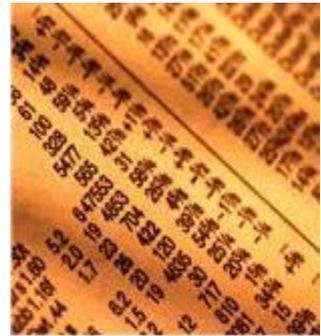




# FUNDING STRATEGY STATEMENT





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# 1 INTRODUCTION

- 1.1 This is the Funding Strategy Statement (“FSS”) for the Royal County of Berkshire Pension Fund (“the Fund”) which is administered by The Royal Borough of Windsor and Maidenhead (“the Administering Authority”). It has been prepared in accordance with Regulation 58 of the Local Government Pension Scheme Regulations 2013.
- 1.2 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).

## *Purpose of the Funding Strategy Statement*

- 1.3 The purpose of the FSS is to explain the Fund’s approach to meeting the employer’s pension liabilities and in particular:

- To establish a clear and transparent Fund-specific strategy which will identify how employers’ pension liabilities are best met going forward;
- To take a prudent longer-term view of funding those liabilities; and
- To support the regulatory framework to ensure the solvency of the Fund and the long-term cost efficiency of the Scheme, and where possible to maintain as nearly constant Scheme employer contribution rates as possible.

- 1.4 The purpose of the Fund is to:

- Collect monies in respect of employee and employer contributions, transfer values and investment income;
- Facilitate payment of Local Government Pension Scheme (LGPS) benefits, transfer values, costs, charges and expenses; and
- Accumulate and invest money received and facilitate the management of this.

## *Funding Objectives*

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

- 1.6 The funding objectives are to

- Set levels of employer contributions that will build up a fund of assets sufficient to ensure the solvency of the Fund and the payment of all future benefit payments from the Fund;
- Set contributions which maximise the long-term cost efficiency. Broadly, this means that paying contributions as soon as possible so that any deficit is addressed quickly is preferable;



- Build up the required assets in such a way that produces levels of employer contributions that are as stable as possible;
- Minimise the risk of employers exiting the Fund with unpaid deficits, which then fall to the other employers;
- Ensure effective and efficient management of employer liabilities; and
- Allow the return from investments to be maximised within reasonable risk parameters.

## 2 KEY PARTIES

2.1 The parties directly concerned with the funding aspect of the Pension Fund are contained in this section of the FSS. A number of other key parties, including investment managers and external auditors also have responsibilities to the Fund but are not key parties in determining funding strategy.



### *The Administering Authority*

2.2 The Administering Authority for the Royal County Berkshire Pension Fund is the Royal Borough of Windsor & Maidenhead. The main responsibilities of the Administering Authority are as follows:

- Operate the Fund in accordance with the LGPS Regulations
- Collect and account for employee and employer contributions;
- Pay the benefits to Scheme members and their dependants as they fall due;
- Invest the Fund's assets ensuring sufficient cash is available to meet the liabilities as and when they become 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 the FSS and also the ISS (Investment Strategy Statement) and after consultation with other interested parties;
- Monitor all aspects of the Fund's performance and funding to ensure that the FSS and the ISS are updated as necessary; and
- Effectively manage any potential conflicts of interest arising from its dual role as both Fund administrator and Scheme employer.

### *Scheme employers*

2.3 The responsibilities of each individual Scheme employer which participates in the Fund, including the Administering Authority in its capacity as a Scheme employer, are as follows:

- Collect employee contributions and pay these together with their own employer contributions as certified by the Fund Actuary within the statutory timescales;
- Promptly notify the Administering Authority of any new Scheme members and any other membership changes in accordance with the pension administration service level agreement;
- Promptly notify the Administering Authority of any Scheme member who leaves or retires from their employment in accordance with the pension administration service level agreement;
- Promptly notify the Administering Authority of all Scheme member data and information required by the Administering Authority in accordance with the pension administration service level agreement so that the Administering Authority is able to accurately calculate the value of benefits payable to each Scheme member;
- Exercise any discretions permitted under the Scheme Regulations and to produce, maintain and publish a policy statement with regard to the exercise of those discretions;
- Meet the costs of any augmentations or other additional costs such as Pension Fund strain costs resulting from decisions to release early Scheme members' retirement benefits in accordance with Scheme regulations and agreed policies and procedures;
- Pay any exit payments due on ceasing participation in the Fund;
- Provide any information as requested to facilitate the Actuarial valuation process.



