POWYS COUNTY COUNCIL PENSION FUND

Funding Strategy Statement

[month agreed] 2014

Funding Strategy Statement

1. Introduction

This is the Funding Strategy Statement (FSS) of the Powys County Council Pension Fund.

It has been prepared by the Administering Authority in collaboration with the Fund Actuary, Aon Hewitt Limited, and after consultation with the Fund's employers and investment advisors and is effective from 31 March 2013. A single strategy is produced for the Pension Fund. The FSS compliments the triennial Actuarial Valuation and the Statement of Investment Principles as follows:

Actuary's Valuation Report	Funding Strategy Statement (FSS)	Statement of Investment Principles (SIP)
Defines what employer contributions should be made to meet current and future pension payments.	States how solvency and risk will be managed in relation to liabilities.	How and where the fund will be invested and managed.

1.1 Regulatory Framework

This statement, originally prepared in accordance with Regulation 76A of the Local Government Pension Scheme Regulations 1997, has been reviewed in accordance with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 (the LGPS Administration Regulations).

As required by Regulation 35(3)(a) of the LGPS Administration Regulations, the Statement has been prepared having regard to guidance published by CIPFA in March 2004. The Statement also has regard to updated guidance published by CIPFA on 3 October 2012.

Members' benefits and contributions are set out in the Local Government Pension Scheme (Membership, Benefits and Contributions) Regulations 2007 (the LGPS Benefits Regulations). The members' contributions do not cover the full cost of benefits and the shortfall or liability is met by the participating employers within the fund. The FSS set outs how this liability will be funded in the long term.

1.2 Purpose of this Funding Strategy Statement

The main purpose of the FSS is to document the processes by which the Administering Authority:

• establishes a <u>clear and transparent fund-specific strategy</u> which will identify how employers' pension liabilities are best met going forward;
• supports the regulatory framework to maintain as nearly <u>constant employer contribution rates</u> as possible;
• takes a <u>prudent longer-term view</u> of funding the Fund's liabilities.

These objectives are desirable individually, but may be mutually conflicting.

This statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis. The focus of the FSS is on those actions which are in the best long term interests of the Fund.

1.3 Reviews of FSS

The FSS will be reviewed in detail at least every three years in line with triennial valuations being carried out. It will be circulated to employers prior to the completion of each valuation. It will only need to be updated in between valuations if there has been material change. Small updates can be attached to the original approved.

1.4 Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice.

The Authority has produced this FSS having taken an overall view of the level of risk inherent in the investment policy set out in the Statement of Investment Principles (SIP) published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the Investment Regulations) and the funding policy set out in this Statement. The Administering Authority will continue to review both documents to ensure that the overall risk profile remains appropriate including, where appropriate, asset liability modelling or other analysis techniques.

2. Purpose and Aims of the Fund

2.1 Purpose of the Fund

The purpose of the Fund is to invest monies in respect of contributions, transfer values and investment income to produce a Fund to pay the Scheme benefits over the long term and in doing so smooth out the contributions required from employers over the long term.

2.2 Aims of the Fund

The aims of the Fund in relation to the Funding Strategy include:

• to ensure the long-term solvency of the Fund. The Fund Solvency should be assessed in light of the risk profile of the Fund and the risk appetite of the Administering Authority and employers;
• to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
• to maximise the returns from investments within reasonable risk parameters;
• to manage employers liabilities effectively through regular review of contributions and additional contributions for early retirement;
• to try to maintain stability of employer contributions, and (subject to the Administering Authority not taking undue risks) at reasonable cost to the taxpayers, scheduled, resolution and admitted bodies.

3. Responsibilities of Key Parties

The LGPS Regulations set out the responsibilities of the key parties and are summarised below.

3.1 The Administering Authority should:-

- administer the Fund
- collect investment income and other amounts due to the Fund including employer and employee contributions and cessation payments from employers whose participation in the Fund has ceased. The administering authority will ensure all individual employers are aware that they must pay contributions in accordance with Regulations 39 to 42 of the LGPS Administration Regulations;
- invest surplus monies in accordance with the regulations;
- pay from the Fund the relevant entitlements as set out in the LGPS Benefits Regulations
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the fund's actuary;
- prepare and maintain a FSS and a SIP, both after proper consultation with interested parties;
- monitor all aspects of the fund's performance and funding and amend the FSS/SIP as necessary;
- effectively manage any potential conflicts of interest arising from its dual role as both Administering Authority and as a Scheme Employer.

