



Pension Fund

Funding Strategy Statement

31 March 2023

A) STATUTORY BACKGROUND AND KEY ISSUES

1. The Local Government Pension Scheme (England and Wales) (Amendment) Regulations 2004 came into effect on 1 April 2004. They originally provided the statutory framework from which Local Government Pension Schemes (LGPS) administering authorities were first required to prepare a Funding Strategy Statement (FSS) by 31 March 2005. The requirements at the date of writing this Statement are now set out under Regulation 58 of the Local Government Pension Scheme Regulations 2013 (the Regulations).
2. Key issues:
 - After consultation with such persons as it considers appropriate (including officers and elected members and Fund employers), the administering authority is required to prepare and publish their funding strategy.
 - In preparing the FSS, the administering authority has to have regard to:
 - guidance published by CIPFA in September 2016 entitled "Guidance on Preparing and Maintaining a Funding Strategy Statement and to the Fund's Statement of Investment Principles"
 - the supplementary statutory guidance issued by MHCLG (now DLUHC); Guidance on Preparing and Maintaining Policies on Review of Employer Contributions, Employer Exit Payments and Deferred Debt Agreements; and
 - its Investment Strategy Statement (ISS) published under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (the Investment Regulations).
 - The Administering Authority has also considered the Scheme Advisory Board's Guide to Employer Flexibilities for Administering Authorities and Employers in developing the FSS
 - The FSS must be revised and published whenever there is a material change in policy either on the matters set out in the FSS or the ISS.
 - Each Fund Actuary must have regard to the FSS as part of the fund valuation process and the Fund Actuary has therefore been consulted on the contents of this FSS.
 - The FSS addresses the issue of managing the need to fund benefits over the long term, whilst at the same time, allowing for scrutiny and accountability through improved transparency and disclosure.
 - Until 1 April 2014, the Scheme was a defined benefit final salary scheme. From 1 April 2014, the Scheme is a defined benefit career average revalued earnings scheme. The benefits at the date of writing this Statement are specified in the Regulations. Constraints on the levels of employee contributions are also specified in the Regulations.
 - Employer contributions are determined in accordance with the Regulations, which require that an actuarial valuation is completed every three years by the Fund Actuary.
3. This Statement was reviewed as part of the 2022 triennial actuarial valuation process, and has been updated in March 2023.

b) PURPOSE OF THE FUNDING STRATEGY STATEMENT

4. The purpose of this Funding Strategy Statement (FSS) is to document the processes by which the Administering Authority:
- establishes a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
 - supports the regulatory requirement of the desirability of maintaining as nearly constant a primary rate of employer contribution rates as possible;
 - enables overall employer contributions to be kept as constant as possible and (subject to the Administering Authority not taking undue risks and ensuring that the regulatory requirements are met) at reasonable cost to the taxpayers, scheduled, designating and admitted bodies;
 - ensures that the regulatory requirements to set contributions so as to ensure the solvency and long-term cost efficiency of the Fund are met; and
 - takes a prudent longer-term view of funding the Fund's liabilities.

The intention is for this Strategy to apply comprehensively for the Fund as a whole to reflect its best interests, recognising that there will always be conflicting objectives which need to be balanced and reconciled. Whilst the position of individual employers must be reflected in the Statement, it must remain a single Strategy for the Administering Authority to implement and maintain.

C) PURPOSE AND AIMS OF THE PENSION FUND

5. The purpose of the fund is to:
- Invest monies in respect of contributions, transfer values and investment income to produce a Fund to pay Scheme benefits over the long term and in so doing to smooth out the contributions required from employers over the long term
6. The aims of the fund are to:
- Comply with Regulation 62 of the Regulations and specifically to adequately fund benefits to secure the Fund's solvency while taking account of the desirability of maintaining as nearly constant primary employer contribution rates as possible.

The Administering Authority aims to keep employer contributions as nearly constant as possible, whilst taking account of:

- the regulatory requirement to secure solvency and long term cost efficiency, which should be assessed in the light of the risk profile of the Fund and risk appetite of the Administering Authority and employers
- the requirement to ensure that costs are reasonable to Scheduled Bodies, Admission Bodies, other bodies and to taxpayers (subject to not taking undue risks), and
- maximising return from investments within reasonable risk parameters

Section G sets out the Administering Authority's approach to investing the assets. To the extent that the assets invested in may have volatile returns in the short-term, this can have an effect on employer contribution rates as the funding position of the Pension Fund is measured at the triennial valuations. The impact of this can be reduced by smoothing adjustments at each actuarial valuation.

The Administering Authority recognises that there is a balance to be struck between the investment policy adopted, the smoothing mechanisms used at valuations, and the resultant stability of employer contribution rates from one valuation period to the next.

The Administering Authority also recognises that the position is potentially more volatile for admission bodies with short term contracts where utilisation of smoothing mechanisms is less appropriate.

- Manage employers' liabilities effectively

The Administering Authority seeks to manage employers' liabilities effectively. In a funding context, this is achieved by seeking actuarial advice and regular monitoring of the investment of the Fund's assets through quarterly meetings of the Pension Fund Committee and appropriate segregation of employers for funding purposes.

- Ensure that sufficient resources are available to meet all liabilities as they fall due

The Administering Authority recognises the need to ensure that the Fund has sufficient liquid assets to pay pensions, transfer values and other expenses. This position is continuously monitored and the cash available from contributions and cash held by Fund Managers is reviewed on a quarterly basis by the Pension Fund Committee.

- Maximise the returns from investments within reasonable risk parameters.

