Item: 14

**Pension Fund Sub-committee, together with Pension Board:
24 February 2021.**

1. Recommendations

It is recommended:

1.1.

That the Committee approves the attached minute as a true record.

2. Appendix

Draft Minute of the Meeting of the Pension Fund Sub-committee, together with the Pension Board, held on 24 February 2021.

Minute

Pension Fund Sub-committee, together with Pension Board

Wednesday, 24 February 2021, 14:15.

Microsoft Teams.

Present

Pension Fund Sub-committee:

Councillors W Leslie Manson, Alexander G Cowie, Steven B Heddle, Rachael A King, Stephen Sankey and James Stockan.

Pension Board:

Employer Representatives:

Councillors J Harvey Johnston, Owen Tierney and Duncan A Tullock, Orkney Islands Council.

Trade Union Representatives:

Karen Kent (Unison), Eoin Miller (Unite) and Eileen Swanney (Unison).

Clerk

- Sandra Craigie, Committees Officer.

In Attendance

- Gareth Waterson, Head of Finance.
- Colin Kemp, Corporate Finance Senior Manager.
- Shonagh Merriman, Accounting Manager (Corporate Finance).
- Michael Scott, Solicitor.

Audit Scotland:

- Gillian Woolman, Audit Director (for Items 1 to 9).

Hymans Robertson:

- David Walker, Chief Investments Officer.
- Tom Hoare, Actuary.

Observing

- Lorraine Stout, Press Officer.

Apologies

Pension Fund Sub-committee:

- Councillor Barbara Foulkes.

Pension Board:

- Andrew Blake, Orkney Ferries, Employer Representative.

Not Present

Pension Board:

Trade Union Representative:

- Mark Vincent (GMB).

Declarations of Interest

- No declarations of interest were intimated.

Chair

- Councillor W Leslie Manson – for Items 1 and 2 and 5 to 10.
- Councillor Rachael A King – for Items 3 and 4.

1. Form of Voting

The Sub-committee resolved that, should a vote be required in respect of the matters to be considered at this meeting, notwithstanding Standing Order 21.4, the form of voting should be by calling the roll or recorded vote.

2. Disclosure of Exempt Information

The Sub-committee noted the proposal that the public be excluded from the meeting for consideration of Item 9, as the business to be discussed involved the potential disclosure of exempt information of the class described in the relevant paragraph of Part 1 of Schedule 7A of the Local Government (Scotland) Act 1973 as amended.

Signed: L Manson.

3. Chair

Councillor W Leslie Manson lost internet connection to the meeting at this point.

The Sub-committee resolved that Councillor Rachael A King should Chair the meeting until such time as Councillor W Leslie Manson could reconnect.

4. Revenue Expenditure Monitoring

After consideration of a report by the Head of Finance, copies of which had been circulated, the Sub-committee:

Noted:

4.1. The revenue financial summary statement, in respect of service areas for which the Pension Fund Sub-committee was responsible, for the period 1 April to 31 December 2020, attached as Annex 1 to the report by the Head of Finance, indicating a budget surplus position of £110,535,500.

4.2. The revenue financial detail by service area statement, in respect of service areas for which the Pension Fund Sub-committee was responsible, for the period 1 April to 31 December 2020, attached as Annex 2 to the report by the Head of Finance.

The Sub-committee scrutinised:

4.3. The explanations given and actions proposed, in respect of significant budget variances, as outlined in the Budget Action Plan, attached as Annex 3 to the report by the Head of Finance, and obtained assurance that action was being taken with regard to significant budget variances.

Councillor W Leslie Manson rejoined the meeting during discussion of this item and resumed the Chair at this point.

Signed: R A King.

5. Pension Fund – Draft Budget

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Corporate Finance Senior Manager, the Sub-committee:

Noted the draft revenue budget for the Orkney Islands Council Pension Fund for financial year 2021/22, attached as Annex 1 to the report by the Head of Finance, which formed part of the assumptions in the overall budget setting process considered by the Policy and Resources Committee on 23 February 2021.

