FUNDING

STRATEGY

STATEMENT

STRATHCLYDE PENSION FUND

Prepared in conjunction with actuarial valuation as at: 31st March 2014

STRATHCLYDE PENSION FUND

FUNDING STRATEGY STATEMENT

1. Introduction

Glasgow City Council is the administering authority for the Strathclyde Pension Fund. The council delegates this responsibility to the Strathclyde Pension Fund Committee. The council and the committee recognise that they have fiduciary duties and responsibilities towards pension scheme members, participating employers and local taxpayers that are analogous to those holding the office of trustee in the private sector. This statement sets out the approach to funding which the committee adopts in light of those duties.

Further background details are set out in Schedule 1 of this statement.

2. Purpose of the Funding Strategy Statement (FSS)

The stated purpose of the FSS is:

- to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

These objectives are desirable individually, but may be mutually conflicting. This statement sets out how the administering authority balances the conflicting aims of affordability and stability of contributions, transparency of processes, and prudence in the funding basis.

3. Aims and Purpose of the Pension Fund

The Fund is the vehicle for the delivery of scheme benefits.

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income;
- invest monies in accordance with policy formulated by the administering authority; and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses.

The aims of the Fund are to:

- ensure that sufficient resources are available to meet all liabilities as they fall due;
- enable employer contribution rates to be kept as nearly constant as possible and at reasonable cost to the taxpayers and employers;
- manage employers' liabilities effectively; and
- maximise the returns from investments within reasonable risk parameters;

as defined in the Local Government Pension Scheme (Scotland) Regulations.

The objectives of the funding strategy are consistent with these aims. The objectives are set out in Schedule 2 of this statement.

The aims of the pension fund can only be achieved if all parties involved in its operation exercise their statutory duties and responsibilities conscientiously and diligently.

4. Responsibilities of Key Parties

The Fund is a multi-employer arrangement with over 200 participating employers. The administering authority manages the Fund to deliver the scheme benefits and to ensure that each employer is responsible for its own liabilities within the Fund.

The responsibilities of the key parties involved in management of the Fund are set out in Schedule 3 to this statement.

5. Target Funding Level

The funding level is the amount of assets compared to liabilities expressed as a percentage.

- The target funding level is at least 100%.
- The target recovery period for any deficit is the weighted average working lifetime of the active membership.
- There are many inherent uncertainties in the funding process and a wide range of possible outcomes. It is acknowledged that the actual funding level will fluctuate as a result.
- The strategy therefore targets an acceptable likelihood of meeting the target funding level within the target recovery period.

For the Fund as a whole and for ongoing employers the funding level will be measured on an ongoing actuarial basis, taking advance credit for investment returns above the risk-free rate.

For employers whose participation in the Fund is to cease the funding level will be measured on a more prudent cessation basis and contribution rates will be set accordingly.

The approach to funding strategy for individual employers including the policies on admission and cessation is set out in Schedule 4.

6. Contributions Strategy

The contributions strategy aims to ensure that the target funding level is achieved at both Fund and employer level in a manner which is fair and affordable for employers.

The Fund actuary will calculate a common employer contribution rate as required by the scheme regulations.

Individual adjustments will then be applied to each employer to reflect their particular circumstances including the strength of their covenant, and their individual membership experience within the Fund.

The Fund will adopt measures to stabilise the common contribution rate and will seek to limit changes to a maximum of **+1%** or **-1%** of pensionable pay each year.

For employers with a less secure covenant or where participation in the Fund may cease, rates and adjustments will be set to minimise risk to the Fund and its other employers.

The contributions strategy is set out in Schedule 5 to this statement.

7. Links to Investment Strategy set out in the Statement of Investment Principles (SIP)

The investment strategy is set for the long-term but is monitored continually and reviewed every 3 years using asset-liability modelling to ensure that it remains appropriate to the Fund's liability profile.

The Fund initially applies a single investment strategy for all employers but may apply notional or actual variations after agreement with individual employers.