#### *Fund Actuary*

2.4 The Fund Actuary for the Royal County of Berkshire Pension Fund is Barnett Waddingham LLP. The main responsibilities of the Fund Actuary are to:

- Prepare the Actuarial Valuation having regard to the FSS and the Scheme Regulations;
- Prepare annual FRS102/IAS19 (accounting standards) reports for all Scheme employers requiring such a report for their annual report and accounts;
- Advise interested parties on funding strategy and completion of Actuarial valuations in accordance with the FSS and the Scheme 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 and valuations relating to new employers, including recommending the level of bonds or other forms of security required to protect the Fund against the financial effect 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;
- Advise on other actuarial matters affecting the financial position of the Fund.

### **3 FUNDING STRATEGY**

- 3.1 The funding strategy seeks to achieve (via employee and employer contributions and investment returns) two key objectives:
- A funding level of 100% as assessed by the Fund’s appointed Actuary, triennially, in accordance with the Scheme Regulations;
  - As stable an employer contribution rate as is practical.
- 3.2 The funding strategy recognises that the funding level will fluctuate with changing levels of employment, retirements, actuarial assumptions and investment returns and that the employer contribution has to be adjusted to a level sufficient to maintain the Pension Fund’s solvency and to achieve a funding level of 100% over the longer term.
- 3.3 The Actuarial valuation process is essentially a projection of future cash-flows to and from the Fund. The main purpose of the triennial valuation is to determine the level of employers’ contributions that should be paid over an agreed period to ensure that the existing assets and future contributions will be sufficient to meet all future benefit payments from the Fund.
- 3.4 The last Actuarial valuation was carried out as at 31<sup>st</sup> March 2019 with the assets of the Fund found to be 78% of the accrued liabilities for the Fund.

#### *Funding Method*

- 3.5 The funding target is to have sufficient assets to meet the accrued liabilities for each Scheme employer in the Fund. The funding target may, however, also depend on certain Scheme employer circumstances and will, in particular, have regard to whether a Scheme employer is an “open” employer (which allows new recruits access to the Fund) or a “closed” employer (which no longer permits new employees access to the Fund). The expected period of participation by a Scheme employer in the Fund may also affect the chosen funding target.
- 3.6 For all Scheme employers the Actuarial funding method adopted considers separately the benefits in respect of service completed before the Valuation date (“past service”) and benefits in respect of service expected to be completed after the Valuation date (“future service”). This approach focuses on:

- The past service funding level of the Fund. This is the ratio of accumulated assets to liabilities in respect of past service after making allowance for future increases to members' pay and pensions in payment. A funding level in excess of 100% indicates a surplus of assets over liabilities whereas a funding level of less than 100% indicates a deficit.
- The future funding rate i.e. the level of contributions required from the individual Scheme employers which together with employee contributions are expected to support the cost of benefits accruing in the future.

3.7 For "open" Scheme employers, the Projected Unit method is used which, for the future service rate, assesses the cost of one year's benefit accrual.

3.8 For "closed" Scheme employers the funding method adopted is known as the Attained Age Method. This gives the same results for the past service funding level as the Projected Unit Method but for the future cost it assesses the average cost of the benefits that will accrue over the remaining working lifetime of the active Scheme members.

#### *Valuation Assumptions and Funding Model*

3.9 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.

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

- The statistical assumptions which generally speaking are estimates of the likelihood of benefits and contributions being paid; and
- The financial assumptions which generally speaking will determine the estimates of the amount of benefits and contributions payable and their current or present value.

#### *Future Price Inflation*

3.11 The base assumption in any triennial valuation is the future level of price inflation. This is derived by considering the average difference in yields from conventional and index linked gilts during the 6 months straddling the valuation date using a point from the Bank of England RPI Inflation Curve. This gives an assumption for Retail Prices Index (RPI) inflation, which is then adjusted to get an assumption for Consumer Prices Index (CPI) inflation. At the 2019 valuation, CPI was assumed to be 1.0% per annum lower than RPI, giving a CPI inflation assumption of 2.6% per annum.

3.12 This assumption was reviewed following the Chancellor's November 2020 announcement on the reform of RPI and is now assumed to be 0.4% p.a. lower than the 20 year point on the inflation curve. This change will be fully reflected in the ongoing funding assumptions from 31 December 2020. This adjustment accounts for both the shape of the curve in comparison to the Fund's liability profile and the view that investors are willing to accept a lower return on investments to ensure inflation linked returns. This assumption will be reviewed at future valuations and the difference between RPI and CPI is expected to move towards 0.0% p.a. as we get closer to 2030.