6. Pension Fund Training

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Accounting Manager (Corporate Finance), the Sub-committee:

Noted:

6.1. Progress made over the 12-month period to 31 December 2020 in relation to meeting the training needs of members of the Pension Fund Sub-committee and the Pension Board, against core areas of the Public Sector Pensions Finance Knowledge and Skills Framework, attached as Appendix 1 to the report by the Head of Finance.

6.2. That, over the 12-month period to 31 December 2020, all members of the Pension Fund Sub-committee, together with 7 of the 8 members of the Pension Board, had achieved the minimum requirement of participation in at least one training event, or equivalent to five hours training.

6.3. That the member of the Pension Board, who had not achieved the minimum requirement for training, had cited work pressure making it difficult to attend training events.

On the motion of Councillor James W Stockan, seconded by Councillor Rachael A King, the Sub-committee resolved, in terms of delegated powers:

6.4. That the Annual Training Plan for 2021 for members of the Pension Fund Sub-committee and the Pension Board, attached as Appendix 1 to this Minute, be approved.

7. Review of Pension Risk Register

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Accounting Manager (Corporate Finance), on the motion of Councillor W Leslie Manson, seconded by Councillor Stephen Sankey, the Sub-committee:

Resolved, in terms of delegated powers, that the updated Risk Register relating to the Orkney Islands Council Pension Fund, attached as Appendix 2 to this Minute, be approved.

8. Triennial Actuarial Valuation

Preliminary Results and Draft Funding Strategy Statement

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Actuary, Hymans Robertson, the Sub-committee:

Noted:

8.1. The Orkney Islands Council Pension Fund 2020 Actuarial Valuation Initial Results issued by the Actuary, Hymans Robertson, attached as Appendix 1 to the report by the Head of Finance.

8.2. The Orkney Islands Council Pension Fund draft Funding Strategy Statement prepared by the Actuary, Hymans Robertson, attached as Appendix 2 to the report by the Head of Finance.

8.3. That the initial valuation results indicated that the funding level of the Pension Fund had increased from 113% to 118% between the 2017 and 2020 valuations.

8.4. That an increase in liabilities had been offset by better than anticipated investment returns, with the valuation surplus increasing from £38,000,000 to £58,000,000 between the 2017 and 2020 valuations.

8.5. The proposal, against the background of increased uncertainty over the future impacting on actuarial assumptions, to maintain the employers' common contribution rate at 17% for the three-year period 2021 to 2024.

On the motion of Councillor Rachael A King, seconded by Councillor W Leslie Manson, the Sub-committee resolved, in terms of delegated powers:

8.6. That the assumptions outlined in the 2020 Actuarial Valuation Initial Results and used in the calculation of the Pension Fund liabilities for the triennial valuation as at 31 March 2020, namely 1.7% Price Inflation; 2.2% Pay Inflation and a Discount Rate of 2.9%, be approved.

8.7. That the Funding Strategy Statement, attached as Appendix 3 to this Minute, be approved.

Eileen Swanney left the meeting at this point.

9. Statement of Managed Pension Funds

On the motion of Councillor W Leslie Manson, seconded by Councillor James W Stockan, the Sub-committee resolved that the public be excluded from the meeting for this item on the grounds that it involved the disclosure of exempt information as defined in paragraph 6 of Part 1 of Schedule 7A of the Local Government (Scotland) Act 1973 as amended.

After consideration of a report by the Head of Finance, copies of which had been circulated, and after hearing a report from the Chief Investments Officer, Hymans Robertson, the Sub-committee:

Noted:

9.1. The review of the investment manager's performance for the quarter to 31 December 2020, attached as Appendix 1 to the report by the Head of Finance, prepared by Hymans Robertson, the Council's appointed investment advisors.

9.2. That the Pension Fund investments returned a gain of £44,600,000, or 9.4%, over the quarter to 31 December 2020, which was 3.4% ahead of the benchmark and was considered excellent.

9.3. That the value of the Pension Fund had increased by 19.5% over the 12-month period to 31 December 2020, being 9.6% ahead of the target, which was considered exceptional.