8. The Identification of Risks and Counter Measures

The Fund actively manages risk and maintains a detailed risk register which is reviewed on a quarterly basis.

The key financial, demographic, regulatory, and governance risks are set out in Schedule 6 to this statement

Schedules:

1. Background
2. Objectives of the Funding Strategy
3. Responsibility of Key Parties involved in management of Fund
4. Funding Strategy for individual employers
5. Contributions Strategy
6. Key financial, demographic, regulatory and governance risks

Schedule 1

Background

1.1 Preparation

This Funding Statement Strategy (FSS) has been prepared by the Administering authority in collaboration with the Fund's actuary, Hymans Robertson LLP, and after consultation with the Fund's employers and other interested parties. This FSS has been prepared in conjunction with the actuarial valuation of the Fund as at 31 March 2014.

This statement applies to the No 1 Fund only. A separate statement is produced for the Strathclyde (No.3) Fund.

1.2 Regulatory framework

Members' accrued benefits are guaranteed by statute. Members' contributions are set at a rate which covers only part of the cost of accruing benefits. Employers pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these benefits are funded and on practical measures to ensure that employers pay for their own liabilities.

The FSS forms part of a framework which includes:

- the Local Government Pension Scheme (Scotland) Regulations 2014
- the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014
- the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008;
- the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (as amended);
- the Local Government Pension Scheme (Transitional Provisions) (Scotland) Regulations 2008;
- guidance issued by Scottish Ministers;
- the Rates and Adjustments Certificate, which can be found appended to the Fund actuary's valuation report;
- the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010; and
- the Fund's 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. The FSS applies to all employers participating in the Fund.

1.3 Reviews of FSS

The FSS is reviewed in detail at least every three years in conjunction with triennial valuations being carried out. The next full review is due to be completed by 31 March 2018.

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. Queries regarding the statement should be addressed to Strathclyde Pension Fund Office, email spfo@glasgow.gov.uk or call 0845 213 0202.

1.4 Funding mechanism

There are three principal income streams for the Fund: employee contributions; employer contributions and investment income.

The Fund sets an investment strategy which seeks to maximise total investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk. Investment income is one component of total investment return. The investment strategy is set out in the Fund's Statement of Investment Principles.

The Fund does not control the level of employee contributions, which is set by statute. From 1 April 2009, employee rates are tiered based on annual pensionable income.

Employer contributions are both variable and controllable and are also in effect the balancing item in funding. Any shortfall in funding not met from employee contributions and investment returns has to be met from employer contributions.

As provided for in section 12 of the Public Service Pensions Act 2013 a cost cap for the Local Government Pension Scheme (Scotland) will be set on the completion of the necessary actuarial work expected to conclude towards the end of 2015. An amendment to the scheme will be made at that time to include the cost cap.

1.5 Intervaluation monitoring of Funding position

The funding position is formally measured every three years in the triennial actuarial valuation.
The administering authority carries out detailed monitoring of investment performance on a quarterly and annual basis via its Investment Advisory Panel. This includes some comparison of investment returns relative to the assumed growth in the liabilities, and review of a quarterly funding projection provided by the actuary. Summary monitoring reports are considered by the Strathclyde Pension Fund Committee and are publicly available via the Fund's (www.spfo.org.uk) and the Council's (www.glasgow.gov.uk) websites. Performance is also reported at the Fund's Annual Meeting.

Schedule 2

Objectives of the Funding Strategy

2.1 Principal Objectives

The principal objectives of a funded scheme are to:

- allocate and safeguard assets to ensure that pensions can be paid as promised;
- reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

2.2 Mechanism

The funding mechanism should also minimise any intergenerational transfer of liabilities.

2.3 Detailed Objectives

The objectives of the funding strategy include the following:

- to ensure the long-term solvency of the Fund and the solvency of individual employers' share of the Fund;
- to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- to provide a framework for the investment strategy of the Fund so that the administering authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to help employers recognise and manage pension liabilities as they accrue;
- to inform employers of the risks and potential costs associated with pension funding;
- to minimise the degree of short-term change in the level of each employer's contributions where the administering authority considers it reasonable to do so;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations; and
- to address the different characteristics of the disparate employers or groups of employers to the extent that this is practical and cost-effective.