The Administering Authority recognises the desirability of maximising returns from investments within reasonable risk parameters, through investment in unmatched investments. Investment returns higher than those of fixed interest and index-linked bonds are sought from investment in equities, property and other growth assets. The Administering Authority ensures that risk parameters are reasonable by:

- Taking advice from its professional advisers, e.g. the Fund Actuary, Investment advisers and investment managers.
- Controlling levels of investment in asset classes through the ISS.
- Limiting default risk by restricting investment to asset classes recognised as appropriate for UK Pension Funds.
- Analysing the volatility and absolute return risks represented by those asset classes in collaboration with the Investment Adviser and Fund Managers, and ensuring that they remain consistent with the risk and return profiles anticipated in the funding strategy statement.
- Limiting concentration risk by developing a diversified investment strategy.
- Monitoring the mismatching risk, i.e. the risk that the investments do not move in line with the Fund's liabilities.

D) RESPONSIBILITIES OF THE KEY PARTIES

7. Although a number of parties including investment fund managers and external auditors have responsibilities to the fund, the three parties whose responsibilities to the Fund are of particular relevance are the Administering Authority, the individual employers and the Fund Actuary:

8. The administering authority should:

- Administer the Fund
- Collect employer and employee contributions as set out in the Regulations
- Determine a schedule of due dates for the payment of contributions - Section 70(1)(a) of the Pensions Act 2004 suggests that Administering Authorities are now required to report breaches as defined in Section 70 (2) of the 2004 Act. This places monitoring of the date of receipt of employer contributions on the Administering Authority and therefore places a duty to report material late payments of contributions to the Pensions Regulator.
- Take action to recover assets from admission bodies whose Admission Agreement has ceased and other bodies whose participation in the Fund has ceased.
- Invest surplus monies in accordance with the Regulations.
- Pay from the Fund the relevant entitlements as set out in the Regulations.
- Ensure that cash is available to meet liabilities as and when they fall due.
- Take measures as set out in the regulations to safeguard the fund against the consequences of employer default
- Manage the valuation process in consultation with the Fund's Actuary.
- Ensure effective communications with the Fund's Actuary to:
 - Ensure that the Fund Actuary is clear about the content of the Funding Strategy Statement;
 - Ensure reports are made available as required by guidance and regulation;
 - Agree timetables for the provision of information and valuation results;
 - Ensure provision of accurate data; and
 - Ensure that participating employers receive appropriate communications.
- Consider the appropriateness of interim valuations.
- Prepare and maintain an FSS and an ISS, both after proper consultation with interested parties, and
- Monitor all aspects of the fund's performance and funding and amend the FSS and ISS regularly as part of the on-going monitoring process.
- Effectively manage any potential conflicts of interest arising from its dual role as both Administering Authority and as a Scheme Employer.
- Enable the local Pension Board to review the valuation process as set out in their terms of reference
- Ensure consistent use of policies relating to revising the employer contributions between formal variations, entering into deferred debt arrangements and spreading exit payments and ensure the process of applying those policies as clear and transparent to all Fund employers

9. The individual employers should:

- Deduct contributions from employees' pay correctly.
- Pay all ongoing contributions, including their own as determined by the actuary, promptly by the due date.
- Pay any exit payments required in the event of their ceasing participation in the Fund.

- Develop a policy on certain discretions and exercise discretions within the regulatory framework, ensuring that the Administering Authority has copies of current policies covering those discretions.
- Make additional contributions in accordance with agreed arrangements in respect of, for example, additional membership or pension, augmentation of scheme benefits and early retirement strain, and
- Notify the administering authority promptly of all changes to membership, or as may be proposed, which affect future funding.
- Noting, and if desired responding to, any consultation regarding the Funding Strategy Statement, the Statement of Investment Principles, or other policies.

10. The fund actuary should:

- Prepare triennial valuations including the setting of employers' contribution rates at a level to ensure solvency and long term cost efficiency after agreeing assumptions with the administering authority and having regard to the FSS and the Regulations.
- Prepare advice and calculations in connection with bulk transfers, the funding aspects of individual benefit-related matters, valuations of exiting employers and other forms of security for the Administering Authority against the financial effect on the Fund of the employer's default. Such advice will take account of the funding position and Funding Strategy Statement, as well as other relevant matters when instructed to do so.
- Assist the Administering Authority in assessing whether employer contributions need to be revised between actuarial valuations as required or permitted by the Regulations.
- Assist the Administering Authority in relation to any decision by the Administering Authority to put in place a Deferred Debt Arrangement under Regulation 64(7B) or spread an exit payment under Regulation 64B.
- In response to a request from the Administering Authority, assess the impact of Regulatory changes on costs.
- Ensure that the Administering Authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the Administering Authority.

E) FUNDING TARGETS, SOLVENCY & EMPLOYER ASSET SHARES

Risk based approach

11. The Fund utilises a risk based approach to funding strategy.

12. A risk based approach entails carrying out the actuarial valuation on the basis of the assessed likelihood of meeting the funding objectives. In practice, three key decisions are required for the risk based approach:

- what the Solvency Target should be (the funding objective - where the Administering Authority wants the Fund to get to),
- the Trajectory Period (how quickly the Administering Authority wants the Fund wants to get there), and
- the Probability of Funding Success (how likely the Administering Authority wants it to be now that the Fund will actually achieve the Solvency Target by the end of the Trajectory Period).

These three choices, supported by modelling carried out by the Fund Actuary, define the discount rate and, by extension, the appropriate levels of contribution payable. Together they measure the riskiness of the funding strategy.