9.4. That an average return of 13.6% per annum for the Pension Fund remained 2.5% ahead of the target over the five-year period to 31 December 2020.

9.5. The Governance Summary, extracted from Baillie Gifford's performance report for the quarter ending 31 December 2020, attached as Appendix 2 to the report by the Head of Finance.

Eileen Swanney rejoined the meeting during discussion of this item.

10. Conclusion of Meeting

At 15:37 the Chair declared the meeting concluded.

Signed: L Manson.

ORKNEY
ISLANDS COUNCIL

Pension Fund Training Plan

2021

1. Introduction

The Orkney Islands Council Pension Fund is committed to providing training to those involved in the governance of the Fund to ensure that they have the skills and understanding required to carry out their stewardship role. This includes regular events to cover the latest developments in the Local Government Pension Scheme, investment strategy and performance monitoring. In April 2015, the Pension Fund Sub-committee adopted the CIPFA Code of Practice on Public Sector Pensions Finance Knowledge and Skills.

It is important that members of both the Pension Fund Sub-committee and the Pension Board receive appropriate training to allow them to carry out their roles effectively

This training plan sets out how levels of understanding will be assessed, and how the knowledge and skills requirement and other regulatory requirements will be supported through training events over the next financial year.

2. Knowledge and Skills Framework

There are six areas of knowledge and skills that have been identified as the core requirements for those with decision making responsibility for Local Government Pension Scheme funds. They are:

- Pensions legislative and governance context.
- Pensions accounting and auditing standards.
- Financial services procurement and relationship management.
- Investment performance and risk management.
- Financial markets and products knowledge.
- Actuarial methods, standards and practices.

Members of the Pension Fund Sub-committee and the Pension Board are expected to have a collective understanding and Officers are expected to have detailed understanding of these areas of knowledge and skills.

3. Pension Board Specific Requirements

Members of the Pension Board are required to have the capacity to take on the role of assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator.

In addition, in accordance with Section 248A of the Pensions Act 2004 which was introduced to make provision relating to pensions and financial planning for retirement, it is expected that every individual who is a member of a Local Pension Board will receive training, and as a result:

- Be conversant with the regulations governing the Local Government Pension Scheme, such as the Transitional Regulations and the Investment Regulations.
- Be conversant with any policy document relating to administration of the Fund.
- Have knowledge and understanding of the law relating to pensions.
- Have knowledge and understanding of such other matters as may be prescribed.

4. Committee and Pension Board Training

Training for the Pension Fund Sub-committee and the Pension Board during 2021 will continue to focus on the following areas:

Knowledge and Skills Framework

All training will focus on maintaining the six areas of knowledge and skills, with any gaps in knowledge identified throughout the past year and including the periodic use of member's self-assessment returns where appropriate.

Training Events

An annual pension's group training event will be provided for all members to attend. In addition, to that, expressions of interest will also be sought from members to attend relevant industry events, including conferences and seminars throughout the year. In the event that there is more interest to attend an event than places available, a decision to determine who should get approval to attend will be made by the Head of Finance, in consultation with the Chair of the Pension Fund Sub-committee, will determine appropriate representation and approve attendance.

Informative Review Presentations

Members will receive regular reports on the performance of the administration and investment functions throughout the year. In addition to this Members will be invited to attend informative review presentations by external advisors including the Pension Fund's appointed actuaries, investment advisors and fund managers.

Electronic Resources

Members are invited to access training information available on the Pension Regulator's website setting out the governance requirements of the local government pension scheme, including the respective roles of the Pension Fund Sub-committee and Pension Board at the following link:

https://trusteetoolkit.thepensionsregulator.gov.uk/login/index.php

Additionally, resources from previous training events have been made available to Councillors on their Council electronic device under "Training". Training materials will be added to this folder going forward as and when events occur.

5. Other Training

Where gaps in individual members' knowledge have been identified that will not be met by the core training described above, then Members should approach Officers in the first instance with a view to addressing those needs.