3.2 Individual Employers should:-

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the Fund's actuary, promptly by the 19th day of the month following the month in which the member paid the contribution. Unless an agreed arrangement is in place, late payments will incur interest of 1% above base rate.
- 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, augmentation of scheme benefits, early retirement strain;
- notify the administering authority promptly of all changes to membership or, as maybe proposed, which affect future funding;
- noting and if desired responding to any consultation regarding the FSS, the SIP, or other policies.

3.3 The Fund Actuary should:-

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters, on valuations on cessation of admission agreements or when an employer ceases to employ any active members, and in connection with bonds and other forms of security against employers default.

Such advice will take account of the funding position and FSS, as well as other relevant matters when instructed to do so.

The Fund Actuary will assist the Administering Authority in assessing whether employer contributions need to be revised between actuarial valuations as required by the Regulations.

The Fund Actuary will 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.

4 Funding Strategy

4.1 Risk Based Approach

The Fund utilises a risk based approach to funding strategy.

A risk based approach entails carrying out the actuarial valuation on the basis of the assessed likelihood of meeting the funding objectives, rather than relying on a 'deterministic' approach which gives little idea of the associated risk. 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 complex risk modelling carried out by the Fund Actuary, define the appropriate levels of contribution payable now and, by extension, the appropriate valuation approach to adopt now. Together they measure the amount of risk in the funding strategy.

These three terms are considered in more detail below.

4.2 Solvency Target

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. 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.

The Fund is deemed to be solvent when the assets held are equal to or greater than 100% of the Solvency Target, where the Solvency Target is the value of the Fund's liabilities evaluated using appropriate actuarial methods and assumptions.

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

4.2.1 Scheduled Bodies and Admission Bodies with guarantors agreeing to subsume assets and liabilities following cessation

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 risk free assets for scheduled bodies and certain other bodies. With regard to Admission Bodies the guarantor must have been judged to be of suitable covenant by the Administering Authority (see section on Guarantors in section 5).

For these bodies, appropriate actuarial methods and assumptions are taken to be measurement by use of the Projected Unit method of valuation, and using assumptions such that, if the Fund had reached the Solvency Target and it's financial position continued to be assessed by use of such methods and assumptions, and contributions were paid in accordance with those methods and assumptions, there would be a chance of at least 80% that the Fund would continue to be 100% funded after a period of 25 years. The level of funding implied by this is the Solvency Target. For the purpose of this Statement, the required level of chance is defined as the Probability of Maintaining Solvency.

4.2.2 Admission Bodies and other bodies whose liabilities are expected to be orphaned

For admission bodies the Administering Authority will have regard to the potential for participation to cease (or to have no contributing members), the potential timing of such cessation, and any likely change in notional or actual investment strategy as regards the assets held in respect of the admission body's liabilities at the date of cessation (i.e. whether the liabilities will become 'orphaned' or a guarantor exists to subsume the notional assets and liabilities). For most bodies where liabilities will become orphaned, the chance of achieving solvency will be set commensurate with assumed investment in an appropriate portfolio of Government index linked and fixed interest bonds after cessation.

If the liabilities for such bodies are deemed to be small compared to the liabilities of the whole Fund (and therefore the risk related to these liabilities is small) then the Administering Authority may decide to use the Funding Target and Solvency Target used for Scheduled Bodies for practical reasons.

4.2.3 Orphan Liabilities

These are liabilities with no access to funding from any employer in the Fund. To minimise the risk to other employers in the Fund the notional assets related to these liabilities may be assumed to be invested in low risk investments. This is described in more detail later in this document.

If these liabilities are deemed to be small compared to the liabilities of the whole Fund (and therefore the risk related to these liabilities is small) then the Administering Authority may decide to use the Funding Target and Solvency Target used for Scheduled Bodies for practical reasons.

4.3 Probability of Funding Success

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 the level of contributions payable by members and employers.

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.

4.4 Funding Target

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 and assumptions. It is a product of the triennial actuarial valuation exercise and is not necessarily the same as the Solvency Target. It is instead the product of the data, chosen assumptions, and valuation method. The valuation method including the components of Funding Target, future service costs and any adjustment for the surplus or deficiency simply serve to set the level of contributions payable, which in turn dictates the chance of achieving the Solvency Target at the end of the Trajectory Period (defined below). The Funding Target will be the same as the Solvency Target only when the methods and assumptions used to set the Funding Target are the same as the appropriate funding methods and assumptions used to set the Solvency Target (see above).