These three terms are considered in more detail below.

Solvency and 'funding success'

13. The Administering Authority's primary aim is long-term solvency. Accordingly, employers' contributions will be set to ensure that 100% of the liabilities can be met over the long term using appropriate actuarial methods and assumptions. The Solvency Target is the amount of assets which the Fund wishes to hold at the end of the Trajectory Period (see later) to meet this aim.
14. The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target. The Administering Authority believes that its funding strategy will ensure the solvency of the Fund because employers collectively have the financial capacity to increase employer contributions should future circumstances require, in order to continue to target a funding level of 100%
 - For tax-raising Scheduled Bodies, and certain other bodies where a Scheme Employer of sound covenant has agreed to subsume its assets and liabilities following the exit of the employer from the Fund, the Solvency Target is set at a level advised by the Fund Actuary as a prudent long-term funding objective for the Fund to achieve at the end of the Trajectory Period, based on continued investment in a mix of growth and matching assets intended to deliver a return above the rate of increases to pensions and pension accounts.
 - For certain Admission Bodies, bodies closed to new entrants and other bodies whose participation in the Fund is believed to be of limited duration through known constraints or reduced covenant, and for which no access to further funding would be available to the Fund after exit, the chance of achieving solvency will be set commensurate with assumed investment in an appropriate portfolio of Government bonds after exit.
 - For deferred employers it is expected that the Solvency Target will be set by considering the valuation basis which would be adopted once the Deferred Debt Agreement ends. For most such bodies, the Solvency Target will be set commensurate with assumed investment in Government Bonds at the end of the period of the deferred debt agreement.

Probability of Funding Success

15. The Administering Authority deems funding success to have been achieved if the Fund, at the end of the Trajectory Period, has achieved the Solvency Target. The Probability of Funding Success is the assessed chance of this happening based on modelling carried out by the Fund Actuary.
16. Consistent with the aim of enabling employers' contribution rates to be kept as nearly constant as possible, the required chance of achieving the Solvency Target at the end of the relevant Trajectory Period for each employer or employer group can be altered at successive valuations within an overall envelope of acceptable risk. The Administering Authority will not permit contributions to be set following a valuation that have an unacceptably low chance of achieving the Solvency Target at the end of the relevant Trajectory Period.

17. At the 2022 valuation, the Trajectory Period used was 25 years, and the probability of Funding Success was set to be 76%.

Funding Target

18. In order to satisfy the legislative requirement to secure long term cost efficiency the Administering Authority's aim is for employer contributions to be set so as to make provision for the cost of benefit accrual, with an appropriate adjustment for any surplus or deficiency. This is achieved through the setting of a Funding Target.
19. The Funding Target is the amount of assets which the Fund needs to hold at the valuation date to pay the liabilities at that date as indicated by the chosen valuation method, assumptions and data. The valuation calculations, including future service contributions and any adjustment for surplus or deficiency, set the level of contributions payable, and dictate the chance of achieving the Solvency Target at the end of the Trajectory Period (defined below).
20. Consistent with the aim of enabling employers' primary contribution rates to be kept as nearly constant as possible:
- Contribution rates are set by use of the Projected Unit valuation method for most employers. The Projected Unit method is used in the actuarial valuation to determine the cost of benefits accruing to the Fund as a whole and for employers who continue to admit new members. This means that the future service (primary) contribution rate is derived as the cost of benefits accruing to employee members over the year following the valuation date expressed as a percentage of members' pensionable pay over that period.
 - For employers who no longer admit new members, the Attained Age valuation method is normally used. This means that the future service (primary) contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.

Application to different types of body

21. Some comments on the principles used to derive the Solvency and Funding Targets for different bodies in the Fund are set out below.

- Tax-raising Scheduled Bodies

For tax raising scheduled bodies, other scheduled bodies of sound covenant, and certain other bodies where a Scheme Employer of sound covenant has agreed to subsume its assets and liabilities following the exit of the Employer from the Fund the Administering Authority will adopt a general approach in this regard of assuming indefinite investment in a broad range of assets of higher risk than low risk assets. This is known as the Scheduled Body/Subsumption Funding Target.

- Non tax-raising scheduled bodies (in particular colleges)

Whilst the Administering Authority will adopt a general approach of assuming indefinite investment in a broad range of assets of higher risk, a reduction may be made to the left

service discount rate to reflect concerns about the covenant strength of certain employers. Currently, this approach is only applied to the Colleges. This is known as the Intermediate Funding Target.

- Admission Bodies and certain other bodies whose participation is limited

For Admission Bodies, Bodies closed to new entrants and other bodies whose participation in the fund is believed to be of limited duration through known constraints or reduced covenant and for which no access to further funding would be available to the fund after exit the administering authority will have specific regard to the potential for participation to cease (or to have no contributing members), the potential timing of such exit, and any likely change in notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date of exit (i.e whether the liabilities will become 'orphaned' or whether a guarantor exists to subsume the notional assets and liabilities). This is known as the ongoing Orphan Funding Target.

For deferred employers where a deferred debt agreement is in place the funding target will take into account any likely change in the notional or actual investment strategy as regards the assets held in respect of the body's liabilities at the date the deferred debt agreement is expected to end and any other factors considered to be relevant by the Administering Authority on the advice of the Actuary, which may include, without limitation:

- the agreed period of the deferred debt agreement;
- the type/group of the employer;
- the business plans of the employer;
- an assessment of the financial covenant of the employer;
- any contingent security available to the Fund or offered by the employer such as a guarantor or bond arrangements, charge over assets, etc.