Specific training can also be provided for the Chair of the Pension Fund Sub-committee and Pension Board to support them in their role, if required.

6. Officer Training

It is important that Officers have the required training to carry out the tasks of managing the Fund's investments and administering the payment of benefits. The knowledge and skills required of staff are set out in their job descriptions, including any formal qualifications required. Officers should be familiar with the requirements of the CIPFA Code of Practice on Knowledge and Skills and should have knowledge of the six areas of the framework.

Officers will attend relevant professional training events, conferences and seminars during the year to ensure that they remain up-to-date with the latest requirements. In addition, they will be expected to keep up-to-date through use of the internet, and conduct research on relevant issues where required. Individual training plans will be put in place and these will be recorded and reviewed as part of the annual staff appraisal process.

For Officers, there will be a particular focus on the following areas:

Governance – Understanding the guidance and regulations in relation to local pension boards and keeping up-to-date with how other Funds are working with their boards, in order that the Pension Board can be supported effectively and add value to the governance of the Fund.

New Investment Arrangements – Understanding the implications of how the Financial Conduct Authority will implement the Markets in Financial Instruments Directive (MiFIDII) and what the Fund will need to do to comply.

New Investment Products – Keeping up-to-date with what the market is offering, in order to assess the validity of new products for investment by the Fund.

Accounting Issues – Keeping up-to-date with the latest CIPFA guidance on the format of the Pension Fund Statement of Accounts and the content of the Annual Report.

Pensions Admin Regulations – Understanding the latest guidance and interpretation of changes to LGPS Regulations and their impact on procedures.

Pensions Admin Systems - Keeping up-to-date with updates/new releases to the software system Altair, passing training onto all staff.

Wider Pensions Issues – Understanding the impact of wider Government reforms to pensions, such as “freedom and choice” on the LGPS.

7. Reporting and Compliance

In line with the CIPFA Code of Practice, a disclosure will be made in the Fund’s Annual Report and Accounts that covers:

- How the Skills and Knowledge framework has been applied.
- What assessment of training needs has been undertaken.
- What training has been delivered against the identified training needs.

Orkney Islands Council
Pensions Fund Risk Register

1. Objectives

The objectives of the Risk Register are to:-

- identify key risks that could prevent the achievement of the Fund's objectives
- evaluate the significance of the risks;
- identify any mitigating controls;
- identify the owner of each risk; and
- act as a basis by which the risks can be monitored and reported upon.

2. Risk Assessment

Identified risks are assessed separately and for each the following is determined:-

- the likelihood of the risk materialising; and
- the impact/potential consequences if it does occur.

3. Risk Evaluation

Risks are evaluated on a sliding scale of 1-10 with 10 the highest value i.e. highest likelihood / most severe impact / consequences. The risk evaluation tables overleaf have been used in order to assess specific risks and to introduce a measure of consistency into the risk assessment process. The overall rating for each risk is calculated by multiplying the likelihood value against the impact value to give the total score. The risk rating scores are then used to prioritise the risk rating which is shown in the register itself.

Risk Evaluation Criteria

The Risk Evaluation Tables: Likelihood	
1	Negligible never happened to the Fund but is theoretically possible
2	Extremely unlikely within the next 3 years, but possible within a 10 year cycle
3	Extremely unlikely within the next 12 months, but possible within a 5 year cycle
4	Feasible within the next 12 months
5	Probable within the next 12 months
6	Confidently expected within the next 12 months

The Risk Evaluation Tables: Impact	
1	Negligible
2	Significant – potential to cause significant damage in the short and medium term without threatening the survival of the Fund
3	Could seriously threaten Fund reputation or weaken its capacity to survive
4	Catastrophic

Risk Matrix

LIKELIHOOD	1	2	3	4
6	8			
5	12, 12A	1, 2		
4		5, 7		
3	25		3, 4	
2	27, 28	13, 14, 15, 16, 17, 18, 19, 20, 21	6, 9, 10, 11	
1		26	22, 23, 24	
	IMPACT			

