Pensions Committee

2.30 p.m., Wednesday, 25 March 2015

Funding Strategy Statement

Item number	5.6
Report number	
Executive/routine	
Wards	All

Executive summary

As required under the Local Government Pension Scheme (Scotland) Regulations, the Lothian Pension Funds' Funding Strategy Statement has been reviewed as part of the actuarial valuation process to ensure that it remains appropriate. In revising the Funding Strategy Statement, due consideration has been given to:

- Actuarial valuation results;
- Consultation feedback from Fund employers;
- Results of the review of employer covenant;
- Revised guidance from CIPFA ; and
- Forthcoming changes to the Local Government Pension Scheme.

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Report

Funding Strategy Statement

Recommendations

The Pensions Committee is requested to:

1.1 Approve the revised Funding Strategy Statement;

1.2 Note the responses received as part of the consultation process.

Background

2.1 The Funding Strategy Statement (FSS) is a policy document which summarises the approach to funding pension liabilities. Relevant policies on:

- Employer admission to the Fund;
- Bulk transfers;
- Employers leaving the Fund and
- Charging

are appended to the FSS for completeness.

2.2 The FSS was last reviewed and updated in March 2012 during the 2011 actuarial valuation.

Main report

Actuarial Valuation of the Pension Funds

3.1 As separately reported to Committee on this agenda, the Fund Actuary carried out a valuation of the Funds as at 31 March 2014. These valuations are required under regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 and the Actuary has prepared the reports in line with required Technical Actuarial Standards.

3.2 The valuation reports contain rates and adjustment certificates setting out employer contribution rates for the 3 years from 1 April 2015. Such certificates must be in place before the first anniversary of the valuation date i.e. by 31 March 2015. In setting contribution rates, the Actuary must have regard to the Funding Strategy, and the Actuary will certify these rates following Committee approval of the FSS.

CIPFA Guidance

3.3 The Scheme regulations require that in formulating the FSS, Funds must have regard to relevant CIPFA Guidance. The draft FSS has been amended to reflect the current CIPFA guidance ("Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2012'), this includes changes to the structure of the document and inclusion of extracts of the Fund's risk register.

Local Government Pension Scheme (Scotland) Regulations 2015

3.4 As reported to Committee separately on this agenda, a new Local Government Pension Scheme will be introduced in Scotland from 1 April 2015. Therefore, regulatory references in the FSS have been amended.

Contribution Stability Mechanism (Section 8.5 of Appendix)

3.5 As previously reported to Committee, a contribution stability mechanism has been in operation since the last actuarial valuation. Following further work with the Fund Actuary, a revised mechanism was agreed for certain employers in Lothian Pension Fund. This mechanism is intended to be in place for 6 years (2 valuation cycles).

3.6 The contribution stability mechanism has been made available to employers:

- which allow new employees to join the Fund;
- have contribution rates calculated on an individual basis;
- offer a satisfactory covenant; and
- (where applicable) have the agreement of their guarantor to participate in the mechanism.

3.7 Employers in this group who are admitted bodies but do not have a guarantor, will be required to obtain a guarantor in order to remain part of the Contribution Stability Mechanism. The Fund will engage with these employers in order to regularise admission documentation and to include an appropriate guarantor.

3.8 Employers had the option to opt out of the contribution stability mechanism. One employer has elected to opt-out and pay the theoretical contribution rate instead.

Change to funding strategy for employers close to exit (Section 8.2 of Appendix)

3.9 Work carried out as part of the review of the employer covenant highlighted the fact that a number of employers have very few active members and are therefore close to exit. When the last active member leaves the Fund, as required by the Scheme regulations (and the Fund's policy on employers leaving Fund), a cessation valuation must be carried out to value the employer's liabilities and identify any payment required to cover such liabilities.

3.10 The Fund's policy has been for the cessation valuation to be undertaken using government bond discount rate with a prudent allowance for mortality improvements. As a result, cessation valuations can often result in large deficits. This approach is unchanged in the draft FSS. However in order to improve employers' understanding of cessation valuations, the Actuary has provided each employer with the value of their pension liabilities on the cessation basis as at 31 March 2015.

3.11 In order to address the previous inconsistency between the actuarial valuation and cessation valuation, a revised funding and contribution strategy has been proposed for those employers with:

- less than 5 active members, and/or
- a future working lifetime of active members of less than 6 years.

3.12 For such employers, the proposed funding strategy is based on a more prudent gilts basis, akin to that used in the cessation valuation. In addition employer contributions have been based on their liabilities, rather than being part of a Pool. In effect, the proposed funding basis aims to spread the deficit payment payable on cessation over the future working lifetime of the active members.

3.13 As well as raising awareness of the cessation valuation, this strategy smoothes employer contributions in the period leading up to the employer's exit from the Fund. It also reduces the risk of employers being unable to pay large deficits when the last active member leaves.

3.14 A change in investment strategy is also proposed for these employers. Assets will be invested in lower-risk investments which will help reduce the degree of short-term change in employer contribution rates in the period prior to the employer leaving the Fund.

Change to employer pooling (Section 8.4 of Appendix)

3.15 The FSS includes a change to the pooling arrangements for the calculation of contribution for small employers. Two previous pools ('Closed' and 'Open' pools for employers closed and open to new entrants respectively) have been merged into one pool for the purposes of sharing demographic experience and smoothing contribution rates. A single pool of employers is thought to be more sustainable as the number of employers open to new entrants reduces over time and employers closed to new members leave the Fund. Actuarial adjustments are made to contribution rates in order to recognise the differences in funding between open and closed employers.

Review of other policies appended to the FSS

3.16 The policies appended to the FSS have also been reviewed. The Bulk Transfer policy has been published which outlines the procedure which will be followed in circumstances where a number of Scheme members are transferred into, or out of, the Fund. The general principle is that bulk transfers should be 'cost neutral' to the Fund.

3.17 The policy on employers leaving the Fund has been amended to allow discretion on the basis of the cessation valuation calculation where a successor body, or guarantor, for an employer has sufficient covenant strength to justify less prudent assumptions. Such flexibility would be useful to cope with the increasingly complex employer reorganisations which the Fund is seeing.

3.18 The Charging Policy has been amended to incorporate costs recharged to Scheme members to provide transparency on all circumstances where fees are recharged by the Fund.

Consultation with employers

3.19 As required under the Scheme regulations, a draft FSS was issued to employers for consultation. Feedback received from employers, together with the Fund's response is summarised and attached as Appendix 2 to this report.

3.20 In addition, several meetings were held with smaller employers close to exit whose contributions payable from 1 April 2015 are adversely affected by the proposed change to the funding strategy.

Measures of success

4.1 The funding strategy should ensure that the Fund has sufficient assets to meet pension obligations in the long term.

Financial impact

5.1 The funding strategy should ensure that the Fund has sufficient assets in the long term to meet its liabilities.

5.2 The funding strategy and the results of the actuarial valuation have significant financial impact on the Fund's employers. The contribution stability mechanism was introduced to provide certainty of pension contributions to certain Fund employers for future years, together with appropriate assurance of funding level to the Fund.