Full Funding and Solvency

22. The Fund is deemed to be fully funded when the assets held are equal to 100% of the Funding Target, where the funding target is assessed based on the sum of the appropriate funding targets across all the employers/groups of employers.

23. The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target.

Recovery Periods

24. The Recovery Period in relation to an employer is the period between the valuation date and the date on which full funding is targeted to be achieved.

25. Where a valuation shows the Fund to be in surplus or deficit against the Funding Target, employers' contribution rates will be adjusted to reach the solvent position over a number of years. The Recovery Period in relation to an employer or group of employers is therefore a period over which any adjustment to the level of contributions in respect of a surplus or deficiency relative to the Funding Target used in the valuation is payable.

26. The Recovery Period applicable for each employer is set by the Fund Actuary in consultation with the Administering Authority and the employer, with a view to balancing the various funding requirements against the risks involved due to such issues as the financial strength of the employer and the nature of its participation in the Fund.
27. The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefits payments over a long period of time. For employers of sound covenant, the Administering Authority is therefore prepared to agree Recovery Periods that are longer than the average future working lifetime of the membership of that employer. In general for employers that are closed to new entrants and are of sufficient term, the Recovery Period is set to be the estimated future working lifetime of the active membership (i.e. the estimated period of time until the last active member leaves or retires). The Administering Authority recognises that such an approach is consistent with the aim of keeping employer contribution rates as nearly constant as possible.
28. However, the Administering Authority also recognises the risk involved in relying on long Recovery Periods and has agreed with the Actuary a maximum recovery period of 30 years for employers which are assessed by the Administering Authority as being a long term secure employer.
- For employers who are less than 100% funded, it is the intention of the Administering Authority to agree with employers a Recovery Period typically shorter where possible within this 30 year limit having regard to the affordability of the revised contribution rate in general taking into account the legislative requirements of securing solvency and maintaining as nearly a constant a contribution rate as possible.
 - For employers who have a surplus, the Administering Authority will aim not to reduce the recovery period from that used at the previous valuation, noting that longer recovery periods lead to a smaller surplus reduction to the contribution rate.
 - In line with the desirability of maintaining as nearly constant a contribution rate at this and future valuations, the Recovery Period shall not apply to any employer subject to the scheduled body and subsumption and intermediate funding targets at a funding level of between 100% - 110%. Those employers will be required to pay the primary rate (i.e. the future service rate) in full, without any adjustment for a surplus. In respect of any employer at a funding level in excess of 110%, the Recovery Period shall only apply to any surplus above the 110% funding level.

A period of 16 years has been used for Durham County Council at the 2022 valuation, the largest employer in the Fund. Recovery Periods for other employers or employer groups may be shorter or longer and may not necessarily be the same as each other, in order to suitably balance risk to the Fund and cost to the employer.

29. For each individual employer the following will also be taken into account:
- covenant and strength of any guarantee relating to an employer and hence the risk of default
 - length of participation in the Fund

- whether the employer is closed to new entrants or is likely to have a contraction in its membership of the Fund
- for deferred employers, the remaining period of the deferred debt agreement

Stepping

30. The Administering Authority will also consider at each valuation whether new contribution rates should be payable immediately or reached by being stepped over a number of years. Stepping is a generally accepted method of smoothing the impact of rate changes for local authority pension funds. In consultation with the Actuary, the Administering Authority accepts that employers may step up (or down) to the new rates subject to this not introducing undue risk to the Fund. This is in line with the aim of having contribution rates as nearly constant as possible. The Administering Authority usually allows a maximum of three steps however, in exceptional circumstances up to six steps may be used.

Advance Funding of Secondary Contributions

31. The Administering Authority may at its discretion, and after considering the advice of the Fund Actuary, permit particular employers to opt to pay early, in lump sum form, the secondary contributions designed to meet a deficit, that would otherwise be payable over the following year (or longer period not exceeding three years). An appropriate discount, as determined by the Fund Actuary, would be applied to the secondary contributions to reflect the early payment.

Grouping / Pooling

32. In some circumstances it may be desirable to group or pool employers within the Fund together for funding purposes (i.e. to calculate employer contribution rates). Reasons might include:

- reduction of volatility of contribution rates for small employers, facilitating situations where employers have a common source of funding or
- accommodating employers who wish to share the risks related to their participation in the Fund such as outsourcings which have been carried out on a 'pass-through' approach where it makes sense for the service provider to be given either the same primary contribution rate as the outsourcing body or the fixed contribution rate agreed contractually, or
- employers have been grouped for practical or commercial reasons.

33. The Administering Authority recognises that grouping of employers can give rise to cross subsidies from one employer to another over time. Employers may be grouped entirely, such that all of the risks of participation are shared, or only partially grouped such that only specified risks are shared. The Administering Authority's policy is to consider the position carefully at initial grouping and at each valuation and to notify each employer that is grouped which other employers it is grouped with and details of the grouping method used. If the employer objects to this grouping, it will be set its own contribution rate.

34. Where employers are grouped together for funding purposes, this will only occur with the consent of the employers involved.

35. All employers in the Fund are grouped together in respect of the risks associated with payment of survivors pensions and lump sum benefits on death in service and, payment of ill health

pensions – in other words, the cost of such benefits is shared across the employers in the Fund. Such benefits can cause funding strains which could be significant for some of the smaller employers without insurance or sharing of risks. The Fund, in view of its size, does not see it as cost effective or necessary to insure these benefits externally and this is seen as a pragmatic and low cost approach to spreading the risk.