Summary and Prioritisation of Pension Fund Risks

Risk Ranking	Risk Theme	Risk	Risk Rating
1	Investment	The COVID-19 pandemic could have both short-term and long-term impacts on the investment returns of the Fund.	10
2	Operational	COVID-19 Government mitigation measures recommend working from home whenever possible.	10
3	Investment	Active investment manager under-performance relative to benchmark at aggregate level and/or failure of investment market(s) from economic and political instability etc resulting in possible liquidity/cash flow risk	9
4	Investment	Changes in legislation and other regulatory frameworks, such as pooling and merging of LGPS schemes in Scotland, may impact adversely on the Fund in terms of funding levels and governance structures.	9
5	Operational	Increased risk or fraud and scams due to the COVID-19 pandemic.	8
6	Operational	Business Continuity (Service delivery threats, Insufficient daily backup etc)	8
7	Investment	Brexit risks potentially impacting the Funds assets and liabilities	8
8	Operational	New pension access reforms, "Freedom and choice", and increase in awareness, may lead to Fund members electing to transfer all or part of their pension entitlement much earlier than projected.	6
9	Operational	Breach of Data Protection Legislation - theft or loss of data.	6
10	Investment	Inefficiencies with the portfolio could result in unintended risks.	6
11	Operational	Failure to produce compliant annual report and accounts within deadline.	6
12	Investment	Outcome of the McCloud judgement and how it will impact on future liabilities of the Fund.	5
12A	Investment	Outcome of the Cost Cap and how it will impact on future contributions.	5
13	Operational	Recruitment and retention of key staff.	4
14	Operational	Scale of Pension Team could create an over reliance on Key Pension Officers and staff absence being problematic.	4
15	Governance	Committee and Board members have inadequate knowledge and understanding.	4
16	Governance	Funding Strategy is only updated following the tri-ennial actuarial valuation and does not reflect any subsequent regulatory changes, longevity, early retirement patterns, or any pay and price inflation.	4
17	Governance	Lack of communication and budgetary controls between Administering Authority and members of the Pension Fund Sub Committee.	4
18	Investment	Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation	4
19	Operational	Incomplete member records and failure to collect and account for contributions in a timely manner.	4
20	Governance	Decisions influenced by possible conflicts of interest or not in the best interests of stakeholders.	4
21	Operational	Fraud/Theft of Fund assets by internal staff members.	4
22	Governance	Failure to adhere to relevant statutory regulations including updates from LGPS	3
23	Investment	Negligence, default, fraud by investment manager.	3
24	Investment	Failure of Global Custodian.	3

25	Investment	As long-term investors, the Fund believes climate risk has the potential to significantly alter the value of the Fund's investments.	3
26	Operational	Failure to process accurate pension benefit payments, including lump sum payments, in a timely manner.	2
27	Operational	The administration performance measure and targets may no longer be the most appropriate for the fund.	2
28	Operational	Pandemic resulting in closure of facilities'.	2

Pension Fund - Governance Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
22	Failure to adhere to relevant statutory regulations including updates from LGPS	Potential overpayment of pensions. Audit criticism, legal challenge, reputational damage and cost. Audit criticism, legal challenge, reputational damage. Lack of adequate of stakeholder representation.	1	3	3	3	• Regular systems checks take place to ensure compliance with current LGPS (Scotland) Regulations. • Continual review of discretionary pension policies. • Participation in the Scottish Pension Investments Governance Group. • Provision of staff training.	PFSC/PB Head of Finance Pensions Manager	Ongoing
15	Committee and Board members have inadequate knowledge and understanding.	Qualified audit report; potential bad publicity; members loss of confidence in officers' abilities; excessive pressure on officers; loss of income to the fund; loss of stakeholder confidence in the ability of the administering authority; potential increase in costs to fund employers.	2	2	4	4	• Training policy statement in line with the Code of Practice on Public Sector Pensions Finance Knowledge and Skills. • A training register maintains a record of all training provided and attended. • A training plan is agreed annually.	Head of Finance	Ongoing
17	Lack of communication and budgetary controls between Administering Authority and members of the Pension Fund Sub Committee.	Unexpected variances over budget headings; members' loss of confidence in officers' abilities; loss of income to the fund; loss of stakeholder confidence in the ability of the administering authority; potential increase in costs to fund employers.	2	2	4	4	• Annual service budget agreed in advance of financial year. • Monthly budget monitoring reports (BMR). • Quarterly budget reports to the PFSC.	Pensions Manager PFSC Head Of Finance	Ongoing
20	Decisions influenced by possible conflicts of interest or not in the best interests of stakeholders.	Limited discretion for interested parties or stakeholders to influence decisions. The pension fund is regulated by the statutory provisions of the LGPS.	2	2	4	4	• Training provided. • Potential conflicts of interest are declared at the beginning of each committee meeting. • Register of Interests for members to the PFSC and PB is in place and reviewed annually.	Head of Finance	Ongoing