Schedule 3

Responsibilities of Key Parties

3.1 Administering Authority

The administering authority is responsible for:-

- collecting employer and employee contributions;
- investing surplus monies in accordance with the regulations;
- paying benefits when they fall due;
- ensuring that liquidity is available to meet liabilities as and when they fall due;
- managing the valuation process in consultation with the Fund's actuary;
- taking measures to safeguard the Fund against employer default;
- preparing and maintaining a Funding Strategy Statement (FSS) and a Statement of Investment Principles (SIP), both after proper consultation with interested parties; and
- monitoring all aspects of the Fund's performance and funding and amending the FSS/SIP.

3.1 Employers

Each individual Employer is responsible for:-

- funding all liabilities relating to their employees within the Fund;
- deducting contributions from employees' pay correctly;
- paying all contributions, including their own as determined by the actuary, promptly by the due date;
- exercising discretions within the regulatory framework and in accordance with their own policies;
- making additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain;
- notifying the administering authority promptly of all actual membership changes including scheme joiners and leavers;
- providing the administering authority with accurate member data including payroll data; and
- notifying the administering authority promptly of any proposed changes to membership which may affect future funding.

3.1 Actuary

The Fund actuary is responsible for:-

- preparing valuations including the setting of employers' contribution rates after agreeing assumptions with the administering authority and having regard to the FSS;
- providing regular inter-valuation monitoring reports;
- providing advice in respect of managing employer risk; and
- producing advice and calculations in connection with bulk transfers and individual benefit-related matters.

Schedule 4

Funding Strategy for Individual Employers

4.1 Employer Risk

Employers vary in size, membership profile, source and security of funding, and length of participation in the Fund. In developing the funding strategy and policies, the administering authority seeks to address the different funding risks of the different employers or groups of employers.

4.2 Participating Employers

Under the 2008 regulations, employers fall into 3 categories:-

Scheme Employers (also know as scheduled bodies) have a statutory right to participate in the scheme by merit of being listed in Schedule 2 of the Administration regulations. Scheme employers include local authorities, joint boards, further education colleges and other statutory bodies.

Community Admission Bodies (CABs) are not-for-profit organisations which participate in the scheme as a result of an admission agreement with the administering authority. They include a diverse range of public sector bodies with some connection or community of interest with a scheme employer.

Transferee Admission Bodies (TABs) are contractors which provide a service for or on behalf of a scheme employer.

Under the 2014 regulations the terminology is different, but the categories remain.

4.3 Employer Groups

For funding purposes employers in the Fund are divided into the following groups of organisations sharing the same broad characteristics and risk profiles.

- Scheduled bodies with tax raising powers (and associated bodies),
- Colleges and scheduled bodies without tax raising powers,
- Transferee admission bodies,
- Other admitted bodies open to new entrants,
- Other admitted bodies closed to new entrants.

A full list of employers and their grouping is set out in an appendix to the actuarial valuation report.

4.4 Employer Liabilities and Asset Tracking

Employer liabilities can be evaluated directly by the actuary at any time based on membership data. Individual employer assets have been apportioned to each employer since 31 March 2002. Prior to that date, each employer was considered to have the same funding level as the whole Fund. The assets attributable to any employer in the Fund are allocated at each triennial valuation using an actuarial technique known as “analysis of surplus”. The principal items included within the actuary’s “analysis of surplus” technique are as follows:

- past contributions relative to the cost of accruals of benefits;

- different liability profiles of employers (e.g. mix of members by age, gender, manual/non manual);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made; and
- the effect of more or fewer withdrawals than assumed;

over the period between each triennial valuation.

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

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

The administering authority recognises the limitations in the process. It considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree, but will work with the actuary to develop the asset tracking approach.

Employer asset values can also be calculated between triennial valuations using a "roll-forward" methodology.