36. There are a small number of different groups and approaches used and these are set out in the Appendix to this FSS.

Asset shares notionally allocated to employers

37. 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 (or group of employers where grouping operates), as if each employer had its own asset share within the Fund.
38. This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, or ownership of any particular assets or groups of assets by any individual employer or group.

Roll-forward of asset shares

39. The asset share allocated to each employer will be rolled forward allowing for all cash flows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income. In general no allowance is made for the timing of contributions and cash flows for each year are assumed to be made halfway through the year with investment returns assumed to be uniformly earned over that year. However, where significant one-off employer contributions have been paid, allowance is made for the timing of such contributions.
40. Further adjustments are made for:
- A notional deduction to meet the expenses paid from the Fund in line with the assumption used at the previous valuation.
 - Allowance for any known material internal transfers in the Fund (cash flows will not exist for these transfers). The Fund Actuary will assume an estimated cash flow equal to the value of the cash equivalent transfer value based on appropriate factors set by the Government Actuary's Department.
 - Allowance for death in service and ill-health benefits shared across all employers in the Fund (see earlier).
 - An overall adjustment to ensure the notional assets attributed to each employer is equal to the total assets of the Fund which will take into account any gains or losses related to the orphan liabilities.
41. In some cases information available will not allow for such cash flow calculations. In such a circumstance:
- Where, in the opinion of the Fund Actuary, the cash flow data which is unavailable is of low materiality, estimated cash flows will be used.

- Where, in the opinion of the Fund Actuary, the cash flow data which is unavailable is material, the Fund Actuary will instead use an analysis of gains and losses to roll forward the asset share. Analysis of gains and losses methods are less precise than use of cash flows and involve calculation of gains and losses relative to the surplus or deficiency exhibited at the previous valuation. Having established an expected surplus or deficiency at this valuation, comparison of this with the liabilities evaluated at this valuation leads to an implied notional asset holding.

42. Analysis of gains and losses methods will also be used where the results of the cash flow approach appears to give unreliable results perhaps because of unknown internal transfers.

Fund maturity

43. To protect the Fund, and individual employers, from the risk of increasing maturity producing unacceptably volatile contribution adjustments as a percentage of pay the Administering Authority will normally require contributions as monetary amounts from employers in respect of any disclosed funding deficiency.

44. In certain circumstances, for secure employers considered by the Administering Authority as being long term in nature, contribution adjustments to correct for any disclosed deficiency may be set as a percentage of payroll. Such an approach carries an implicit assumption that the employer's payroll will increase at an assumed rate. If payroll fails to grow at this rate, or declines, insufficient corrective action will have been taken. To protect the Fund against this risk, the Administering Authority will monitor payrolls and where evidence is revealed of payrolls not increasing at the anticipated rate, the Administering Authority will consider requiring deficit contributions as monetary amounts rather than percentages of payroll.

F) SPECIAL CIRCUMSTANCES RELATED TO CERTAIN EMPLOYERS

Interim reviews

45. Regulation 64 and 64A of the Regulations provide the Administering Authority with a power to carry out interim valuations and for the Actuary to certify revised contribution rates, between triennial valuation dates. Further details of the Fund's policy in relation to Regulation 64A is set out the Pension Fund's Policy on Employer Flexibilities.

46. The Administering Authority's overriding objective at all times in relation to employers is that, where possible, there is clarity over the Funding Target for that body, and that contribution rates payable are appropriate for that Funding Target. However, this is not always possible as any exit date may be unknown (for example, participation may be assumed at present to be indefinite), and also because market conditions change daily.

47. Further details of the Fund's policy in relation to Regulation 64(4) are set out in the Pension Fund's Policy on Employer Exits and Flexibilities. Notwithstanding these, the Administering Authority reserves the right to request an interim valuation of any employer at any time if Regulation 64(4) of the Regulations applies.

Guarantors

48. Some employers may participate in the Fund by virtue of the existence of a Guarantor. The Administering Authority maintains a list of employers and their associated Guarantors. The Administering Authority, unless notified otherwise, sees the duty of a Guarantor to include the following:
- If an employer exits and defaults on any of its financial obligations to the Fund, the Guarantor is expected to provide finance to the Fund such that the Fund receives the amount certified by the Fund Actuary as due, including any interest payable thereon.
 - If the Guarantor is an employer in the Fund and is judged to be of suitable covenant by the Administering Authority, the Guarantor may defray some of the financial liability by subsuming the residual liabilities into its own pool of Fund liabilities. In other words, it agrees to be a source of future funding in respect of those liabilities should future deficiencies emerge.
49. During the period of participation of the employer a Guarantor can at any time agree to the future subsumption of any residual liabilities of an employer. The effect of that action would be to reduce the Funding and Solvency Target for the employer, which would probably lead to reduced contribution requirements.