Pension Fund - Governance Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
	Employers' failure to carry out statutory functions including submission of member data and contributions to the Pension Fund.	Potential underfunding at employer level with residual liability falling on remaining employers. Missing, incomplete and incorrect records on pensions administration system; undermines service delivery and causes difficulties in establishing correct benefits at individual level and liabilities at whole of Fund level.			Merged	4	• Monitor membership from triennial actuarial valuation. • Admitted Bodies (AB) to notify of significant structural changes. • Vetting on any new or prospective employers before entering into an admission agreement. • Monthly communication with employers and submission of year-end employer returns. • Annual contribution return certificates.	Pensions Manager Head of Finance/ PFSC/PB	Ongoing
16	Funding Strategy is only updated following the tri-ennial actuarial valuation and does not reflect any subsequent regulatory changes, longevity, early retirement patterns, or any pay and price inflation.	Increase in employers contribution rates. Increase in liabilities leading to increase in employer contribution rates. Pressure on cash flow and funding equation. Pressure on cash flow and funding and equation.	2	2	4	4	• The focus of the actuarial valuation process on real returns, net of prices and pay increases. Valuation monitoring by annual Navigator reports are intended to act as an early warning system. • Expert Actuaries appointed to monitor and forecast accordingly.	PFSC	Ongoing

Pension Fund - Operational Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
6	Business Continuity (Service delivery threats, Insufficient daily backup etc)	Temporary loss of ability to provide service to stake holders. Staff downtime, loss of service delivery. Monthly pension payroll to pensioners delayed resulting in possible hardship.	2	3	6	8	• Business continuity and disaster recovery plans in place. • Procedures to back-up IT System are fully developed and stored securely. • Contingency arrangements are in place including staff ability to work from home. • Pensions Administration system is now fully operational with established procedures in place.	IT / Pensions Manager	Ongoing
9	Breach of Data Protection Legislation - theft or loss of data.	Audit criticism, legal challenge, reputational damage, financial penalties.	2	3	6	6	• Data securely sent/received to/from the fund actuary using a secure internet portal. • Pension Fund adopted internal controls of Administering Authority. • Staff complete the online i-Learn module on Data Protection.	Pensions Manager /IT/Legal	Ongoing
21	Fraud/Theft of Fund assets by internal staff members.	Overpayment, unauthorised payment, system corruption, audit criticism, reputational damage	2	2	4	4	• Established systems of internal controls and security are in place • Segregation of duties • Supervisory checking of all calculations • Internal audit and monitoring arrangements	Head of Finance Pensions Manager/ Internal Audit	Ongoing
13	Recruitment and retention of key staff.	Loss of failure of service delivery	2	2	4	9	• OIC's policy includes actively encouraging skilled and educated workers to remain on the island. • Existing staff are given the opportunity to gain an appropriate pension qualification.	Head of Finance Pensions Manager/ HR	Ongoing