4.5 New Employers – Admissions Policy

New bodies are admitted to participate in the Fund in accordance with the provisions of the regulations and with legal and actuarial advice.

The regulations include specific requirements for a risk assessment, bond, indemnity or guarantee. These are designed to protect the Fund and its employers from the risk of default by a new employer.

In assessing new employers for admission to the fund the interests of existing employers will take priority.

4.6 Opening Funding Position

Where a new employer will have employees with existing service in the Fund, an opening funding position will be established usually on a fully funded basis at the point of transfer. Alternatively, a share of Fund or other basis may be adopted subject to agreement between the parties to the admission agreement. Employer contribution rates will be set accordingly.

4.7 Transfers

Transfer of service where members move between employers within the Fund is effected automatically or in accordance with the member's wishes. The employer to whom service is transferred receives a notional transfer of assets and becomes responsible for all past service liabilities. Individual transfers to and from public sector pension funds are processed in accordance with the provisions of the Local Government Pension Scheme regulations.

4.8 Bulk transfers

When a group of employees joins the Fund as part of a bulk transfer from another fund or scheme, the administering authority's objective is to ensure that the Fund does not accept an ongoing funding deficit in respect of the transferring employees, i.e. the Fund will not usually accept a bulk transfer unless the transfer amount is at least sufficient to meet the value of the benefits being transferred, calculated on the ongoing funding basis. When a group of employees leaves the Fund as part of a bulk transfer to another scheme, the administering authority's objective is to protect the funding position in respect of the remaining members and employers (i.e. the transfer amount offered in respect of the transferring employees should be at most 100% of the transferring liabilities calculated on the transfer date on the ongoing funding basis as set out in this strategy statement). A transfer amount of less than 100% of the transferring liabilities may be offered in order to minimise any deficit in the employer's remaining liabilities in the Fund. An additional employer contribution may be required as part of this process.

In addition to its objective to protect the financial position of the Fund, the administering authority's objective in all bulk transfers is to ensure that the service credits or other benefits granted to transferring members fully reflect the value of the benefits being transferred, irrespective of the transfer value paid or received.

4.9 Existing Employers – Cessation Policy

Admission agreements are generally assumed to be open-ended. However, either party can voluntarily terminate the admission agreement by giving an appropriate period of notice to the other party (or parties). The Fund also considers any of the following as triggers for the admission agreement to cease to have effect:

- the last active member of the employer ceasing contributory service in the LGPS;
- the employer ceasing to be eligible under the regulations to participate in the Fund;
- the insolvency, winding up or liquidation of the employer;
- any breach by the employer of any of its obligations under the admission agreement that they have failed to remedy to the satisfaction of the Fund; or
- a failure by the employer to pay any sums due to the Fund within the period required by the Fund.

When an admission agreement ceases to have effect and an employer's ongoing involvement with the Fund ends the administering authority must look to protect the interests of other ongoing employers. The administering authority will therefore instruct the Fund's actuary to carry out a cessation valuation to determine whether there is any deficit. In most circumstances this will require the actuary to adopt valuation assumptions which protect the other employers from the likelihood of any material loss emerging in future. The administering authority reserves the right to determine the appropriate assumptions having taken advice from the Fund's actuary.

Any deficit arising from the cessation valuation will usually be calculated and levied on the departing employer as a capital payment. Alternatively, payment by instalments over a limited number of years may be agreed. In the event that the Fund is not able to recover the required payment in full directly from the Admission body or from any bond or indemnity, then:

a) In the case of admission bodies with guarantors, the guarantor will be liable. At its absolute discretion, the administering authority may agree to recover any outstanding amounts via the guarantor's contribution rate over an agreed period (if the guarantor is an active employer in the Fund).

b) In the case of admission bodies which have no guarantor; the unpaid amounts will be shared amongst all of the remaining employers in the Fund. This will normally be reflected in contribution rates set at the formal valuation following the cessation date. The Fund will take all reasonable steps to avoid this situation by enforcing the cessation debt on the departing employer.