Risk, policy, compliance and governance impact

6.1 An extract from the Lothian Pension Fund risk register is included in the FSS. The change in funding strategy for small employers close to exit should improve employers' awareness of cessation valuations and reduce the risk that such employers are unable to meet deficit payments with the resulting liability being spread over all other employers within the Fund.

Equalities impact

7.1 There is no equalities impact.

Sustainability impact

8.1 There is no sustainability impact.

Consultation and engagement

9.1 The revised FSS was drafted in consultation with the Fund Actuary, Hymans Robertson. As noted above, a copy of the draft revised FSS was issued to employers for consultation. A summary of the responses received is attached as Appendix 2 to this report.

9.2 In addition, the Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to governance.

Background reading / external references

None.

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Links

Coalition pledges	
Council outcomes	CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed
Single Outcome Agreement	
Appendices	Appendix 1: Revised Funding Strategy Statement Appendix 2: Feedback from consultation

FUNDING STRATEGY

STATEMENT

MARCH 2015

Contents

1. Introduction

This is the Funding Strategy Statement (FSS) of Lothian Pension Fund ("the Fund"). It is prepared and maintained by the City of Edinburgh Council, the Administering Authority for the Fund, in consultation with the Fund's Actuary and following a period of consultation with participating employers.

The Funding Strategy Statement is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues.

This Funding Strategy Statement is produced in accordance with the Chartered Institute of Public Finance & Accountancy (CIPFA) revised guidance "Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2012"), which affirms the FSS as being a key part of a pension fund's risk management framework.

This statement was agreed by the Pensions Committee on 25 March 2015 and is effective from 1 April 2015. It replaces all previous Funding Strategy Statements and policies on funding.

1.1 Maintenance

The Administering Authority will review the Funding Strategy Statement every three years in conjunction with actuarial valuations or more frequently if considered appropriate.

1.2 Availability

This document is available on the Fund's web site (www.lpf.org.uk). Printed copies are available on request.

2. Purpose of the Funding Strategy Statement

The Department for Communities and Local Government has stated that the purpose of the Funding Strategy Statement is:

- "to establish a ***clear and transparent Fund-specific strategy*** which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory 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 statement and appendices set out how the Administering Authority balances the potentially conflicting aims of affordability of contributions, transparency of process, stability of employers' contributions, and prudence in the funding basis. Specific clarity is provided as to the Fund's policies in respect of:

- employers being admitted to the Fund;
- employers leaving the Fund (cessations);
- bulk transfers; and
- the charging for services and recovery of costs incurred.

2.1 Regulatory Framework

Pension benefits accrued by members of Lothian Pension Fund are determined by statute.

The contributions paid by the members of the Fund are fixed in the Scheme Regulations. Employers pay the balance of the cost of delivering the benefits, however, in line with the requirements of the Public Service Pensions Act 2013, the Scheme Regulations incorporate a cost sharing mechanism to ensure sustainability of the Scheme over the long term.

The Funding Strategy Statement focuses on the pace at which employers pay for the benefits i.e. the approach used to determine contribution rates. It forms part of a framework that includes:

- the Local Government Pension Scheme) (Scotland) Regulations 2014 (as amended) and the LGPS (Management and Investment of Funds) (Scotland) Regulations 2010;
- the Pensions Committee, the Pensions Audit Sub-Committee and the Pension Board;
- the Rates and Adjustments Certificate, which can be found appended to the Fund Actuary's valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and

- the Fund's Annual Report, including the Annual Governance Statement, the Governance Compliance Statement and the Statement of Investment Principles.

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.

3. Purpose of the Fund

3.1 Purpose of the Fund

- The Fund provides benefits to members and their dependants. The Fund receives contributions, transfer payments and investment income;
- pays pension benefits, transfer values and administration costs; and
- makes investments to meet the future costs of pension promises made to members of the Scheme.

as defined in the Local Government Pension Scheme (Scotland) Regulations 2014 and the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.

4. Responsibilities of the Key Parties

The sound and effective management of the Fund can only be achieved if all interested parties exercise their statutory responsibilities conscientiously. Although a number of these parties, including investment managers and external auditors, have a responsibility to the Fund, the following may be considered of particular relevance to the funding strategy:

4.1 The Administering Authority should:

- operate the Fund as per the Regulations;
- collect and account for employer and employee contributions, investment income and other amounts due to the Fund as stipulated in the Scheme regulations;
- invest surplus monies in accordance with the regulations;
- ensure that sufficient cash is available to meet liabilities as and when they fall due;
- pay relevant benefits from the Fund as set out in the Scheme regulations;
- manage the actuarial valuation process in consultation with the Fund's Actuary;
- prepare and maintain a Funding Strategy Statement and Statement of Investment Principles after proper consultation with interested parties;
- monitor all aspects of the Fund's performance and funding, and amend the FSS/SIP accordingly;
- take measures as set out in the Scheme regulations to safeguard the Fund against the consequences of employer default;
- effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and scheme employer;
- manage any cessation valuation in consultation with the Fund's Actuary;
- prepare and maintain admission, cessation, bulk-transfer and charging policies. The admission, cessation and charging policies are included in this document, and

- fulfil all other duties as specified in Lothian Pension Fund's Pensions Administration Strategy – available in the 'publications' section of the Fund's website www.lpf.org.uk

4.2 The Individual Employers should:

- calculate an employee's contribution rate and deduct the correct contributions from members' salaries;
- pay employee and employer contributions to the Administering Authority on a timely basis and provide appropriate supporting documentation in a format and timescale specified by the Fund;
- develop and maintain a policy where discretion can be exercised within the regulatory framework (e.g. granting enhanced benefits) bearing in mind costs
- make additional contributions, in accordance with agreed arrangements, for augmentation of scheme benefits and early retirement strain;
- notify the Administering Authority promptly of organisation changes for example, changes in ownership or structure, TUPE transfers which could affect future funding;
- notify the Administering Authority of a possible ending of its admission agreement/participation in the Fund within the terms of that agreement or otherwise as required by the Regulations (typically a 3 month notice period is required), including closed employers where the last employee member is leaving (whether due to retirement, death or otherwise leaving employment);
- meet costs as specified in the Charging Policy (see appendix D); and
- fulfil all other duties as specified in the Fund's Pensions Administration Strategy.

4.3 The Fund Actuary should:

- prepare actuarial valuations to assess the solvency of the Fund and the required employers' contribution rates;
- engage with the Administering Authority in consultation processes;
- advise on bulk transfers and individual benefit related matters;
- provide advice and valuations on the termination of admission agreements;
- provide advice to the Administering Authority as required 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 required by the regulations; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

5. General Funding and Solvency Issues

5.1 Funding Principles

The cost of the benefits is not known in advance. The approach to funding determines the pace at which employers pay for the benefits and the ways in which the Fund ensures that it will have enough money to pay the benefits due to its members.