Consistent with the aim of enabling employers' 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 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 contribution rate is derived as the average cost of benefits accruing to members over the period until they die, leave the Fund or retire.

4.5 Full Funding and Solvency

The Fund is deemed to be fully funded when the assets held are equal to or greater than 100% of the Funding Target. When assets held are greater than this amount the Fund is deemed to be in surplus, and when assets held are less than this amount the Fund is deemed to be in deficiency.

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

4.6 Recovery and Trajectory Periods

Where a valuation reveals that the Fund is in surplus or deficiency against the Funding Target, employer contribution rates will be adjusted to target restoration of the Funding Target over a period of years (the recovery period). The recovery period applicable for each participating employer is set by the Administering Authority in consultation with the Fund actuary 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.

For simplicity, the Trajectory Period for is set to be the same as the Recovery period for the largest employer in the Fund.

The Administering Authority recognises that a large proportion of the Fund's liabilities are expected to arise as benefit payments over long periods of time. For employers of sound covenant, the Administering Authority is prepared to agree to recovery periods which 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 with regard to 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. However, the Administering Authority also recognises the risk in relying on long recovery and trajectory periods when the employer has a deficiency and has agreed with the Fund actuary a limit of 25 years in these circumstances. The Administering Authority's policy with regard to employers with a deficit (surplus) is to agree recovery periods with each employer which is as short (long) as possible within this framework. The Administering Authority may encourage employers with a surplus not to take any reduction in their contribution rate to assist with stability requirements.

For employers whose participation in the Fund is for a fixed period it is unlikely that the Administering Authority and Fund actuary would agree to a recovery period longer than the remaining term of participation.

4.6 Phasing in of Contribution Rates

Phasing in periods will be influenced by the perceived credit worthiness of the employer when there is a deficiency. The Administering Authority's policy is that in the normal course of events no more than 3 annual steps will be permitted. Further steps may be permitted in extreme cases, but the total is unlikely to exceed 6 steps. No limit will be set to phasing in contribution rates when the employer has a surplus.

4.7 Grouping

In some circumstances it is desirable to group 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.

The Administering Authority recognises that grouping 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 that this is the case, which other employers it is grouped with and details of the grouping method used. If the employer objects to this grouping, it will be offered its own contribution rate.

All employers in the Fund are grouped together in respect of the risks associated with payment of lump sum benefits on death in service – in other words, the cost of such benefits is shared across the employers in the Fund. Such lump sum benefits at no fault of the employer 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.

4.8 Notional Sub Funds (assets shares notionally allocated to employers)

In order to establish contribution rates for individual employers or groups of employers it is convenient to notionally subdivide the Fund as a whole between the employers, as if each employer had its own notional sub fund within the Fund.

This subdivision is for funding purposes only. It is purely notional in nature and does not imply any formal subdivision of assets, nor ownership of any particular assets or groups of assets by any individual employer or group.

The notional sub fund allocated to each employer will be rolled forward allowing for all cashflows associated with that employer's membership, including contribution income, benefit outgo, transfers in and out and investment income allocated as set out below. In general no allowance is made for the timing of contributions and cashflows for each year are assumed to be made half way through the year with investment returns assumed to be uniformly earned over that year. 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 (cashflows will not exist for these transfers). The actuary will assume an estimated cashflow equal to the value of the liabilities transferred from one employer to the other unless some other approach has been agreed between the two employers.
- Allowance for lump sum death in service benefits shared across all employers in the Fund.
- 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.

In some cases information available will not allow for such cashflow calculations. In such a circumstance:

- Where, in the opinion of the actuary, the cashflow data which is unavailable is of low materiality, estimated cashflows will be used
- Where, in the opinion of the actuary, the cashflow data which is unavailable is material, or the results of the cashflow approach appears to give unreliable results perhaps because of unknown internal transfers, the actuary will instead use an analysis of gains and losses to roll forward the notional sub fund. Analysis of gains and losses methods are less precise than use of cashflows and involve calculation of gains and losses 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.

4.9 Fund Maturity

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 defined capital streams from employers in respect of any disclosed funding deficiency.

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. To protect the Fund against the risk of payroll failing to grow at the assumed rate, the Administering Authority will monitor payrolls where this approach is agreed.