Schedule 5

Contributions Strategy

5.1 Common Contribution Rate

The Fund's actuary is required by the regulations to report the Common Employer Contribution Rate for all employers at each triennial valuation. The common rate is the amount which, in the actuary's opinion, should be paid to the fund by all bodies whose employees contribute to it so as to secure its solvency.

5.2 Modelling

There are significant uncertainties involved in calculating the Common Contribution Rate. In recognition of these and the potentially conflicting funding objectives, the administering authority has commissioned the Fund actuary to carry out extensive modelling exploring the interaction between different contribution strategies and the likelihood of the Fund reaching its solvency target under many different economic scenarios. This modelling recognises that there are many potential outcomes for how the Fund may evolve over time and that a single set of assumptions, such as are used to determine the solvency level may not provide the fullest information for deciding on a contribution strategy. The modelling shows both the likelihood that a given contribution strategy will be successful and assesses the potential downside risks of pursuing a given strategy.

5.3 Probability

Based on actuarial modelling the Common Employer Contribution Rate will be sufficient to give the Fund at least a 2/3 probability of meeting the funding target over the average future lifetime of active employees and is expressed as a percentage of pensionable pay.

5.4 Stabilisation

The Fund will adopt measures to stabilise the Common Contribution Rate and will seek to limit changes in the contribution rate to a maximum of **+1%** or **-1%** of pensionable pay each year.

5.5 Employer Review

The Fund carries out a set of objective tests in respect of each employer's covenant, funding, membership and circumstances to determine if they should remain eligible to pay the Common Contribution Rate or an Individual Contribution Rate.In general, ongoing employers with a strong covenant have their rate set in line with the Common Contribution Rate. Due to different risk profiles, individual adjustments lead to higher individual contributions for some employers.

5.6 Individual Contribution Rates - Application

For certain employers or groups of employers in the Fund, the Common Employer Contribution Rate is not considered appropriate. For employers not permitted to pay the Common Contribution Rate, an Individual Contribution Rate will be set to minimise risk to the Fund and its other employers. In general, an Individual Contribution Rate is set in the following circumstances:

- where the employer is a transferee admission body;
- where the employer does not admit or has not admitted new entrants to the Fund;

- where the employer is deemed likely to cease participation in the Fund over the short to medium term;
- where the strength of the employer covenant is considered to be weak;
- where there has been a substantial transfer of members and hence liabilities to or from the employer which, in the opinion of the administering authority and the Fund actuary, warrants individual treatment;
- in any other circumstances, where the experience of an employer has been out-of-line with that of the Fund as a whole, and an individual adjustment is deemed to be appropriate by the administering authority and the Fund actuary.

The Fund has taken a progressive approach to the application of Individual Contribution Rates and these will continue to be applied more widely at future valuations. A grouped approach for certain similar employers has been introduced to help maintain stability of contributions for them.

5.7 Individual Contribution Rates - Principles

Individual Contribution Rates, where they apply, are based on the following principles:

- Employers should pay the Common Contribution Rate as a minimum in any one year. In exceptional circumstances (e.g. an employer in surplus nearing cessation), an individual rate below the Common Contribution Rate may apply at the discretion of the administering authority.

- Employers in surplus and not close to cessation should pay the highest of: the rate they paid in 2014/15; their respective future service rate calculated as at the 2014 valuation; and the Common Contribution Rate for each year of the certificate. Any adjustment will be expressed as a percentage of pensionable pay.

- Employers in deficit should pay the highest of: the rate they paid in 2014/15; their respective total contribution rate as at the 2014 valuation; and the Common Contribution Rate for each year of the certificate. Any deficit adjustment will be expressed in monetary terms.

5.8 Individual Contribution Rates - Deficit recovery periods

The administering authority normally targets the recovery of any deficit over a period not exceeding the remaining working lifetime of each employer’s active members. This *maximum* period is used in calculating each employer’s *minimum* contributions. Employers may opt to pay higher regular contributions than these minimum rates. Employers should discuss with the administering authority before making one-off capital payments.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2015 for the 2014 valuation). The administering authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions. The administering authority also reserves the right to set shorter or longer recovery periods for individual employers at future valuations.