### *Future Pay Inflation*

3.13 As benefits accrued before 1<sup>st</sup> April 2014 (and in the case of some protected members after 31<sup>st</sup> March 2014) are linked to pay levels at retirement it is necessary to make an assumption as to future levels of pay inflation. The assumption adopted in the 2019 valuation is that pay increases will, on average over the longer term, exceed CPI by 1.0% per annum.

### *Future Pension Increases*

- 3.14 Pension increases are assumed to be linked to CPI. Inflation as measured by the CPI has historically been less than RPI due mainly to different calculation methods. A deduction of 1.0% p.a. is therefore made to the RPI assumption to derive the CPI assumption.

This assumption was also reviewed in light of the Chancellor's announcement on the reform of RPI mentioned above. From 31 December 2020 CPI inflation is assumed to be 0.4% p.a. lower than the RPI assumption (i.e. a total of 0.8% p.a. below the 20 year point on the Bank of England implied RPI inflation curve). This reflects the anticipated reform of RPI inflation from 2030 following the UK Statistics Authority's proposal to change how RPI is calculated to bring it in line with the Consumer Prices Index including Housing costs (CPIH). This assumption will be reviewed at future valuations and the difference between RPI and CPI is expected to move towards 0.0% p.a. as we get closer to 2030.

### *Future Investment Returns/Discount Rate*

- 3.15 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.

- 3.16 For "open" Scheme employers the discount rate 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 and indicators in the 6 months straddling the valuation date. This discount rate so determined may be referred to as the "ongoing" discount rate.



The level of prudence at the 2019 valuation was set to be 0.7% p.a. This gave a discount rate of 5.3% per annum for all employers.

- 3.17 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 Scheme employer either wishes to leave the Fund or the terms of their admission requires it.

- 3.18 The Fund Actuary will incorporate such an adjustment after consultation with the Administering Authority.
- 3.19 The adjustment to the discount rate is essentially to set 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 to minimise the risk of deficits arising after the termination.

#### *Asset Valuation*

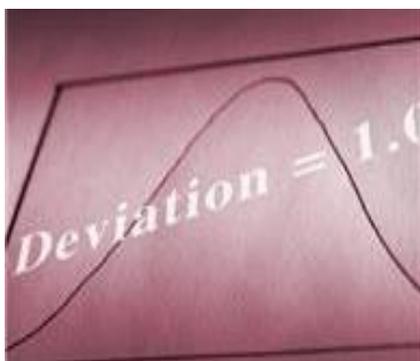
- 3.20 The asset valuation is a market value of the accumulated Fund at the triennial valuation date adjusted to reflect average market conditions during the 6 months straddling the triennial valuation date.

#### *Statistical Assumptions*

- 3.21 The statistical assumptions incorporated into the triennial valuation such as future rates of mortality etc are based on national statistics but then adjusted where deemed appropriate to reflect the individual circumstances of the Fund and/or individual Scheme employers. For the 2019 valuation, the Fund received a bespoke analysis of the pensioner mortality and the results of this analysis were used to aid in setting a suitable assumption for the Fund.

#### *Deficit Recovery/Surplus Amortisation Periods*

- 3.22 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.



- 3.23 Where the Actuarial valuation discloses a significant surplus or deficit then the levels of required Scheme employers’ contributions will include an adjustment to either amortise the surplus or fund the deficit over a period of years. At the 2019 valuation, a deficit was revealed and contributions were set to recover this deficit over a period no longer than 21 years.

- 3.23 The period that is adopted for any particular Scheme employer will depend upon:
- The significance of the surplus or deficit relative to that Scheme employer’s liabilities;
  - The covenant of the individual Scheme employer and any limited period of participation in the Fund; and
  - The implications in terms of stability of future levels of Scheme employers’ contributions.
- 3.24 At the 2019 triennial valuation the period adopted to recover the deficit was:

Type of Scheme Employer	Maximum Length of Recovery Period
Unitary Authorities and Associated Employers	21 years
Housing Associations	11 years
Colleges (excluding the University of West London)*	8 years
Academies	12 years
Community Admission Bodies	11 years (for the majority of employers, but this may differ for some depending on individual circumstances)
Transferee Admission Bodies	Future working life of current employees or contract period whichever is the shorter period

3.25 Where a Scheme employer's contribution has to increase significantly then the increase may be phased in over a period not exceeding 3 years although this may only be allowed for some Scheme employer types or if the increase in contributions would increase the risk of an employer insolvency, leaving an unpaid deficit and adversely affecting other employers' contributions and the solvency of the Fund as a whole.