The "solvency" or "funding level" is a measure of the amount of money held in the Fund at a point in time compared to the value of the benefits promised to its members. It is calculated by dividing the assets of the Fund by the value of the accrued liabilities.

The Fund's Actuary is required to report on the solvency of the Funds and recommend future employer contribution rates every three years. In assessing the solvency and employer contribution rates, the Actuary makes a number of financial and demographic assumptions (see below). The solvency of the Funds and the contribution rates can be very sensitive to these assumptions.

The Funds seek to achieve solvency (i.e. a funding level) of 100% over a period in time.

In calculating solvency, the Actuary values the benefits using the assumptions described above. Assets are taken into account at their market value.

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

The principal issues facing the solvency of the Funds include the ability to finance liabilities as and when they arise, the rate or volatility in the rate of contribution paid by the employers, the pace at which deficits are recovered (or surpluses used up) and the returns on the Fund's investments.

5.2 Financial Assumptions and Link to Investment Strategies

The key financial assumption in calculating the solvency and contribution rates is the rate of return which will be achieved on the Funds' investments. The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns (resulting from the investment strategy). To the extent that investment returns may be lower than expected, then higher contributions may be required from employers, and vice versa. Hence, the funding and investment strategy are inextricably linked.

The expected return is based on the yield on UK government bonds (gilts) at the time of the actuarial valuation. If appropriate, allowance is made for the fact that the investment strategy includes assets other than gilts which are expected, over the long term, to deliver a higher return for the Fund.

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

The Funds invest in assets other than gilts in order to reduce the cost to the employer in the long term.

However, the investments are not guaranteed to deliver returns in excess of gilts. This means that the solvency can be volatile, particularly in the short term. In order to minimise the degree of short-term change in employer contribution rates, expected investment returns are considered over the long term.

The Pensions Committee is responsible for setting investment strategies after taking professional investment advice. The Funds shall undertake a regular review of the Funds' investment strategies to ensure appropriate alignment with their liabilities. Employer covenant and membership maturity profile are both risk factors which may impact on liabilities and therefore which will be taken into account.

The Investment Strategy Panel meets quarterly to monitor the investments of the Fund. The Panel discusses issues such as asset allocation, risk and performance. This includes how investments are spread across different assets, countries, sectors and companies in order to reduce the overall risk.

Further information on the investment strategy can be found in the Funds' Statement of Investment Principles which is available on the website (www.lpf.org.uk).

5.3 Demographic Assumptions

The Actuary makes a number of demographic assumptions including mortality, salary growth, rates of retirement, commutation experience and withdrawal. They are intended to be best estimates of the future experience of the Funds.

The assumptions take into account the past experience of the employer and Funds, other Local Government Pension Schemes and/or the general population, as considered appropriate by the Actuary.

5.4 Contributions

Employee contributions are determined by the Local Government Pension Scheme (Scotland) Regulations 2014. A member's contribution rate is calculated on an annual basis, dependent on their actual pensionable pay at 31 March each year and allowing for any election made under Regulation 10 (50:50 option).

Employer contributions are calculated by the Fund Actuary. They are made up of two elements:

A. an estimate of the cost of benefits accruing in the future, referred to as the “future service rate” and;
B. an adjustment for the solvency of the Fund based on the benefits already accrued. If there is a surplus, there may be a contribution reduction; if there is a deficit there may be a contribution increase. For all employers, contributions to cover any Past Service Deficit are expressed as a fixed monetary sum, rather than as a percentage of payroll. The period over which any funding deficit or surplus is spread for each Fund is covered further in Sections 6, 7 and 8 below.

All employers are required to pay the estimated additional cost (strain cost) of **non-ill health early retirements**, to allow for the fact that the pension is paid earlier and for longer. This is calculated and payable at the time of the early retirement.

The Administering Authority periodically monitors the actual contributions received to ensure they are in line with those expected. As set out in the Fund’s Pensions Administration Strategy, employers are expected to provide requisite detailed information on a monthly basis to assist this monitoring exercise and to substantiate the payments made.

The contribution rates are subject to review and change if there are changes in employer circumstances between actuarial valuations for example if an employer closed to new members or left the Fund.

6. Funding – Scottish Homes Pension Fund

Scottish Government acts as guarantor to the Scottish Homes Pension Fund. A bespoke funding strategy has been developed for the Scottish Homes Pension Fund. This has been agreed by the Administering Authority, the Fund's Actuary and the Scottish Government (previously known as the Scottish Executive).

The strategy aims for the Fund to be 100% solvent by 2044 using a discount rate based on government bonds. It includes target funding levels at each actuarial valuation. Contributions from the Scottish Government are determined by reference to the target funding levels. The deficit recovery period is 8 years.

The funding strategy is designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time, with a reducing allocation to equities over time reflecting the requirement of the Scottish Government to lock away any surpluses that may occur over time by accelerating the transfer into bonds.

7. Funding – Lothian Buses Pension Fund

The Lothian Buses Pension Fund closed to new members in 2008 and the liabilities are expected to mature over time.

The objectives of the funding strategy include:

- to ensure solvency of the Fund;
- to minimise the degree of short-term change in employer contribution rates;
- reduce the risk of the investment strategy over time;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment

When determining employer contributions at the Fund Actuary's triennial valuation the Administering Authority may (after consultation with the Fund Actuary) take into account any events that arise after the valuation date, but before the formal valuation report is signed off (which must occur within one year of the valuation date), that materially affect the employer contributions. In doing so, the Fund will aim to achieve the objectives of the funding strategy.

Changes in employer contributions may be phased over time in order to minimise the degree of short-term change. The Administering Authority in consultation with the Fund's Actuary and the employer decides how any reductions or increases to contribution rates are introduced.

8. Funding – Lothian Pension Fund

8.1 Objectives of the Lothian Pension Fund's Funding Strategy

The objectives of the funding strategy include:

- to ensure the long-term solvency of the overall Fund;
- to ensure the solvency of each individual employers' share of the Fund based on their expected term of participation in the Fund;
- to minimise the degree of short-term change in employer contribution rates;
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities; and
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

8.2 Investment Strategy

Overall the Fund adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer.

However employers (with the exception of Transferee Admitted Bodies) who are closed to new members and have less than 5 active members, or are expected to leave the Fund within two valuation periods (6 years), will be assumed to be invested in lower-risk investments i.e. index-linked government bonds. This aims to reduce the degree of short-term change in employer contribution rates in the period prior to the employer leaving the Fund and hence manage risks for both the individual employer and for the Fund as a whole,

In addition it is recognised that within Lothian Pension Fund, employers' circumstances vary and there may be demand from other employers for a lower-risk investment strategy for their section of the Fund. The Fund will consider such requests subject to practical implementation. However it is not practical for the Fund to offer individual employers full flexibility on asset allocation.