5.9 Individual Contribution Rates - Calculation

Individual Contribution Rates, where they apply, are calculated on the following basis:

- Each employer's primary rate (future service rate) should aim to achieve a 75% likelihood that contributions paid in respect of future service would be sufficient to cover the cost of benefits earned in the year by the end of the average working lifetime of the employer's active members. This is set as an annual percentage of pensionable pay.

- Each employer's secondary rate (deficit recovery payments) should aim to achieve a 75% likelihood that any deficit on the ongoing funding basis would be repaid by the end of the average working lifetime of the employer's active members. This is set as an annual monetary contribution.

- The Fund and the actuary monitor employer experience with a view to identifying employers which may be approaching cessation and setting an appropriate contributions and funding strategy for those employers. Where an employer has been identified as nearing cessation, they should pay contributions targeting the Fund's cessation basis.

5.10 Phasing in of contribution rises

The administering authority recognises that, in certain circumstances, increases to individual contribution rates may be contradictory to the principle of keeping rates as stable as possible. Therefore, the Fund will allow the phasing in of contribution rates over a maximum of 3 years if:

- the employer's liabilities are guaranteed by another Fund employer or the Government; and/or
- the employer will be open to new entrants for the foreseeable future and the administering authority is satisfied with the strength of the employer's covenant.

5.11 Contributions Payable

A breakdown of each employer's contributions for the financial years 2015/16, 2016/17 and 2017/18 can be found in the Fund actuary's formal valuation report dated March 2015.

Employers' contributions are expressed as minima, with employers able to pay regular contributions at a higher rate. Employers should discuss with the administering authority before making one-off capital payments.

5.12 Non ill health retirements ("Strain on the Fund" costs)

The actuary's funding basis makes no allowance for premature retirement except on grounds of ill health. Employers are required to pay a "strain on the fund" cost whenever an employee retires before attaining the age at which the valuation assumes that benefits are payable.

Any additional costs of non ill health early retirements (strain on the fund costs) must be paid as lump sum payments at the time of the employer's decision in addition to the contributions described above or by limited instalments shortly after the decision.

It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire. The additional costs of premature retirement are calculated by reference to these ages. Strain costs are usually based on standard tables, but individual factors may be applied in certain circumstances. From 1st April 2010 strain costs were extended to include retirals on redundancy or efficiency grounds where the scheme member is over 60 and would otherwise have suffered an actuarial reduction to their benefits.

5.13 Ill Health Retirement Monitoring

The actuary's funding basis makes some allowance for premature retirement on grounds of ill health. Each employer's actual ill health retirement experience impacts on their liabilities and net funding calculation. This may be reflected in an employer's contribution rate, particularly if their experience exceeds the allowance made by the actuary. The Fund monitors each employer's, or pool of employers', ill health experience but does not currently levy additional "strain on the fund" contributions in respect of ill health retirals. This approach may change in future.

5.14 Ill Health Insurance

Employers may enter into an insurance contract to provide cover for the cost of ill health retirements. With the agreement of the Fund's actuary, the cost of such a contract may be offset against the employer's contributions to the Fund.

5.15 Cessation Basis

The Fund actuary agrees the financial and demographic assumptions to be used for the cessation basis with the administering authority. Typically, on a cessation basis, less or no allowance is made for an additional return above the return available from UK fixed interest gilts at the time of the valuation and an increased allowance is made for future improvements in life expectancy. This policy is intended to protect the interests of other employers in the Fund.

5.16 Security

The Fund may accept alternative forms of security to be held against any funding deficit in lieu of immediate cash contributions. This might include a bond or indemnity, group, parent company or funder guarantee, or some form of contingent asset.