Pension Fund - Operational Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
11	Failure to produce compliant annual report and accounts within deadline.	Audit criticism, reputational damage.	2	3	6	6	• Agree audit program timeously • Plan timetable annually • Use of qualified staff	Accounting / Pensions	Ongoing
14	Scale of Pension Team could create an over reliance on Key Pension Officers and staff absence being problematic.	Failure to process payments on time or correctly leading to possible delays or overpayments. Loss or failure of service delivery.	2	2	4	9	• Checklists • Pensions Manager focused on mentoring and knowledge sharing • Front line management course • Staff complement in the Pensions section has been increased	Head of Finance Pensions Manager/ HR	Ongoing
26	Failure to process accurate pension benefit payments, including lump sum payments, in a timely manner.	Possible unacceptable delays in making full payments to pensioners, possible overpayment of monies.	1	2	2	2	• Segregation of duties • Regular checks by Internal Audit • Subscription to tracing service for deceased pensioners	Pensions Manager/ Internal Audit	Ongoing
19	Incomplete member records and failure to carry out statutory functions including submisison of member data and contributions to the Pension Fund in a timely manner.	Adverse impact on cash flow position; delays in closure of year end accounts; employers forced to leave the scheme. Possible adverse audit opinions, possible unacceptable delays in settlements or overpayments. Missing, incomplete records on pensions administration system undermines service delivery and causes difficulties in establishing correct benefits at individual level and liabilities at whole Fund level.	2	2	4	4	• Monitor membership on triennial actuarial valuation. • Admitted bodies to notify of significant structural changes. • Vetting on any new or prospective employers before entering into an admission agreement. • Senior Officers liaise closely with employers • Contribution monitoring procedures • Monthly monitoring of receipts and escalation procedures in place. • Annual contribution return certificates.	Pensions Manager/ Internal Audit	Ongoing

Pension Fund - Operational Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
27	The administration performance measures and targets may no longer be the most appropriate for the fund.	Poor peformance of the administration of the Pension Fund.	2	1	2	2	• Performance is measured and reported to the Pension Board twice yearly. • Increased staffing within the Pensions Section has resulted in more targets being met. • Regular reviews of performance measures will take place.	Pensions Manager	Ongoing

Pension Fund - Investment Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
3	Active investment manager under-performance relative to benchmark at aggregate level and/or failure of investment market(s) from economic and political instability etc.	Illiquidity or loss of investments. Negative publicity and adverse reporting. Potential loss of interest from any excessive holding of funds.	3	3	9	9	• Regular review of Funding Strategy. • Regular review of Investment Strategy in line with the actuarial valuation. • External investment consultants and actuary are appointed to advise the PFSC. • Diversified long-term investment strategy focused on developed markets and managed by experienced Investment Managers. • Market regulation. • Robust governance and investment monitoring framework. • Quarterly monitoring of investment managers performance by external independent advisers and PFSC.	Head of Finance/ PFSC	Ongoing
10	Inefficiencies with the portfolio could result in unintended risks.	Underperformance of investments.	2	3	6	6	• Diversified strategic asset allocation policy which is regularly reviewed by the PFSC. • Investment Management Agreement that incentivises the Fund Manager to outperform the benchmark and drive out any inefficiencies. • External independent consultants review the investment performance quarterly.	Head of Finance/ PFSC	Ongoing

Pension Fund - Investment Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
18	Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation	Financial loss borne by the Pension Fund	2	2	4	4	• The Council's Annual Treasury Management Strategy sets out the Fund's approach to credit risk for internally managed funds. Deposits are only made with banks and financial institutions if they are independently rated and meet the OIC's credit criteria. The strategy also sets limits as to the maximum percentage of deposit with any one class of financial assets.	Head of Finance	Ongoing
23	Negligence, default, fraud by investment manager.	Loss of value to the Fund; reputational damage.	1	3	3	3	• Indemnities in Investment Management Agreements and Financial Conduct Authority (FCA) Regulations. • Separation of assets from management via global custody arrangement. • Document review process on internal control reports from Fund custodians takes place. • Process in place for reporting any significant issues to members of the Pension Board and Sub-Committee.	PFSC	Ongoing
24	Failure of Global Custodian.	Loss of investments or control of investments.	1	3	3	3	• Regular review and periodic re-tendering. • Banking and FCA regulation. Fund's assets not on custodian's balance sheet.	PFSC	Ongoing