Where a different investment strategy is adopted for specific employer(s), the basis used to calculate employer contribution rates may be adjusted if appropriate.

8.3 Notional Sub-Funds for Employers

In order to establish contribution rates for individual employers or groups of employers, it is convenient to notionally subdivide the Fund as a whole between the employers, as if each employer had its own notional sub-fund within the Fund. This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, nor ownership of any particular assets or groups of assets by any individual employer or group.

The Lothian Pension Fund does not account for each employer's assets separately on a cashflow basis. The Fund's Actuary apportions the assets between the employers at each valuation using income and expenditure figures and an 'analysis of surplus' approach.

8.4 Grouping

Changes in employer contributions may be phased over time in order to minimise the degree of short-term change. The Administering Authority, in consultation with the Fund's Actuary and the employer, decides how any reductions or increases to contribution rates are introduced.

The **large employers** in the Fund are required to fund the benefits of their own employees; the Actuary calculates a different contribution rate specific to each large employer.

Individual contribution rates will also apply to:

- Transferee Admission Bodies;
- employers who have less than five active members or are expected to leave the Fund within two valuation periods (6 years). See Section 8.2 above; and
- other small employers who do not qualify for inclusion in the pool due to the funding level criteria (see below).

Other **smaller employers** who are grouped together for the purpose of calculating contribution rates at the actuarial valuation. This grouping provides some protection against changes in the contribution rate of a small employer from one actuarial valuation to the next.

Criteria are set for the purpose of determining which employers should be part of the Pool in order to manage the risk for both the individual employer and for the Fund as a whole. The Administering Authority has ultimate discretion in determining whether or not an employer joins and remains in the Pool and may remove an employer from the Pool if its experience or characteristics are extreme or untypical compared to other employers in the Pools. To be included:

- an employer should generally have less than 100 total members and/or;
- have an average full time equivalent annual salary of less than £40,000;
- funding level of at least 80% at each of the current and previous actuarial valuations for an employer open to new entrants; and
- funding level of at least 90% at each of the current and previous actuarial valuations for an employer which is closed to new entrants.

The Pool criteria and individual employer's participation in the Pool will be reviewed at each valuation. For example if a small employer's funding level has recovered, they will rejoin the Pool, and pay the appropriate Pool contribution rate.

Employers in the Pool pay either the Open Rate or Closed Rate.

- The Open Rate applies to employers who allow new employees to join the Fund;
- Those employers in the Pool, who no longer allow new employees to join the Scheme, pay a higher rate (‘the Closed Rate’) to account for the fact that membership numbers are reducing over time, and so their membership profile is maturing; and
- Any employer who does not admit any new entrants within a reasonable period is deemed to be closed to new entrants. For the purposes of this statement, a reasonable period is an inter-valuation period (i.e. three years between formal valuations of the Fund). Any employer who elects to close to new entrants will revert to the Closed Rate with immediate effect. Any employer classed as ‘deemed closed’ which takes on new staff who join the Scheme will revert to the Open Rate with immediate effect.

8.5 Contribution Stability

The policy of the Fund is to operate a Contribution Stability Mechanism on an ongoing basis subject to regular reviews in order to provide certainty of pension contributions to Fund employers for future years, together with ensuring appropriate assurance of funding level to the Fund. Contribution stability will not be offered to all employers – each employer’s particular circumstances will be considered, in particular the strength of the covenant offered and the extent of membership commitment to the Fund. Employers are not obliged to participate in the Contribution Stability Mechanism, but if they wish to opt out, they must make an election at the outset. This election will cover the entire duration of the current Contribution Stability Mechanism (expected to be 6 years from the 2014 actuarial valuation) as well as future reviews of the Contribution Stability Mechanism. Any decision to allow an employer to join the Contribution Stability Mechanism at a later date will be at the discretion of the Administering Authority.

An employer which chooses not to participate will instead pay the theoretical contribution rate (as set by the Fund Actuary at the actuarial valuation) for the 3 years from 1 April 2015 (allowing for phasing to minimise the degree of short term change) and thereafter.

Employers which are open to new entrants and have contribution rates calculated based on their individual circumstances will be offered contribution stability subject to:

- satisfactory assessment of the employer covenant; and
- agreement by their guarantor to inclusion of the employer in the contribution stability mechanism where appropriate

For the 2014 actuarial valuation, the Contribution Stability Mechanism is expected be in place for 2 actuarial valuation periods (or 6 years). Employer contributions will be frozen, at the total rate determined at the 2011 valuation, until 31 March 2018. Thereafter, for the next three years, rates could only vary from this rate by a maximum of plus or minus 0.5% per annum.

An employer's participation in the Contribution Stability Mechanism is expected to extend to the full duration of the mechanism. However, contribution stability will be subject to ongoing review by the Fund which reserves the right to remove an employer from the Contribution Stability Mechanism should particular circumstances deem it prudent to do so, for example assessment of employer covenant, financial or demographic experience. In addition, if an employer closes to new entrants they will be removed from the Contribution Stability Mechanism and a recalculation of their contribution rate may be required.

Contribution stability will not be afforded to the following employers:

- Employers which are closed to new entrants;
- Transferee Admission Bodies; and
- Community Admission Bodies which are part of the Pool.

Full information on the Contribution Stability Mechanism is available on the Fund's website.

8.6 Deficit/Surplus Spreading

In deciding the period over which any funding deficit or surplus is spread, the Administering Authority considers a number of factors including the objective of minimising the degree of short term change in employer contribution rates and employers' ability to meet their commitments to the Fund.

The deficit recovery periods used for different employers range from 20 years for Councils to the remaining contract period for Transferee Admission Bodies which can in some cases be a matter of months. The differences in deficit recovery periods reflect the financial strength of the employers and the perceived long-term commitment to the Fund.

The following table shows the employers in the Fund for which are required to fund the benefits of their own employees, setting out the key characteristics of each type of employer which influence the period over which any surplus/deficit has been spread.