#### *Pooling of Individual Scheme employers*

3.26 The policy of the Fund is that each individual Scheme employer should be responsible for the costs of providing pensions for its own employees who participate in the Fund. Accordingly contribution rates are generally set for individual employers to reflect their own particular circumstances.

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

3.28 Currently, other than Scheme employers that are already legally connected, there are the following pools:

- Colleges (with the exception of the University of West London)\*
- Academies
- 'Community' Admission Bodies



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

3.30 Prior to the 2016 valuation the Fund had a pool for the Housing Associations which has been disbanded due to only two employers remaining in the pool following one employer exiting the Fund and another employer leaving the pool.

\*The University of West London is a closed employer whose membership and liability profile no longer makes it a viable employer for inclusion within the college pool.

### *New employers joining the Fund*

- 3.31 Admission bodies - 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.

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.

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.

### *New Academies*

- 3.32 When a school converts to academy status, the new academy (or the sponsoring multi-academy trust) becomes a Scheme employer in its own right. On conversion to academy status, the new academy will be allocated assets based on the active cover of the relevant local authority at the conversion date. The active cover approach is based on the funding level of the local authority's active liabilities, after fully funding the local authority's deferred and pensioner liabilities. The new academy will join the existing academy pool.

The contribution rate for a new academy will be in line with the rate paid by the other academies in the academy pool, as calculated at the most recent actuarial valuation.

### *Contribution reviews between actuarial valuations*

- 3.33 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.
- 3.34 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.
- 3.35 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 found from the Policy section of the Fund's website. This includes details of the process that should be followed where an employer would like to request a review.
- 3.36 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.
- 3.37 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.
- 3.38 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.

### *Cessation Valuations*

- 3.39 On the cessation of a Scheme employer's participation in the Fund, the Actuary will be asked to make a termination assessment. Any deficit in the Fund in respect of the Scheme employer will be due to the Fund as a termination contribution, unless it is agreed by the Administering Authority and the other parties involved that the assets and liabilities relating to the Scheme employer will transfer within the Fund to another participating Scheme employer.

- 3.40 In assessing the deficit on termination, the Actuary may adopt a discount rate based on gilt yields or other lower risk assets and adopt different assumptions to those used at the previous triennial valuation to protect the other Scheme employers in the Fund from having to fund any future deficits from the liabilities that will remain in the Fund.

### *Exit Credit Policy*

- 3.41 Following the recent Regulations coming into force on 20 March 2020 which are effective from May 2018, the Fund has set out their exit credit policy as follows:

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 and any employer that is participating in the Fund where the ceding employer is the deemed employer. This is on the basis that these employers would not have been asked to pay an exit payment had a deficit existed at the time of exit. Any exit credit payment will be at the Fund’s discretion and will take into account relevant factors as set out in Regulation 64 (2ZC).

Exit credits will only be paid if the ceasing employer has a surplus on the minimum risk basis at the cessation date. Allowance will be made for additional liabilities incurred as a result of redundancies.

Any exit credit payable will be the lower of the surplus on the minimum risk basis above and the actual employer contributions paid into the Fund. Where risk sharing arrangements are in place, any contributions made or required to be made to meet additional liabilities incurred as a result of redundancies, ill health retirement strains, excessive salary increases or anything else covered in the risk sharing agreement will not be included in the calculation of any exit credit payable.

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 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.

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 absolute 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.

### *Managing exit payments*

- 3.42 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.

- 3.43 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.
- 3.44 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.
- 3.45 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.
- 3.46 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 which can be found on the Policies section of the Fund's website. 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.

#### *Bulk transfers*

- 3.47 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.
- 3.48 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).
- 3.49 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)*

- 3.50 Where an academy is transferring into or out of the 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.
- 3.51 The Fund's preference would be for any transfer to include all members, including deferred and pensioner members. Should a situation arise where an academy is transferring out of the Fund and only active members are transferring, the Fund would

seek to retain a level of assets to be at least sufficient to fully fund any deferred and pensioner members left behind, as measured by the Fund's ongoing funding basis at the transfer date.