Bonds and other securitisation

50. Paragraph 6 of Part 3, Schedule 2 of the Regulations creates a requirement for a new Admission Body to carry out, to the satisfaction of the Administering Authority (and the Scheme Employer in the case of an Admission Body admitted under paragraph 1(d)(i) of that Part), an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.
51. Where the level of risk identified by the assessment is such as to require it, the admission body shall enter into an indemnity or bond with an appropriate party. Where it is not desirable for an Admission Body to enter into an indemnity or bond, the body is required to secure a guarantee in a form satisfactory to the Administering Authority from an organisation who either funds, owns or controls the functions of the admission body.
52. The Administering Authority's approach in this area is as follows:
- In the case of Admission Bodies admitted under Paragraph 1(d) of Part 3, Schedule 2 of the Regulations and other Admission Bodies with a Guarantor, and so long as the Administering Authority judges the relevant Scheme Employer or Guarantor to be of sufficiently sound covenant, any bond exists purely to protect the relevant Scheme Employer on default of the Admission Body. As such, it is entirely the responsibility of the relevant Scheme Employer or Guarantor to arrange any risk assessments and decide the level of required bond. The Administering Authority will be pleased to supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer, but this should not be construed as advice to the relevant Scheme Employer on this matter. The Administering Authority notes that levels of required bond cover can fluctuate and recommends that relevant Scheme Employers review the required cover regularly, at least once a year.
 - In the case of:
 - admission bodies admitted under paragraph 1(e) of Part 3, Schedule 2;

- admission bodies admitted under paragraph 1(d) of Part 3, Schedule 2 where the administering authority does not judge the Scheme Employer to be of sufficiently strong covenant;
- other admission bodies with no Guarantor or where the administering authority does not judge the Guarantor to be of sufficiently strong covenant;

The administering authority must be involved in the assessment of the required level of bond to protect the Fund. The admission will only be able to proceed once the Administering Authority has agreed the level of bond cover. The Administering Authority will supply some standard calculations provided by the Fund Actuary to aid the relevant Scheme Employer to form a view on what level of bond would be satisfactory. The Administering Authority will also on request supply this to the Admission Body or Guarantor. This should not be construed as advice to the Scheme Employer, Guarantor or Admission Body. The Administering Authority notes that levels of required bond cover can fluctuate and will recommend the relevant Scheme Employer to jointly review the required cover with it regularly, at least once a year.

Subsumed liabilities

53. Where an employer is exiting the Fund such that it will no longer have any contributing members, it is possible that another employer in the Fund agrees to provide a source of future funding in respect of any emerging deficiencies in respect of those liabilities. This is a form of risk sharing between the employers.
54. In such circumstances the liabilities are known as subsumed liabilities (in that responsibility for them is taken on by the accepting employer).

Orphan liabilities

55. Where an employer is exiting the Fund such that it will no longer have any contributing members, unless any residual liabilities are to become subsumed liabilities, the Administering Authority will act on the basis that it will have no further access for funding from that employer once any exit valuation, carried out in accordance with Regulation 64 of the Regulations, has been completed and any sums due have been paid. Residual liabilities of employers from whom no further funding can be obtained are known as orphan liabilities.
56. The Administering Authority will seek to minimise the risk to other employers in the Fund that any deficiency arises on the orphan liabilities such that this creates a cost for those other employers to make good the deficiency. To give effect to this, the Administering Authority will seek funding from the outgoing employer sufficient to enable it to match the liabilities with low risk investments, generally Government fixed interest and index linked bonds.
57. To the extent that the Administering Authority decides not to match these liabilities with Government bonds of appropriate term then any excess or deficient returns will be added to or deducted from the investment return to be attributed to the other employer's notional assets.

58. Liabilities in the Fund which are already orphaned will be assumed to be 100% funded on the appropriate funding target at each triennial valuation. This will be achieved by the Actuary notionally re-allocating assets within the Fund as required.

Commencement of Employers

59. When a new employer starts in the Fund, and members transfer from another employer in the Fund, a notional transfer of assets is needed from the original employer to the new employer. The approach used will depend on the circumstances surrounding the commencement of the new employer and some comments are set out below.

60. When a new admission body starts in the Fund due to an outsourcing event, they will usually start as fully funded on the Funding Target appropriate to the new employer. This means that any past service surplus or deficit for the members who are transferring to the new employer remains with the original employer and does not transfer to the new employer.

61. For academies, a prioritised share of fund approach is followed. This involves fully funding the non-active members of the original employer at the previous triennial valuation, and using the residual assets to calculate the funding level applicable to the active members of the original employer. This is rolled forward in line with the progression of the overall funding level of the original employer during the period from the last valuation date to the date of commencement of the academy, to a maximum of 100%. The funding level applicable to the active members is then used to calculate the notional asset transfer to the new employer.

62. In other circumstances the notional asset transfer will often be subject to the agreement between the relevant parties and the Administering Authority (who will take advice from the Fund Actuary). In the event of any dispute the Administering Authority will take make the final decision having taken account of the issues related to the setting up of the new employer.

Cessation of participation

63. The Fund's policy on the following areas are set out in the Fund's Employer Exits and Flexibilities Policy: exit valuations, exit payments and credits, spreading of exit payments, and the way benefit uncertainties (such as the proposed McCloud remedy and the expected changes to GMP indexation) are allowed for in exit valuations.

64. In certain circumstances it may be agreed to enter into a deferred debt agreement rather than require an immediate exit payment. In that case, the employer would remain a participating body as a deferred employer. Further details are set out in the Fund's Exits and Flexibilities Policy.

G) LINKS TO INVESTMENT POLICY SET OUT IN THE STATEMENT OF INVESTMENT PRINCIPLES OR INVESTMENT STRATEGY STATEMENT

65. The current investment strategy, as set out in the ISS, is summarised below:

General Principles and diversification

66. The Fund believes that the emphasis of investment over the long term should be on real assets, particularly equities and property. These are most likely to maximise the long term returns. The balance between UK and Overseas equities is, however, a matter of investment judgement. The Fund should also be diversified to include other real assets, such as Index-Linked and 'monetary' assets, such as Bonds and Cash.
67. The neutral benchmark proportions of the various asset classes have been determined by the Fund in consultation with the Investment Advisers and are reviewed at least once every three years to coincide with the Triennial Actuarial Valuation.
68. The active Investment managers are expected to adopt an active asset allocation policy to take advantage of the shorter term relative attractions of the various asset types.
69. The Administering Authority has produced this Funding Strategy Statement having taken a view on the level of risk inherent in the investment policy set out in the ISS and the funding policy set out in this document.
70. The ISS sets out the investment responsibilities and policies relevant to the Fund.
71. The Administering Authority will continue to review both documents to ensure that the overall risk profile remains appropriate.