	Employer	Deficit Recovery Period (Years)
Councils/Large Scheduled bodies	City of Edinburgh Council	20
	Midlothian Council	
	West Lothian Council	
	East Lothian Council	
	Scottish Fire & Rescue Service (Civilians)	20
	Police Scotland (Civilians)	20
	Lothian Valuation Joint Board	20
	Forth Estuary Transport Authority	20
	Scottish Water	20
	Lothian Buses	FWL [1]
	Scottish Police Authority	FWL [1]
Universities / Colleges	Heriot-Watt University	15
	Newbattle Abbey College	
	Queen Margaret University College	
	Napier University	
	Edinburgh College	
	West Lothian College	
	Scottish Rural University College	FWL [1]
	University of Edinburgh	
Other Large employers	Audit Scotland	15
	Barony Housing Association	
	Convention of Scottish Local Authorities	
	Visit Scotland	
	West Lothian Leisure	FWL[1]
	Edinburgh Leisure	
	EDI	
	CHAS	
	The Improvement Service	
	SESTRAN	
Transferee Admission Bodies		Shorter of FWL [1] or contract period

[1] Future Working Lifetime of current active members

In calculating the contribution rate for the groups of small employers (including the 'Pools), the deficit is spread over the Future Working Lifetime of current active members

8.7 Post Valuation Adjustments

When determining future employer contributions at the triennial actuarial valuation the Administering Authority may (after consultation with the Fund Actuary) take into account any events that arise after the valuation date, but before the formal valuation report is signed off (which must occur within one year of the valuation date), that materially affect the employer contributions referred to above. In doing so, the Fund will aim to minimise the degree of short-term change in employer contribution rates while still ensuring the long-term solvency of the overall Fund

8.8 Employers Joining the Fund

Appendix A sets out in full the Fund's policy on employers joining the Fund.

Bodies applying to join the Fund will be provided with a copy of this Statement and will be required to provide a written undertaking that they understand and are aware of the long-term financial implications of participation in the Fund.

8.9 Employers Leaving the Fund

Appendix C sets out in full the Fund's policy on employers leaving the Fund in any of the following circumstances:

- When the employing authority is wound up or liquidated;
- When the last active member leaves or retires from an employer;
- When the admission agreement is otherwise terminated by either the employing authority or the admission authority, subject to the notice period specified in the admission agreement;
- In the case of Transferee Admission Bodies, when the contract comes to an end and is not renewed;
- In the case of scheduled bodies, when the body no longer has an active member contributing to the Fund or through changes in over-riding legislation or Government policy can no longer contribute to the Local Government Pension Scheme; and
- Where an employer has an active admission agreement, but no active members and no new members will join in the future, then the admission agreement will be terminated and actions detailed in Appendix C will apply, other than where specific provision exists in the admission agreement for such circumstances.

8.10 Bulk Transfers

The treatment of bulk transfers of pension rights to and from the Fund are detailed in Appendix B.

Lothian PENSION FUND

9. Key Risks and Controls

The Administering Authority has an active risk-management programme in place. The risk register is reviewed periodically with a quarterly summary provided to the Pensions Committee. The following extract from the risk register, with Impact and Likelihood for each risk scored on a scale of 0-10, highlights those risks which can be considered of particular relevance to the funding strategy:

Risk	Existing controls	Impact*	Likelihood*	Current Risk
Investment performance leading to pressure on employer contributions	• Regular actuarial valuations & review of funding strategy, including longevity assessment. • Regular asset liability studies. • Frequent performance assessment by Investment Strategy Panel. • Bespoke investment strategy offered to employers.	5	4	20

The collapse of an Employer body member, leading to pressure on other employers	• Improved and enhanced Admissions Policy including use of guarantees.
	• Regular contact with employers.
	• Education to improve understanding, including grant funding implications.
	• Employer covenants on-going review.
	  • Membership and employer monitoring
	  • Funding strategy now consistent with cessation policy
		4	8	32

Employers make HR decisions without considering the impact on the pension fund	• Monitoring via actuarial valuation. • Employer training programme. • Communications - employer bulletin. • Individual employer contribution rates. • Pensions Administration Strategy. • Funding Strategy Statement. • Staff Training. • Take note/action when last active member leaves or retires.	3	3	9
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	• Regular actuarial valuations and review funding strategy, including longevity assessment. • Pooling for small employers to reduce volatility. • Regular contact with employers. • Contribution stability in place	5	6	30

*Assessed on a scale of 1-10

Appendix A: Admission Policy

1. Background

The Local Government Pension Scheme (LGPS) (Scotland) Regulations contain powers for the City of Edinburgh Council (CEC) to admit bodies into the Lothian Pension Fund. Those bodies must meet certain conditions, generally relating to their purpose and aims, contained in the regulations before being considered for admission.

This document sets out the policy of CEC as Administering Authority of Lothian Pension Fund ('the Fund') in applying discretion to admit, on application, a new body into the fund for the purposes of allowing employees of that body access to the LGPS.

This policy will be reviewed as and when considered necessary.

2. General application of discretion to admit new bodies

The Pensions Committee of the City of Edinburgh Council, as the executive body responsible for the administering authority function, delegates power to approve or reject applications to the Director of Corporate Governance.

The Director of Corporate Governance will consider all applications from bodies who meet the conditions of the scheme regulations. In making his decision, due weight will be given to the merit of the body's financial covenant.

Approved applications will be subject to the conclusion of an admission agreement containing the appropriate matters prescribed in scheme regulations. Appropriate legal advice will be obtained in drafting and concluding admission agreements.

The body will be provided with a copy of the current Funding Strategy Statement of the Fund and will be required to provide a written undertaking that they understand and are aware of the long-term financial implications of participation in the Fund.

A bi-annual report will be submitted to the Pensions Committee providing details of the delegated decisions made during the year.

3. Policy in relation to Transferee Admission Bodies (TABS)

TABS as defined in the scheme regulations will be admitted, subject to the conclusion of an admission agreement between the CEC, the scheme employer (where different) and the TAB. The Scheme employer will also be required to act as a guarantor and undertake to meet any amounts due to the Fund in respect of any funding or contribution shortfall either during or at the cessation of the contract.

4. Policy in relation to Community Admission Bodies (CABS)

CABs as defined in the scheme regulations, and who are based at least in part in the Lothian area, may be admitted to the Fund.

The applying CAB must provide documentary evidence of their:

- aims and objectives;
- articles of association;
- latest annual accounts; and
- future income streams including the source and timing.

CABs will be expected to find a guarantor who will undertake to meet any amounts due to the Fund in respect of any funding or contribution shortfall either during or cessation of the admission agreement. The body must supply documentary evidence of the guarantee obtained and, where considered necessary by CEC, of the financial security of the guarantor.

Appendix B - Bulk Transfer Policy

1. Introduction

This is the policy of Lothian Pension Fund (“the Fund”) as regards the treatment of bulk transfers of pension rights to and from the Fund.

These procedures and policies apply to employers participating in the Main Fund and the Lothian Buses Pension Fund**.**

1.1 Regulatory Framework

The Local Government Pension Scheme (Scotland) Regulations 2014 outline the general framework for employees and employers participating in the Local Government Pension Scheme in Scotland.

1.2 Reviews of Policy

This policy will be reviewed at least every three years following triennial valuations or following changes in the Regulations pertaining to employees transferring rights.

It should be noted that this statement is not exhaustive and individual circumstances may be taken into consideration where appropriate.

2. Principles

2.1 Overriding Principles

The purpose of bulk transfer negotiations is to determine the amount of service credits to be awarded and transfer payment to be paid when a number of members transfer their benefits from one pension scheme or Fund to another.