- 3.52 Where the academy is transferring into the Fund, where appropriate, the academy will become part of the Fund's Academy pool. However, the Fund would not accept a transfer in which would lead to a deterioration in its overall funding level, and in particular as a minimum receive a transfer amount that was no less than the equivalent individual CETVs for the transferring members, based on Government Actuary factors in force at the transfer date. The agreed basis of transfer could take into account the funding basis of the Fund and a top up payment could be made to ensure the Fund would not be significantly worse off or be subject to an unacceptable level of risk.

### *Early Retirement Costs*

- 3.53 The Actuary's funding basis makes no allowance for premature retirement except on grounds of permanent ill health. Scheme employers are required to pay additional contributions whenever an employee retires before attaining the age at which the triennial valuation assumes that benefits are payable. The calculation of these costs is carried out with reference to a calculation approved by the Actuary to the Fund.



- 3.54 The Fund monitors each Scheme employer's ill health experience on an ongoing basis. If the cumulative number of ill health retirements in any financial year exceeds the allowance at the previous triennial valuation by a statistically significant amount, the Scheme employer may be charged additional contributions on the same basis as apply for non-ill health cases.

### *Triennial Valuation*

- 3.55 The next triennial valuation is due as at 31<sup>st</sup> March 2022.

## **4 LINKS WITH THE INVESTMENT STRATEGY STATEMENT (ISS)**

- 4.1 The main link between the 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.
- 4.2 As explained above the ongoing discount rate adopted in the Actuarial valuation is derived by considering the expected return from the underlying investment strategy and so there is consistency between the funding strategy and the investment strategy.

## **5 RISKS AND COUNTER MEASURES**

- 5.1 Whilst the funding strategy attempts to satisfy the funding objectives of ensuring sufficient assets to meet pension liabilities and stable levels of Scheme employer contributions, it is recognised that there are a number of risks that may impact on the funding strategy and hence the ability of the strategy to meet the funding objectives.
- 5.2 The major risks for the funding strategy are financial risks although there are external factors including demographic risks, regulatory risks and governance risks.

### *Financial Risks*

- 5.3 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 chosen fund managers who are employed to implement the chosen investment strategy failing to achieve their performance targets. The triennial valuation results are most sensitive to the real discount rate. Broadly speaking an increase/decrease of 0.1% per annum in the real discount rate will decrease/increase the liabilities by 2% and decrease/increase the required Scheme employer contribution by around 0.5% of payroll.

- 5.4 The Pension Fund Committee regularly monitor the investment returns achieved by the fund managers and seek advice from Officers and independent advisors on investment strategy. In the inter-valuation period 2016 to 2019 such monitoring activity saw investment returns higher than assumed in the 2016 valuation.



- 5.5 In addition the Fund Actuary provides monthly funding updates between triennial valuations to check whether the funding strategy continues to meet the funding objectives.

### *Demographic Risks*

- 5.6 Allowance is made in the funding strategy via the actuarial assumptions of continuing improvement in life expectancy. However, the main risk to the funding strategy is that it might underestimate the continuing improvement in mortality. For example an increase in 1 year to life expectancy of all members in the Fund will reduce the funding level by around 2%.
- 5.7 The actual mortality of retired members in the Fund is, however, monitored by the Fund Actuary at each Actuarial valuation and assumptions kept under review.
- 5.8 The liabilities of the Fund can also increase by more than has been planned as a result of early retirements (including redundancies).
- 5.9 However, the Administering Authority monitors the incidence of early retirements and procedures are in place that require individual Scheme employers to pay additional amounts to the Fund to meet any additional costs arising from early retirements thereby avoiding unnecessary strain on the Fund.

## *Regulatory Risks*

- 5.10 The benefits provided by the Scheme and employee contribution levels are set out in Statutory Regulations as determined by central Government. The tax status of the invested assets is also determined by central Government.
- 5.11 The funding strategy is therefore exposed to the risks of changes in the Statutory Regulations governing the Scheme and changes to the tax regime which increase the cost to individual Scheme employers of participating in the Scheme.
- 5.12 The Administering Authority actively participates in any consultation process of any change in Regulations and seeks advice from the Fund Actuary on the financial implications of any proposed changes
- 5.13 The 2016 national Scheme valuation was used to determine the results of HM Treasury's (HMT) employer cost cap mechanism for the first time. The HMT cost cap mechanism was brought in after Lord Hutton's review of public service pensions with the aim of providing protection to taxpayers and employees against unexpected changes (expected to be increases) in pension costs. The cost control mechanism only considers "member costs". These are the costs relating to changes in assumptions made to carry out valuations relating to the profile of the Scheme members; e.g. costs relating to how long members are expected to live for and draw their pension. Therefore, assumptions such as future expected levels of investment returns and levels of inflation are not included in the calculation, so have no impact on the cost management outcome.