H) IDENTIFICATION OF RISKS AND COUNTER-MEASURES

72. The Administering Authority seeks to identify all risks to the Fund, will monitor the risks and take appropriate action to limit the impact of them wherever possible. The Administering Authority will ensure that funding risks are included within their overarching risk management framework and strategy, linking to their risk register and risk management policy as appropriate and includes defining a role for the Local Pension Board within this framework.
73. For ease of classification some of the key risks may be identified as follows:
74. Investment Risks
These include:
 - assets not delivering the required return (for whatever reason, including manager underperformance)
 - systemic risk with the possibility of interlinked and simultaneous financial market volatility
 - having insufficient funds to meet liabilities as they fall due
 - inadequate, inappropriate or incomplete investment and actuarial advice is taken and acted upon
 - counterparty failure
 - risks associated with the transition of assets to the pool

- risks associated with climate change

The specific risks associated with assets and asset classes are:

- equities – industry, country, size and stock risks
- fixed income - yield curve, credit risks, duration risks and market risks
- alternative assets – liquidity risks, property risk, alpha risk
- money market – credit risk and liquidity risk
- currency risk
- macroeconomic risks

The Administering Authority reviews each investment manager’s performance quarterly and annually considers the asset allocation of the Fund by carrying out an annual review meeting. The Administering Authority also annually reviews the effect of market movements on the Fund’s overall funding position.

At the 2022 valuation the Fund Actuary will undertake scenario analysis to assess the resilience of the funding strategy to climate change risk over an agreed period.

75. Employer Risks

These include:

- the risk arising from ever changing mix of employers, from short term and exiting employers, and the potential for a shortfall in payments and / or orphaned liabilities.
- the response to COVID-10 pandemic may have adverse consequences in relation to employer finances and their ability to make contributions. The Administering Authority monitors employer payments and expects employers in financial difficulty to engage with the Fund, noting that contributions can be reviewed between formal valuations, if the conditions in Regulation 64A and the terms of the Fund’s policy are met.

The Administering Authority will put in place a Funding Strategy Statement which contains sufficient detail on how funding risks are managed in respect of the main categories of employer (e.g. scheduled and admission bodies) and other pension fund stakeholders.

The Administering Authority maintains a knowledge base on their employers, their basis of participation and their legal status and will use this information to set a funding strategy for the relevant employers.

76. Liability Risks

These include:

- Interest rates being lower than expected
- Pay increases being higher than expected
- Price inflation being higher than expected
- The longevity horizon continuing to expand
- Deteriorating patterns of early retirements

The Administering Authority will ensure that the Actuary investigates these matters at each valuation. Prudent management of the fund should ensure that sound policies and procedures are in place to manage, e.g. potential ill health or early retirements.

Where 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 the Administering Authority may consider revising an employer's contributions as permitted by Regulation 64A.

77. Regulatory Risks

These include:

- Changes to general and LGPS specific regulations, e.g. more favourable benefits package, potential new entrants to the scheme e.g. part-time employees
- Changes to national pension requirement and/or Inland Revenue rules

There are a number of uncertainties associated with the benefit structure at the current time including:

- The timing of any final regulations in relation to the remedy to compensate members of illegal age discrimination following the outcome of the McCloud / Sargeant cases.
- The outcome of the cost management process as at 31 March 2020
- The Goodwin case in which an Employment Tribunal ruled (in relation to the Teachers' Pension Scheme) that the less favourable provisions for survivor's benefits of a female member in an opposite sex marriage compared to a female in a same sex marriage or civil partnership amounts to direct discrimination on grounds of sexual orientation. Following a written ministerial statement by the chief secretary to the Treasury on 20 July 2020 it is expected that changes will be made to the LGPS Regulations to reflect the ruling, but no changes have yet been proposed.

In determining how these uncertainties should be allowed for in employer contributions the Administering Authority will have regard to guidance issued by SAB and take advice from the Fund Actuary.

For the purposes of the 2022 valuation, an approximate employer specific allowance will be made in respect of the McCloud remedy based on a high level analysis of the employer's fund membership. Members' benefits will be valued as required by relevant legislation as in force as at 31 March 2022, except for the following assumptions:

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

In addition, a consultation document was issued by MHCLG (now DLUHC) entitled "Local Government Pension Scheme: Changes to the Local Valuation Cycle and the Management of Employer Risk" dated May 2019. This included a proposal to change the LGPS local fund valuations to quadrennial cycles. The Administering Authority will have regard to any changes in the LGPS 2013 Regulations as a result of this consultation and consider any actions required at the 2022 or subsequent valuations, taking account of the Fund Actuary's advice.

78. Liquidity and Maturity Risks

These include:

- An increased emphasis on outsourcing and alternative models for service delivery may result in active members leaving the LGPS (eg where new admissions are closed or scheduled bodies establish wholly owned companies which do not fully participate in the LGPS)
- Transfer of responsibility between different public sector bodies
- Scheme changes which might lead to increased opt-outs
- Spending cuts and their implications

All of these may result in workforce reductions that would reduce membership, reduce contributions and prematurely increase retirements in ways that may not have been taken into account in previous forecasts.