On transfers out from the scheme, it is the Fund’s general policy that the bulk transfer amount should not leave the Fund (and the specific employer concerned) with insufficient assets to meet the remaining members’ liabilities. Further, where possible, all bulk transfers should be “cost neutral” for the ceding employers, i.e. there should be no financial impact on them, positive or negative, based on the ongoing valuation basis.

On transfers in from another scheme, it is the Fund’s general policy that bulk transfers be treated in the same manner as a transfer out.

However, it should be noted that if a deficit arises as a result of a bulk transfer, either into the Fund or out of the Fund, the employer may, at the discretion of the Administering Authority, be required to repay this deficit as a lump sum or, depending on their financial circumstances, through their ongoing contribution rates.

On transfers from one Fund employer to another existing Fund employer, assets equal to 100% of the transferring liabilities will be notionally transferred, unless otherwise agreed.

On transfer from one Fund employer to a new Fund employer, the following principles will apply:

- A fully funded transfer, on the ongoing valuation basis, will be notionally transferred to the new employer, if the new employer is a TAB, unless otherwise agreed; and
- A share of deficit transfer, on the ongoing valuation basis, will be notionally transferred to the new employer for all other types of employer, unless otherwise agreed.

2.2 Interaction with Funding Policy

It is the Fund's policy that each employer is responsible for the funding of all Fund benefits of its own members, including current and previous employees. Whilst employer contributions may be pooled in the interests of stability and administrative ease for the purpose of triennial funding valuations the individual funding position for each employer is tracked by the Actuary at each triennial valuation.

Any transfer of pension rights may have an effect on the valuation position of the employer and an individual contribution rate may be calculated depending on the effect of the transfer.

2.3 Principles for Determining Payment

The Fund will determine the transfer payment and service credits having taken actuarial advice.

The assumptions proposed / accepted by the Actuary are to be, at a minimum, as strong as those set as at the latest formal valuation of the Fund updated for financial conditions on the date of transfer.

For transfers out of the scheme, the transfer amount will be set equal to the value of benefits accrued to the transfer date for transferring members based on the agreed transfer basis, adjusted to take account of any underfunding in the transferring employer's share of the Fund such that the maximum transfer value is not greater than the reserves held for the transferring members. This approach is known as a 'share of fund' or 'share of deficit' approach.

If, as a result of the transfer out, the employing authority within LPF no longer has any active membership, then a cessation valuation may be triggered. If this is the case, the transfer value may be adjusted such that the reserves of the employer, following transfer, are equal to the value of the remaining deferred pensioner and pensioner benefits within the scheme on the appropriate cessation basis as outlined in the Fund's cessation policy.

For transfers in from a funded scheme, the actuary will be instructed to agree terms where the minimum transfer amount from the ceding scheme should be cost neutral to that scheme. This approach is consistent to the calculation of the transfer amount if there was a transfer out of LPF. If the transfer is from an unfunded scheme, the actuary will be instructed to ensure the transfer value is equal to the value of transferring benefits based on the ongoing valuation basis of LPF based on financial conditions at the date of transfer.

There is normally a lag between the date of the actual transfer of staff and the date of payment. During this period, on transfers out, the agreed transfer value will be adjusted by a factor determined by an estimate of the movement in the investments as determined by the asset allocation of the Fund (or sub-Fund if appropriate) and the respective market indices.

This method of rolling up the transfer payment is to be recommended for incoming bulk transfers as well.

3. Process

3.1 Responsibilities of ceding/receiving employers

An employer which is aware of a transfer from or into the Fund is required to:

- advise the Fund, in writing, of the transfer. This communication should indicate where members are transferring to/from and how many members will potentially transfer;
- provide information and data as requested by City of Edinburgh Council and the actuary to the Fund which is relevant, including in particular any changes to the membership which could affect the liabilities (e.g. salary increases and early retirements), contact details for the ceding/receiving scheme, etc.; and
- assist in the administration of option forms to transferring members as and when required.

3.2 Responsibilities of Administering Authority

The Administering Authority will gather information as required, including, but not limited to, the following:

- details of the transfer – where are members transferring to/from, how many members are involved and (where a transfer out to a non-LGPS scheme) if the receiving scheme is broadly comparable to the LGPS;
- complete membership data for the transferring members;
- commission the Fund actuary to carry out bulk transfer negotiations where necessary;

- where applicable, liaise with the employer and ensure they are aware of their responsibilities, in particular for any residual deficit or risk associated with the transfer; and
- ensure that payments or receipts of transfer value payments are carried out on the agreed dates.

3.3 Responsibilities of the Actuary

Following commission of bulk transfer negotiations by the Administering Authority, the Fund Actuary will:

- on notification of the transfer, ensure that the data and information required is collated;
- propose / agree assumptions and transfer values based on the policies set out by Lothian Pension Fund;
- propose / agree service credits in line with relevant legislation and policies; and
- negotiate and agree the final transfer payment date and amount.

Appendix C: Policy on employers leaving the Fund

1. Introduction

This is the policy of Lothian Pension Fund ('the Fund') as regards the treatment of employers of the Fund.

This policy replaces all previous policies on employer termination and is effective from 1 April 2015.

1.1 Scope of Policy

This policy covers employers leaving the Fund in any of the following circumstances:

- when the employing authority is wound up or liquidated;
- when the last active member leaves or retires from an employer;
- when the admission agreement is otherwise terminated by either the employing authority or the admission authority, subject to the notice period specified in the admission agreement;
- in the case of Transferee Admission Bodies, when the contract comes to an end and is not renewed; and
- in the case of scheduled bodies, when the body no longer has an active member contributing to the Fund or through changes in over-riding legislation or Government policy determines that members can no longer contribute to the Local Government Pension Scheme;

1.2 Reviews of Policy

This policy will be reviewed at least every three years following triennial valuations or following changes in the Scheme Regulations relevant to employers leaving the Fund.

2. Principles

2.1 Overriding Principles

If an employer leaves the Fund, or their admission agreement is otherwise terminated, the Administering Authority will instruct the Fund's Actuary to carry out a valuation of that employer's liabilities (a 'cessation valuation').

Payment of any deficit does not guarantee that the assets in the fund will be sufficient for the liabilities in the future: the actual cost of benefits will only be known after the last dependant dies and there is a risk that the amount estimated in the cessation valuation does not cover the actual cost of the liabilities. In this situation, the Fund would seek recourse from the body which acted as guarantor to the employer, or alternatively the body which the employer was aligned.

The basis used to carry out such a valuation will depend on the circumstances of the change. The Fund's general policy is that the valuation will be carried out on a more prudent basis than that used in the ongoing actuarial valuation. However the Fund may take into account the covenant strength of any successor body and/or guarantor which may be in place after the cessation date.

The employer, successor body and/or guarantor may be required to pay additional contribution(s) or capital payments to the Fund.

