensures consistency between the funding strategy and investment strategy.

## **15. Risks and counter measures**

Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of employer contributions, it is recognised that there are risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.

The major risks to the funding strategy are financial, although there are other external factors including demographic risks, regulatory risks and governance risks.

### **Financial risks**

The main financial risk is that the actual investment strategy fails to produce the expected rate of investment return (in real terms) that underlies the funding strategy. This could be due to a number of factors, including market returns being less than expected and/or the Brunel Pension Partnership Ltd. and other fund managers, who are employed to implement the chosen investment strategy, failing to achieve their performance targets.

The valuation results are most sensitive to the real discount rate. Broadly speaking an increase/decrease of 0.1% p.a. in the real discount rate will decrease/increase the valuation of the liabilities by 2%, and decrease/increase the required employer contribution by around 0.7% of payroll p.a.

However, the Investment and Pension Fund Committee regularly monitors the investment returns achieved by Brunel and the other fund managers and receives advice from the independent advisers and officers on investment strategy. The Fund's strategic asset allocation is reviewed on a regular basis.

The Committee may also seek advice from the Fund Actuary on valuation related matters.

In addition, the Fund Actuary provides funding updates between valuations to check whether the funding strategy continues to meet the funding objectives.

### **Demographic risks**

Allowance is made in the funding strategy via the actuarial assumptions for a continuing improvement in life expectancy. However, the main demographic risk to the funding strategy is that it might underestimate the continuing improvement in longevity. For example, an increase of one year to life expectancy of all members in the Fund will increase the liabilities by approximately 4%.

The actual mortality of pensioners in the Fund is monitored by the Fund Actuary at each actuarial valuation and assumptions are kept under review. For the past three funding valuations, the Fund has commissioned a bespoke longevity analysis by Barnett Waddingham's specialist longevity team in order to assess the mortality experience of the Fund and help set an appropriate mortality assumption for funding purposes.

The liabilities of the Fund can also increase by more than has been planned as a result of early retirements. However, the administering authority monitors the incidence of early retirements; and procedures are in place that require individual employers to pay additional amounts into the Fund to meet any additional costs arising from early retirements.

### **Climate risk**

There are a large number of interlinked systemic long-term financial risks related to climate change which could potentially have a material impact on the assets and/or the liabilities of the Fund. The most obvious of these climate change risks will be the financial risks to the value of the Fund's assets, the potential increased volatility of markets and potential changes in life expectancy. It is possible that some of these factors will impact the assets and liabilities of the Fund in the same direction, although not necessarily by the same amount.

As part of its fiduciary duty the fund therefore has a duty to consider climate change risk when making investment decisions and to ensure any decisions support the effective management of climate change. The Fund therefore expects their appointed investment managers to be informed about climate change risks and take investment opportunities accordingly within their processes. More detail is included in the Fund's Investment Strategy Statement.

As part of the 2022 valuation, the Fund Actuary provided the Fund with a climate risk analysis which assessed the potential exposure of the Fund's funding position to climate risk under different climate scenarios. The principles behind the analysis were agreed with the Government Actuary's Department (GAD).

The results of this analysis demonstrated that the funding strategy agreed as part of the 2022 valuation was sufficiently robust in the context of climate scenario analysis and any potential contribution impacts.

The Fund will continue to assess this risk on a regular basis.

### **Maturity risk**

The maturity of a Fund (or of an employer in the Fund) is an assessment of how close on average the members are to retirement (or already retired). The more mature the Fund

or employer, the greater proportion of its membership that is near or in retirement. For a mature Fund or employer, the time available to generate investment returns is shorter and therefore the level of maturity needs to be considered as part of setting funding and investment strategies.

The cashflow profile of the Fund needs to be considered alongside the level of maturity: as a Fund matures, the ratio of active to pensioner members falls, meaning the ratio of contributions being paid into the Fund to the benefits being paid out of the Fund also falls. This therefore increases the risk of the Fund having to sell assets in order to meet its benefit payments. The Fund regularly monitors its cashflow forecasts, and will at least once every three years commission the Fund Actuary to provide a forward looking cashflow forecast for the next 20-25 years to inform its investment strategy.

The government has published a consultation (*Local government pension scheme: changes to the local valuation cycle and management of employer risk*) which may affect the Fund's exposure to maturity risk. More information on this can be found in the Regulatory risks section below.

### **Regulatory risks**

The benefits provided by the Scheme and employee contribution levels are set out in Regulations determined by central Government. The tax status of the invested assets is also determined by the Government.

The funding strategy is therefore exposed to the risks of changes in the Regulations governing the Scheme and changes to the tax regime which may affect the cost to individual employers participating in the Scheme.

However, the administering authority participates in any consultation process concerning proposed changes in Regulations and seeks advice from the Fund Actuary on the financial implications of any proposed changes.

There are a number of general risks to the Fund and the LGPS, including:

- If the LGPS was to be discontinued in its current form it is not known what would happen to members' benefits.
- More generally, as a statutory scheme the benefits provided by the LGPS or the structure of the scheme could be changed by the government.
- The State Pension Age is due to be reviewed by the government in the next few years.

At the time of preparing this FSS, specific regulatory risks of particular interest to the LGPS are in relation to the McCloud/Sargeant judgments and the timing of future funding valuations consultation. These are discussed in the sections below.

### **McCloud/Sargeant judgments**

The Court of Appeal judgment on the McCloud and Sargeant cases, relate to age discrimination against the age-based transitional provisions put into place when the new judicial pension arrangements were introduced in 2015. The members argued that these transitional provisions were directly discriminatory on grounds of age and indirectly discriminatory on grounds of sex

and race, based on the correlation between these two factors reflected in the judicial membership. The Tribunal ruled against the Government, deeming the transitional provisions as not a proportionate means of achieving a legitimate aim.