The 2016 HMT cost cap valuation revealed a fall in these costs and therefore a requirement to enhance Scheme benefits from 1 April 2019. However, as a funded Scheme, the LGPS also had a cost cap mechanism controlled by the Scheme Advisory Board (SAB) in place and HMT allowed SAB to put together a package of proposed benefit changes in order for the LGPS to no longer breach the HMT cost cap. These benefit changes were due to be consulted on with all stakeholders and implemented from 1 April 2019.

However, on 20 December 2018 there was a judgement made by the Court of Appeal which resulted in the government announcing their decision to pause the cost cap process across all public service schemes. This was in relation to two employment tribunal cases which were brought against the government in relation to possible discrimination in the implementation of transitional protection following the introduction of the reformed 2015 public service pension schemes from 1 April 2015. Transitional protection enabled some members to remain in their pre-2015 schemes after 1 April 2015 until retirement or the end of a pre-determined tapered protection period. The claimants challenged the transitional protection arrangements on the grounds of direct age discrimination, equal pay and indirect gender and race discrimination.

The first case (McCloud) relating to the Judicial Pension Scheme was ruled in favour of the claimants, while the second case (Sargeant) in relation to the Fire scheme was ruled against the claimants. Both rulings were appealed and as the two cases were closely linked, the Court of Appeal decided to combine the two cases. In December 2018, the Court of Appeal ruled that the transitional protection offered to some members as part of the reforms amounts to unlawful discrimination. On 27 June 2019 the Supreme Court denied the government's request for an appeal in the case. A remedy is still to be either imposed by the Employment Tribunal or negotiated and applied to all public service schemes, so it is not yet clear how this judgement may affect LGPS members' past or future service benefits. It has, however, been noted by government in its 15 July 2019

statement that it expects to have to amend all public service schemes, including the LGPS.

On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits and at the same time announced the unpausing of the 2016 cost cap process which will take into account the remedy for the McCloud and Sargeant judgement. The consultation closed on 8 October 2020 and the final remedy will only be known after the consultation responses have been reviewed and a final set of remedial Regulations are published. At the time of drafting this FSS, it is not yet known what the effect on the current and future LGPS benefits will be. As the remedy is still to be agreed the cost cannot be calculated with certainty, however, the Fund Actuary has reduced the discount rate assumption by 0.1% to allow for the possible impact.

- 5.14 As part of the restructuring of the state pension provision, the government needs to consider how public service pension payments should be increased in future for members who accrued a Guaranteed Minimum Pension (GMP) from their public service pension scheme and expect to reach State Pension Age (SPA) post-December 2018. In addition, a resulting potential inequality in the payment of public service pensions between men and women needs to be addressed. Information on the current method of indexation and equalisation of public service pension schemes can be found [here](#).

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 2019 valuation assumption 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, it is assumed that the Fund will be required to pay the entire inflationary increase.

### *Governance*

- 5.15 Several different Scheme employers participate in the Fund. Accordingly it is recognised that a number of Scheme employer specific events could impact on the funding strategy including:
- Structural changes in an individual Scheme employer's membership;
  - An individual Scheme employer deciding to close the Scheme to new employees;
  - A Scheme employer ceasing to exist without having fully funded their pension liabilities; and
  - New Scheme employers being created out of existing Scheme employers.
- 5.16 The Administering Authority monitors the position of Scheme employers participating in the Fund particularly those that may be susceptible to the aforementioned events and takes advice from the Fund Actuary when required.

5.17 In addition the Administering Authority keeps in close touch with all individual Scheme employers participating in the Fund and regularly holds meetings with Scheme employers to ensure that, as Administering Authority, it has the most up to date information available on individual Scheme employer situations and also to keep individual Scheme employers fully briefed on funding and related issues.

## **6 MONITORING AND REVIEW**

6.1 This FSS is reviewed formally, in consultation with the key parties, at least every three years to tie in with the triennial valuation process.

6.2 The Administering Authority also monitors the financial position of the Fund between triennial valuations and may review this FSS more frequently if deemed necessary.

Approved by the Berkshire Pension Fund Committee: 14 June 2021

Next Review date: June 2022