Schedule 6

Key Risks & Controls

6.1 Financial Risks

Risk	Summary of Control Mechanisms
• Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term	• *Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.* • *Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.* • *Analyse progress at three yearly valuations for all employers.* • *Review inter-valuation roll-forward of liabilities between formal valuations at whole Fund level, provided by the actuary on a quarterly basis.*
• Inappropriate long-term investment strategy	• *Since 1998 have set Fund-specific strategy informed by Asset-Liability modelling.* • *Strategy is reviewed at least every 3 years in light of current valuation results.* • *Overall investment strategy options considered as an integral part of the funding strategy. Asset liability modelling to measure 4 key outcomes.* • *Chosen option considered to provide the best balance.*
• Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	• *Modelling at whole Fund level allows for the probability of this within a longer term context.* • *Inter-valuation monitoring, as above.* • *Some investment in bonds helps to mitigate this risk.*
• Active investment manager under-performance relative to benchmark	• *Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.*
• Pay and price inflation significantly more than anticipated	• *The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.* • *Inter-valuation monitoring, as above, gives early warning.* • *Employers ultimately pay for their own salary awards and should be mindful of the geared effect on pension costs and liabilities of any bias in pensionable pay rises towards longer-serving employees.*
• Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	• *An explicit stabilisation mechanism has been agreed as part of the funding strategy.* • *Impact is also mitigated through deficit spreading and phasing in of contribution rises.*
• Orphaned employers give rise to added costs for the Fund	• *The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.* • *If it occurs, the Actuary calculates the added cost spread pro-rata among all employers.*

6.2 Demographic risks

Risk	**Summary of Control Mechanisms**
• Pensioners living longer.	• *Set mortality assumptions with some allowance for future increases in life expectancy.* • *The Fund participates in Club Vita which provides detailed analysis of its mortality experience annually.*
• Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	• *Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.* • *Cash-flow position is monitored to ensure that liquid funds are available to pay pensions.*
• Deteriorating patterns of early retirements and/or early leavers	• *Employers are charged the extra capital cost of non ill health retirements following each individual decision.* • *Employer ill health retirement experience is monitored and insurance is an option.*

6.3 Regulatory risks

Risk	Summary of Control Mechanisms
• Changes to regulations	• *The administering authority is alert to the potential effects, liabilities and administration for employers and itself.* • *It considers all consultation papers issued by SPPA and comments where appropriate.* • *Copies of submissions are available for employers to see at www.spfo.org.uk.* • *The Fund has a pro-active communications strategy*

6.4 Employer Risks

Risk	Summary of Control Mechanisms
• Administering authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements). • Administering authority not advised of an employer closing to new entrants. • Administering authority failing to commission the Fund actuary to carry out a termination valuation for a departing admission body and losing the opportunity to call in a debt.	• *The administering authority monitors membership movements on a triennial basis via the actuarial valuation and pro-actively through employer liaison in the intervaluation period.* • *Employers are required to advise the administering authority of any significant structural changes during the intervaluation period. (e.g. large changes in membership; merger; acquisition; change of corporate status; cessation of activities, etc.)* • *The actuary may revise the rates and adjustments certificate to increase an employer's contributions between triennial valuations* • *Deficit contributions may be expressed as monetary amounts.*

• An employer ceasing to exist with insufficient funding or adequacy of a bond, indemnity or guarantee.	• *The regulations include specific requirements for a risk assessment, bond, indemnity or guarantee. These are designed to protect the Fund and its employers from the risk of default by a new employer.*
	• *Historically this was not the case, but the risk was mitigated by:*
	  - *seeking a funding guarantee at least in respect of the exercise of employer discretions.*
	  - *vetting prospective employers before admission.*
	  - *where provided for under the regulations, requiring a bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.*
	• *In assessing new employers for admission to the fund the interests of existing employers take priority.*
	• *Contributions, bond and guarantor arrangements are reviewed at regular intervals and well ahead of cessation as far as possible.*
	• *There remain, however, some "orphan" liabilities from employers which have failed and where no guarantee was in place. These liabilities are effectively borne by all remaining Fund employers.*