5. Special Circumstances related to certain employers

5.1 Interim Reviews for Admission Bodies

Regulation 38(4) of the Local Government Pension Scheme (Administration) Regulations 2008 provides the Administering Authority with a power to carry out valuations in respect of employers expected to cease at some point in the future, and for the Fund Actuary to certify revised contribution rates, between triennial valuation dates.

The Administering Authority's overriding objective at all times in relation to admission bodies 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 date of cessation of participation may be unknown (for example, participation may be assumed at present to be indefinite), and also because market conditions change daily.

The Administering Authority's general approach in this area is as follows:

- Where the date of cessation is known, and is more than 3 years hence, or is unknown and assumed to be indefinite, interim valuations will generally not be carried out at the behest of the Administering Authority.
- For transferee admission bodies falling into the above category, the Administering Authority sees it as the responsibility of the Relevant Scheme Employer to instruct it if an interim valuation is required. Such an exercise would be at the expense of the Relevant Scheme Employer unless otherwise agreed.
- A material change in circumstances, such as the date of cessation becoming known, material membership movements or material financial information coming to light may cause the Administering Authority to informally review the situation and subsequently formally request an interim valuation.
- For an employer whose participation is due to cease within the next 3 years, the Administering Authority will monitor developments and may see fit to request an interim valuation at any time.

Notwithstanding the above guidelines, the Administering Authority reserves the right to request an interim valuation of any employer at any time if with Regulation 38(4) applies.

5.2 Guarantors

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 ceases 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.

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 admission body. 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.

5.3 Bonds and other securitization

Regulation 7 of the Local Government Pension Scheme (Administration) Regulations 2008 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 a Transferee Admission Body admitted under Administration Regulation 6(2)(a)) an assessment taking account of actuarial advice of the level of risk on premature termination by reason of insolvency, winding up or liquidation.

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.

The Administering Authority's approach in this area is as follows:

- In the case of Transferee Admission Bodies admitted under Regulation 6(2)(a) 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.

- In the case of Transferee Admission Bodies admitted under Regulation 6(2)(b), or under Regulation 6(2)(a) where the Administering Authority does not judge the Relevant Scheme Employer to be of sufficiently strong covenant, and 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 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 review, or recommends the Scheme Employer reviews, the required cover regularly, at least once a year.

5.4 Subsumed Liabilities

Where an admission body is ceasing participation in the Fund such that it will no longer have any contributing members, it is possible that another employer in the Fund (the 'accepting employer') has agreed to provide a source of future funding in respect of any emerging deficiencies in respect of those liabilities.

In such circumstances the liabilities are known as subsumed liabilities (in that responsibility for them is subsumed by the accepting employer). For such liabilities the Administering Authority will assume that the investments held in respect of those liabilities will be the same as those held for the rest of the liabilities of the accepting employer. Generally this will mean assuming continued investment in more risky investments than Government bonds.

5.5 Orphan Liabilities

Where an admission body is ceasing participation in the Fund such that it will no longer have any contributing members, unless any residual liabilities are to become subsumed liabilities, the Administering Authority may act on the basis that it will have no further access for funding from that employer once any cessation valuation, carried out in accordance with Regulation 38, 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.

The Administering Authority will seek to minimise the risk to other employers in the Fund that any deficiency arising on the orphan liabilities creates a cost for those other employers to make good such deficiency. To give effect to this, the Administering Authority may 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.

However, if these liabilities are deemed to be small compared to the liabilities of the whole Fund (and therefore the risk related to these liabilities is small) then the Administering Authority may decide to use the Funding Target used for Scheduled Bodies for practical reasons.

Any excess or deficient returns on the notional or actual assets attributable to these liabilities relative to the Funding Target will be added to or deducted from the investment return to be attributed to the notional assets of all employers in the Fund.

5.6 Cessation Valuations

Where an admission body ceases participation, a cessation valuation will be carried out in accordance with regulation 38. That valuation will take account of any activity as a consequence of cessation of participation regarding any existing contributing members (for example any bulk transfer payments due) and the status of any liabilities that will remain in the Fund.

In particular, the cessation valuation may distinguish between residual liabilities which will become orphan liabilities, and liabilities which will be subsumed (see above) by other employers.

For subsumed liabilities the cessation valuation will anticipate continued investment in assets similar to those held in respect of the subsuming employer's liabilities.