In normal circumstances, the Actuary will use the following assumptions for the cessation valuation:

- A discount rate equivalent to the gilt yield at the date of the cessation, with no allowance for outperformance of investments;
- An increase in the liabilities by 5% reflecting anticipated additional future improvements to life expectancies (over and above the ongoing valuation assumption); and
- Other assumptions would be consistent with the most recent actuarial valuation.

However, where the employer leaving the Fund is a Transferee Admission Body, the ongoing basis will be used. On joining the Fund, these employers are set up on a fully funded basis with contribution rates calculated based on the duration of the contract in order to reduce the likelihood of a deficit arising on leaving.

If an employer becomes insolvent and it, or its guarantor, is unable to meet any deficit, additional contributions will be required from each remaining employer in the Fund, in proportion to their liabilities. This means that the majority of any deficit will fall on the large employers. However, where it has been established that there is a specific alignment to one or more other employers, then the pension liability will be assigned or apportioned accordingly to those other employer(s).

In the event of a Transferee Admission Body leaving the Fund and being unable to pay additional contributions to the Fund, the employer granting the contract will be liable for the additional contributions or capital payments.

The purpose of a cessation valuation is to determine the level of any surplus or deficit in an employer's share of the Fund as at the date the employer leaves the Fund. Unless the cost of doing so is deemed to outweigh the likely recovery to the Fund, the Fund will pursue an outgoing body (including the liquidator, receiver, administrator or successor body if appropriate) for any deficit. The Fund will also pursue guarantor, for payment where appropriate.

It is the Fund's policy that the determination of any surplus or deficit on termination should aim to minimise, as far as is practicable, the risk that the remaining, unconnected employers in the Fund have to make contributions in future towards meeting the past service liabilities of current and former employees of employers leaving the Fund.

2.2 Principles for Determining Payment of Cessation Debt

City of Edinburgh Council will determine the deficit / surplus attributable to the employer on cessation having taken actuarial advice.

If the employer is in surplus, there is no mechanism by which this surplus can be repaid by the Fund. If an employer is aware that it will be leaving the Fund for any reason in the near future, it should alert the Administering Authority as soon as it is aware and request a valuation as required under the Scheme regulations. If this valuation indicates that a surplus position is likely, then the Actuary will be able to advise the Administering Authority whether a contribution reduction (before the employer ceases) is appropriate. The Administering Authority will monitor potentially affected employers in order to reduce the risk that an irrecoverable surplus is left in the Fund. In particular, the Authority will carry out periodic reviews of Transferee Admission Bodies whose contract is due to end before the next triennial valuation.

If it is determined that there is a deficit and the employer will be required to make a payment to the Fund, the administering authority will advise the employer of the amount required.

The Fund's general policy is for any deficit on cessation to be recovered through a single lump sum payment to the Fund. In exceptional circumstances, the Fund may consider permitting an employer to spread the payment over an agreed period where it considers that this does not pose a material risk to the solvency of the Fund. The Fund may take into account the covenant strength of any successor body and/or guarantor which may be in place after the cessation date. In this instance, interest at a rate advised by the Actuary will be applied to determine the appropriate payments to be made.

Appendix D Charging Policy

This appendix sets out Lothian Pension Fund's policy on meeting the cost of actuarial fees and other service costs which are recharged to employers. It covers the main circumstances where fees are payable, but is not exhaustive.

The Fund will obtain the consent of the employer or member before carrying out any work which is likely to lead to fees being recharged.

1. Costs recharged to Scheme members

The costs of general pension administration are not recharged to members of the pension fund. However costs associated with complex pieces of work, as well as costs of providing certain other confirmation may be recharged. This includes (but is not limited to) the following:

- costs associated with providing valuations under the Family Law (Scotland) Act 1985;
- costs of implementing pension sharing orders;
- costs of providing further cash equivalent transfer values where this information has already been provided once in the last twelve months; and
- costs of appointments with the Fund's independent medical advisers where appointments have been repeatedly missed without good reason, or where habitual requests for assessment are received without new medical evidence.

Details of the costs payable can be found on the Fund's website (www.lpf.org.uk). These costs will increase annually each April by CPI over the 12 months to the previous September.

2. Costs recharged to Scheme employers

Employers should always contact the Fund in the first instance to establish whether fees will be recharged for any administration process or obtaining professional advice, and to obtain an estimate of likely fees.

Actuarial charges will be met by Lothian Pension Fund where the work is common to all or most employers, or where the work is required by the Scheme regulations and the employer has no choice whether the work is carried out.

However, where work is carried out or advice obtained at the request of a single or small number of employers, is not required by other employers, and is not a regulatory requirement, then the charges for that work or advice are generally recharged to the employer(s) concerned.

The schedule below sets out these activities for which fees will be charged to the Fund and those that will be recharged to the commissioning employer.

3. Schedule

3.1 Actuarial Fees

Activities for which Lothian Pension Fund should be charged:

- all matters relating to the triennial actuarial valuation, except additional work done at the direct request of an individual employer;
- interim actuarial valuations if and when the Administering Authority require such valuations;
- actuarial advice regarding questions concerning the interpretation of Scheme Regulations and matters pertaining to the administration of Fund benefits;
- preparation for and attendance at the Fund meetings; and
- any other matters which affect, or are likely to affect all or a significant number of Fund employers.

Activities for which actuarial fees will be recharged to an employer:

- extra, non-standard triennial actuarial valuation work done for and at the direct request of an individual employer;
- a common actuarial service used by most employers is the provision of figures for IAS19/FRS17/FRS102 accounting disclosure purposes. As this information is for the benefit of individual employers and not the Fund itself, the relevant costs are recharged to the individual employers;
- interim valuations where these are not a requirement for all employers but are either: -
    - required by an employer's admission agreement or;
    - not required but specifically requested by the employer concerned;
- calculations etc. in respect of the admission of a new Fund employer;
- Best Value and other outsourcing calculations and consequent interim valuations;
- where an employer has been admitted to the Fund and is required to provide a bond or indemnity to meet any shortfall in funding in the event of the employer ceasing to participate in the Pension Fund, the cost of assessment and subsequent annual reassessment of the value of the bond or indemnity;
- assessing whether a potential/actual contractor's pension arrangement is "broadly comparable" to the Local Government Pension Scheme;
- any other interim valuations for an employer that is required through some action, or failure to act, by that employer;
- bulk transfer work in respect of transfers out of or into the Fund;
- cessation valuations; and
- any other charges specific to one employer, or specific to such a small number of employers that it would be unreasonable to spread the cost between the membership as a whole. Where a number of employers are involved, the charges will be proportioned in light of the circumstances of the case.

3.2 Other charges

In addition to recharging actuarial fees as specified above, certain requests which result in:

- additional administrative work and advice over and above the norm;
- complex calculations;
- specific work for high earners; and
- the requirement for the Fund to seek advice or commission work from other providers e.g. lawyers will be charged to employers on a full cost recovery basis where this work is specific to one employer or specific to such a small number of employers that it would be unreasonable to spread the cost across all employers. Where more than one employer is involved, charges will be proportioned depending on the circumstances of the case.