The Government subsequently applied to the Supreme Court to appeal the judgment but their application was denied on 27 June 2019. On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases. A ministerial statement in response to this was published on 13 May 2021 and revised Regulations are awaited to bring a remedy into play.

At the time of drafting this FSS, Regulations and therefore confirmation of the remedy are not yet finalised and are expected in 2023.

#### **Cost control mechanism**

As a result of the public service pension schemes reforms, the Government established a cost control mechanism for all those schemes to ensure a fair balance of risks between scheme members and the taxpayer. The process has been complex and has still not been fully resolved. Although the 2016 cost cap valuation report for the LGPS has been published, at the time of writing there is still a challenge outstanding regarding the inclusion of McCloud in the cost cap. Therefore, there is still a possibility that the 2016 valuation may have to be revisited with the small chance that benefit improvements will be required and potentially backdated to April 2019.

For the purposes of the 2022 valuation, we have made no allowance for any potential benefit changes. The Fund's prudence allowance already allows for an element of regulatory uncertainty and any potential impact is not deemed to be material.

#### **Consultation: Local government pension scheme: changes to the local valuation cycle and management of employer risk**

On 8 May 2019, the government published a consultation seeking views on policy proposals to amend the rules of the LGPS in England and Wales. The consultation covered:

- amendments to the local fund valuations from the current three year (triennial) to a four year (quadrennial) cycle;
- a number of measures aimed at mitigating the risks of moving from a triennial to a quadrennial cycle;
- proposals for flexibility on exit payments;
- proposals for further policy changes to exit credits; and
- proposals for changes to the employers required to offer LGPS membership.

The proposals for flexibility on exit payments and for further policy changes to exit credits have been finalised, however, the other three proposals are still to be finalised. This FSS will be revisited once the outcome is known and reviewed where appropriate.

*Timing of future actuarial valuations*

LGPS valuations currently take place on a triennial basis which results in employer contributions being reviewed every three years. In September 2018 it was announced by the then Chief Secretary to HMT, Elizabeth Truss, that the national Scheme valuation would take place on a quadrennial basis (i.e. every four years) along with the other public sector pension schemes. The results of the national Scheme valuation are used to test the cost control mechanism and HMT believed that all public sector schemes should have the cost control test happen at the same time.

*Changes to employers required to offer LGPS membership*

At the time of drafting this FSS, under the current Regulations further education corporations, sixth form college corporations and higher education corporations in England and Wales are required to offer membership of the LGPS to their non-teaching staff.

With consideration of the nature of the LGPS and the changes in nature of the further education and higher education sectors, the government has proposed to remove the requirement for further education corporations, sixth form college corporations and higher education corporations in England to offer new employees access to the LGPS. Given the significance of these types of employers in the Fund (colleges and universities make up around 10% of payroll), this could impact on the level of maturity of the Fund and the cashflow profile. For example, increased risk of contribution income being insufficient to meet benefit outgo, if not in the short term then in the long term as the payroll in respect of these types of employers decreases with fewer and fewer active members participating in the Fund.

This also brings an increased risk to the Fund in relation to these employers becoming exiting employers in the Fund. Should they decide not to admit new members to the Fund, the active membership attributable to the employers will gradually reduce to zero, triggering an exit under the Regulations and a potential significant exit payment. This has the associated risk of the employer not being able to meet the exit payment and thus the exit payment falling to the other employers in the Fund.

In November 2022, the Office of National Statistics reclassified FE colleges as public sector employers. At the time of writing, this does not require any action for colleges with regards to the LGPS, and therefore there has been no change in treatment of these employers as a result of the reclassification.

**Governance**

Many different employers participate in the Fund. Accordingly, it is recognised that a number of employer-specific events could impact on the funding strategy including:

- Structural changes in an individual employer's membership;
- An individual employer deciding to close the Scheme to new employees; and
- An employer ceasing to exist without having fully funded their pension liabilities.

However, the administering authority monitors the position of employers participating in the Fund, particularly those which may be susceptible to the events outlined, and takes advice from the Fund Actuary when required. In particular, the Fund will commission an employer risk review from the Fund Actuary on a regular basis, as part of each actuarial valuation as a minimum, to help identify the employers in the Fund that might be considered as high risk. In the case of admitted bodies, the Fund has a policy of requiring some form of security from the employer, in the form of a guarantee or a bond, in case of employer default where the risk falls to the Fund. Where the risk of default falls on the original letting authority, the Fund provides advice to the letting authority to enable them to make a decision on whether a guarantee or a bond should be required.

In addition, the administering authority keeps in close touch with all individual employers participating in the Fund to ensure that, as administering authority, it has the most up to date information available on individual employer situations. It also keeps individual employers briefed on funding and related issues.

## **16. Monitoring and review**

This FSS is reviewed formally, in consultation with the key parties, at least as part of each actuarial valuation process.

The most recent valuation was carried out as at 31 March 2022, certifying the contribution rates payable by each employer in the Fund for the period from 1 April 2023 to 31 March 2026.

The timing of the next funding valuation is due to be confirmed as part of the government's *Local government pension scheme: changes to the local valuation cycle and management of employer risk* consultation which closed on 31 July 2019. At the time of drafting this FSS, it is anticipated that the next funding valuation will be due as at 31 March 2025.

The administering authority also monitors the financial position of the Fund between actuarial valuations and may review the FSS more frequently if necessary.