For orphan liabilities the funding target in the cessation valuation should generally be broadly consistent with the Funding Target used for that employer at the previous triennial valuation. The cessation valuation could therefore anticipate investment in low risk investments such as Government bonds or be calculated in the same way as subsumed liabilities as considered appropriate.

Regardless of whether the residual liabilities are orphan liabilities or subsumed liabilities, the departing employer will be expected to make good the funding position revealed in the cessation valuation. In other words, the fact that liabilities may become subsumed liabilities does not remove the possibility of a cessation payment being required.

6. Key Risks & Controls

6.1 Types of Risk

The Administering Authority's has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- investment;
- solvency;
- liability;
- regulatory;
- employer.

6.2 Investment Risks

Risk	*Control*
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. Analyse progress at three yearly valuations for all employers. The Administering Authority will request quarterly funding updates between the completion of the valuation report and the date of the next valuation to monitor the position.
Inappropriate long-term investment strategy	Set Fund-specific benchmark in accordance with appropriate advice.
Active investment manager underperformance relative to benchmark	Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark. The Fund Actuary will be asked to evaluate the implications if there is significant underperformance.
Effect of possible increase in employer's contribution rate on service delivery and admission/ scheduled bodies	Seek feedback from employers on scope to absorb short-term contribution rises. Mitigate impact through deficit spreading and phasing in of contribution rises. Consult employers on possibility of paying more (extra administration and higher regular contributions) to enable employer-specific investment strategies to give greater certainty of cost.

Risk	*Control*
Potential cashflow implications of increasing maturity of the Fund, for example as a result of reduced numbers of staff working in local government or through outsourcing	Regularly review position including communication with employers about their plans. Plan investments to ensure sufficient liquidity.

6.3 Solvency Risks

Risk	Control
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.	It is policy to discuss the risks inherent in each situation with the Fund Actuary and to limit the permitted length of recovery period to no longer than 25 years**.**
Permitting contribution rate changes to be introduced by annual steps rather than immediately introduces a risk that action to restore solvency is insufficient between successive measurements.	The risks inherent in each situation are discussed with the Fund Actuary and to limit the number of permitted steps to three annual steps or, in exceptional circumstances, to six annual steps.

6.4 Liability Risks

Risk	Control
Pensioners living longer and changing retirement patterns.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund Actuary investigates these matters at each valuation or if appropriate more frequently and will report on developments. If significant demographic changes become apparent between valuations, the Administering Authority will notify all participating employers on the anticipated costs that will emerge at the next valuation and will review the bonds that are in place for the Transferee Admitted Bodies.
Deteriorating patterns of ill health and other early retirements	Employers are charged the extra capital cost of early retirements following each individual decision. Ill health retirements will be monitored.

Risk	Control
Demographic experience differing from the assumptions used by the actuary	The Administering Authority will ensure that the Fund Actuary investigates these matters at each valuation, or more frequently if appropriate.
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	Allowing for a risk-based approach should limit the impact of short term changes in returns on Government bonds on the liabilities. Some investment in bonds also helps to mitigate this risk. Inter-valuation monitoring, as set out above, gives early warning of changing liability values.
Pay and price inflation significantly more than anticipated	Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.

6.5 Regulatory Risk

Risk	Control
Changes to regulations.	The Administering Authority will keep abreast of all proposed changes and where possible express their opinion during consultation periods after careful consideration. The Fund Actuary is asked to assess the impact on costs of any changes and where these are likely to be significant, the Administering Authority will notify Employers of the possible impact and the timing of any change.

6.6 Employer Risk

Risk	Control
Administering Authority being unaware of structural changes in an employer's membership (e.g. large fall in employee members or a large number of retirements).	The Administering Authority monitors membership movements on an annual basis, via a report from the administrator to the Pension Fund Committee. The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions under Regulation 38 of the LGPS (Administration) Regulations 2008 between triennial valuations.
The risk of being unable to collect contributions from employers with no contributing members (e.g.risk associated with employers with a small number of declining contributing members).	The Administering Authority monitors membership movements on an annual basis as set out above. The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions under Regulation 38 of the LGPS (Administration) Regulations 2008 between triennial valuations.
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.	In addition to the Administering Authority monitoring membership movements on an annual basis, it requires employers to inform it of forthcoming changes
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by : Seeking a funding guarantee from another scheme employer, or external body, wherever possible. Requiring a bond or some other security to protect the scheme from the existing deficit and the extra cost of early retirements on redundancy if the employer failed. Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.

Risk	Control
	Vetting prospective employers before admission.

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