Activities for which fees will be recharged to an employer:

- disclosure of information relating to Senior Officers and Councillors for inclusion in Local Authority Accounts:
    - provision of Cash Equivalent Transfer Value calculations and appropriate pension benefit calculations;
    - charges applied per case;
- setting up an Admission Agreement with the Fund for new employers joining the Fund;
    - costs to cover legal fees incurred by the Fund in drafting and finalising the Admission Agreement;
    - See note 1 below;
- attendance at meetings and associated work in connection with Employer projects involving transfers of staff (e.g. outsourcing, mergers etc);
    - a charge will be made where the Fund considers the work undertaken to be in excess of normal advice to employers;
    - costs will be based on Fund Officers time plus VAT;
- interest payable on a cessation valuation where the Fund allows payment to be spread over and agreed period; and
    - Interest will be charged at a rate advised by the Fund Actuary

Notes:

1. Any additional costs arising if specialist actuarial, legal etc advice is requested will be charged in full in addition to the figures quoted above.
2. The Fund will act in accordance with relevant procurement guidance in obtaining external professional services.

Appendix 2

2014 Actuarial Valuation and revision of Funding Strategy Statement

Feedback from consultation

Introduction

The latest actuarial valuation of the Lothian Pension Funds was carried out as at 31 March 2014. As part of the valuation process, the Funds' Funding Strategy Statement (FSS) was reviewed and revised.

Indicative valuation results and proposed changes to the FSS were presented at the Fund's annual seminar on 4 December 2014 (slides are available on the Lothian Pension Fund website), and a copy of the draft revised FSS was issued to employers for consultation in January 2015. This revision also took into consideration:

- Revised guidance from CIPFA published in 2012 'Preparing and maintaining a funding strategy statement in the Local Government Pension Scheme 2012'
- Forthcoming changes to legislation, in particular the introduction of a new Local Government Pension Scheme from 1 April 2015.

In January and February 2015, we also held further meetings with some of the smaller employers to discuss a proposed change in contribution strategy affecting such employers.

This document summarises feedback received from employers including the issues discussed at meetings with employers.

Key issues raised by employers

1) Proposed change in contribution strategy for small employers close to exit

A change in contribution strategy has been proposed for certain smaller employers within the Lothian Pension Fund. Community Admission Bodies with fewer than six active members and/or have a future working lifetime (FWL) of under six years were proposed to move to a 'gilts cessation' basis using more prudent assumptions than the ongoing funding basis. This change results in a higher liability figure and increased employer contributions but is intended to smooth the path to cessation so that when the last active member leaves the Fund, any deficit payment calculated on cessation will be lower.

Employers appreciated the need to address these issues and the opportunity to make a planned exit from the Fund. However some employers directly affected by the change commented that the revised contribution rates were a significant increase and had the potential to lead to issues with service provision and/or the continued existence of the organisation. It was also highlighted that some of the organisations had already provided budgetary information to their funders some time prior to the results being provided and that the proposed contribution rates were in excess of those previously budgeted for. The proposed change in investment strategy for such employers (a move to lower-risk assets – index linked government bonds), was queried by some employers as higher potential returns enjoyed through investing in other asset classes cannot be achieved. Other employers queried the timing of the change in contribution strategy, asking why no previous notification of these issues had been communicated.

Response: *As reported at both the 2014 Finance Briefing and Annual Seminar, the Fund has carried out extensive research on the covenant of all employers contributing to the Lothian Pension Fund. In addition monitoring of membership numbers is carried out regularly and we have contacted employers with small numbers of active members on a number of occasions to highlight the risk of cessation. Despite this, many employers have limited understanding of their pension liabilities. The Fund therefore requested the Actuary provide each employer with the value of their liabilities on a cessation basis as at 31 March 2014 as part of the 2014 actuarial valuation.*

Although Lothian Pension Fund is a multi-employer Fund, each employer is responsible for their own pension liabilities, and the Fund has a duty to <u>all</u> employers within the Fund to ensure that liabilities can be paid for by the relevant employer. The Fund appreciates the funding difficulties faced by third-sector bodies and suggested a number of options which could be available to such bodies as a way forward:

- *Obtain a guarantor to improve the covenant which could allow rates to be reviewed*
- *Offer the Fund security over assets to improve the covenant*

The Fund appreciates that options are limited, but is happy to discuss these options further with organisations providing funding/guarantor to employers.

If an employer is able to materially improve the covenant offered to the Fund, then in consultation with the Actuary, the rates and adjustments certificate would be reviewed to ease the pressure on contribution rates in the short term.

Some employers have requested details of options to exit the Fund sooner than might have been expected in order to prevent the build up of further liability. This would have implications for the affected employees which the employers would need to manage. The Fund will discuss options with those employers.

The Fund acknowledges investment in lower-risk asset classes is expected to produce lower returns in the long term. However returns over shorter periods are more difficult to predict and higher-risk asset classes are more volatile. The affected employers are expected to leave the fund in relatively short periods. Adopting a lower-risk investment strategy is consistent with the use of a government bond discount rate in the cessation valuation, reflecting the fact that no further employer contributions are anticipated after the cessation.

2) The salary assumptions used in the valuation

The long-term salary assumption used in the valuation is 5%. Several employers noted that such increases were unrealistic and they did not expect to be able to increase salaries in the near future.

Response: *The salary assumption is one of many used in the valuation process and applies only to active member liabilities.* Lower salary growth rate has been used for the initial years following the valuation, reflecting the current pay restraint in the public and third sectors. *Although recent financial pressures have resulted in fairly flat salaries, the Actuary has advised that historically, following a period of pay restraint salaries do tend to increase again. As a multi-employer Fund, it would be difficult to use bespoke salary assumptions for different employers.*

3) Risk register

In line with CIPFA guidance, an extract from the Funds' Risk Register highlighting those risks of particular relevance to the funding strategy has been included in the Funding Strategy Statement. One employer asked why only an extract was included in the document rather than the entire risk register.

Response: *The Funds' risk register is an active document which is reviewed quarterly and covers all aspects of the Funds' operations, rather than just funding. The register is a tool to manage risks on a proactive basis. Public disclosure of the risk register could jeopardise the effectiveness of the risk management process itself, for example by potentially hindering discussion and recording of risks due to the fact that disclosure could disadvantage the Fund.*

However a summary is reported to the Pensions Committee. Papers for the Pensions Committee are available on the Fund's website.

4) General comments

The FSS was said to be 'understandable and appropriate'.

Employers close to exit who attended the meetings to discuss the change in strategy were appreciative of the opportunity to engage and discuss the relevant issues.

Other comments from employers related to clarity of certain parts of the FSS.