The Administering Authority's policy is to require regular communication between itself and employers and to ensure reviews of maturity at overall Fund and employer level where material issues are identified.

79. Governance Risks

These include:

- 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; and
- An employer ceasing to exist with insufficient funding or adequacy of a bond

The Administering Authority requires regular communication with employers to ensure that it is made aware of any such changes in a timely manner.

80. Choice of Solvency and Funding Targets Risks

The Administering Authority recognises that future experience and investment income cannot be predicted with certainty. Instead, there is a range of possible outcomes, and different assumed outcomes will lie at different places within that range.

The more optimistic the assumptions made in determining the Funding Target and Solvency Target, the more that outcome will sit towards the 'favourable' end of the range of possible outcomes, the lower will be the probability of experience actually matching or being more favourable than the assumed experience, and the lower will be the Funding Target and Solvency Target calculated by reference to those assumptions.

The Administering Authority will not adopt assumptions for Scheduled Bodies and certain other bodies which, in its judgement, and on the basis of actuarial advice received, are such that it is less than 55% likely that the strategy will deliver funding success (as defined earlier in this document). Where the probability of funding success is less than 65% the Administering Authority will not adopt assumptions which lead to a reduction in the aggregate employer contribution rate to the Fund. The Administering Authority's policy will be to monitor the underlying position assuming no excess returns are achieved relative to gilts to ensure that the funding target remains realistic relative to the low risk position.

81. Smoothing of Assets Risks

These include:

- The utilisation of a smoothing adjustment in the solvency measurement introduces an element of risk, in that the smoothing adjustment may not provide a true measure of the underlying position

The Administering Authority's policy is to review whether an approach is suitable and if so, ensure the impact of this adjustment remains within acceptable limits.

82. Recovery Period Risks

These include:

- Permitting surpluses or deficiencies to be eliminated over a recovery period rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements

The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of Recovery Period where appropriate. Details of the Administering Authority's policy are set out earlier in this Statement.

83. Stepping Risks

These include:

- Permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient in the early years of the process

The Administering Authority's policy is to discuss the risks inherent in each situation with the Fund Actuary and to limit the number of permitted steps as appropriate. Details of the Administering Authority's Policy are set out earlier in this Statement.

I) MONITORING AND REVIEW

84. The Administering Authority must keep the FSS under review and make appropriate revisions following a material change in policy. The triennial valuation exercise will establish contribution rates for all employers contributing to the fund within the framework provided by the strategy.

Issues relevant to all employers

The assets and liabilities for employers will allow for any assets and liabilities the employer has agreed to subsume relating to employers who have exited or have been taken over / merged as a result of reorganisation. This for example includes:

- For Durham County Council the assets and liabilities relating to the District Councils which formed the Durham County Council unitary authority and the assets and liabilities those District Councils originally were responsible for.
- For Multi Academy Trusts (MAT) the assets and liabilities relating to schools or other academies which now form part of the MAT.

Town Council Group

Employers in this group are pooled together for funding and contribution purposes, all risks are shared within the group and they have a single contribution rate.

The active participants of this Group at the date of writing this Statement are:

- Barnard Castle Town Council
- Bishop Auckland Town Council
- Brandon & Byshottles Parish Council
- Chilton Town Council
- Easington Colliery Parish Council
- Easington Village Parish Council
- Ferryhill Town Council
- Fishburn Parish Council
- Framwellgate Moor Parish Council
- Great Aycliffe Town Council
- Greater Willington Town Council
- Haswell Parish Council
- Horden Parish Council
- Hutton Henry Parish Council
- Lanchester Parish Council
- Langley Parish Council
- Monk Hesleden Parish Council
- Murton Parish Council
- Murton Welfare Association
- North Lodge Parish Council
- Peterlee Town Council
- Seaham Town Council
- Sedgfield Town Council
- Shildon Town Council
- Shotton Parish Council
- South Hetton Parish Council
- Spennymoor Town Council
- Thornley Parish Council

- Trimdon Parish Council
- Wheatley Hill Parish Council
- Wingate Parish Council
- Winston Parish Council

In addition, there are liabilities related to the following bodies which currently have no active members. These liabilities remain part of the group:

- Central Durham Joint Crematorium Committee
- Esh Parish Council
- North Lodge Parish Council
- Trimdon Foundry Parish Council

If a Town Council has no contributing members it will become an exiting employer under Regulation 64(1) unless a suspension notice has been issued (a suspension notice can be issued for a period of up to three years if there is a reasonable likelihood an active member will join the Fund within the suspension period (Regulations 64(2A) to 64(2C)).

Given the liabilities are generally small the Administering Authority will not expect an exiting employer from the Group to make an exit payment or receive any exit credit unless the exiting employer has a material impact on the other employers in the Group. The assets and liabilities relating to the exiting employer will remain part of the Group.

Durham County Council

In addition to the subsumption of the assets and liabilities relating to relevant exiting employers and District Councils referred to above, Durham County Council has a pass through contractual arrangement with the following employers who as a consequence have been pooled with Durham County Council and will pay the primary contribution rate relating to the pool:

- Investing in Children (195)
- Harbour Support Services (206)
- Science Museum Locomotion (224)
- YS Services (228)

Darlington County Borough Council

In addition to the subsumption of the assets and liabilities relating to relevant exiting employers Darlington Council has a pass through contractual arrangement with the following employers who as a consequence have been pooled with Darlington Council and will pay the primary contribution rate relating to the pool:

- Blackwell Grange Golf Club (198)
- Making Space (205)