Pension Fund - Investment Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
7	Brexit risks include the following which could impact the Funds Assets and Liabilities - • Risk of rising inflation increasing the amount of future pensions paid. • Actuarial basis risk of falling gilt yields, which could accelerate rate at which contributions are required to be paid following the next actuarial valuation.	Loss of value to the Fund.	4	2	8	8	• Triennial valuation for 2020 will be completed and necessary adjustments made to the investment strategy as required. • Performance of the Pension Fund will continue to be monitored quarterly by Hymans Robertson and any recommendations they make on the assets held will be considered by the Pension Board and Sub-Committee.	Head of Finance/ PFSC	Ongoing
12	The outcome of the recent court judgements, including Mcloud and Goodwin, will impact future liabilities of the Fund and increase pressure on contributions depending on the remedy decided by the UK Government to compensate individuals for the difference in treatment since public service pension reforms in 2015 on the grounds of age and gender discrimination.	Increase in employer contribution rates.	5	1	5	5	• Hymans Robertson provided an updated actuarial present valuation at the end of financial year 2018-2019 following the Court of Appeal judgement to estimate the impact of the McCloud judgement. A provision was made to recognise this in the Annual Accounts 2018-19. • Once the full implications of the ruling are established officers with assistance from Hymans Robertson will further quantify the impact on the Fund. • The cost cap introduced in 2015 will limit the impact.	Head of Finance/ PFSC	Ongoing

Pension Fund - Investment Risks

Ranking	Risk	Impact	L	I	Current Risk Rating	Previous Risk Rating	Risk Control Measures	Assigned to	Target Date (priority items)
12A	The Cost Cap or Cost Management as it is also known as, is being introduced to the LGPS as a mechanism for sharing funding risk between the employers and members. It will not be fully implemented until the outcome of the Mcloud judgement is known but could lead to scheme benefits changing and either employers or employees paying higher contributions.	Increase in employer contribution rates.	5	1	5	5	• Once the full implications of the cost cap are established officers, with assistance from Hymans Robertson, will further quantify the impact on the Fund. • Good investment returns protect the Fund in the short term and the impact will be further reviewed in the interim valuations each year and at the next triennial valuation in 2023.	Head of Finance/ PFSC	Ongoing
4	Changes in legislation and other regulatory frameworks, such as pooling or merging of LGPS schemes in Scotland, may impact adversely on the Fund in terms of funding levels and governance structures	Loss of investments or control of investments.	3	3	9	9	• Participation in active CIPFA and Scottish Pension network allow changes and impacts to be identified quickly. • Involvement with COSLA discussions on Pensions. • Participation in consultation on pooling/merger by the Scheme Advisory Board. • Monitoring and highlighting actions and decisions from scheme advisory board.	Head of Finance/ PFSC	Ongoing

Appendix 3

Orkney Islands Council Pension Fund

Funding Strategy Statement

February 2021

Contents

1 Introduction

1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the Orkney Islands Council Pension Fund (“the Fund”), which is administered by Orkney Islands Council, (“the Administering Authority”).

It has been prepared by the Administering Authority in collaboration with the Fund’s actuary, Hymans Robertson LLP, and after consultation with the Fund’s employers and investment adviser. It is effective from [DATE POST CONSULTATION].

1.2 What is the Orkney Islands Council Pension Fund?

The Fund is part of the Scottish Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole country. The Administering Authority runs the Orkney Islands Council Pension Fund, in effect the LGPS for the Orkney Islands area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund’s assets grow over time with investment income and capital growth; and
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the various LGPS Regulations applicable to Scotland. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in Appendix B.

1.3 Why does the Fund need a Funding Strategy Statement?

Employees’ benefits are guaranteed by the LGPS Regulations and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees’ contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers’ contributions, and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in Appendix A.

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the LGPS Regulations applicable in Scotland;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Statement of Investment Principles (see Section 5)

1.4 How does the Fund and this FSS affect me?

This depends on who you are:

- a member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;
- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, in what circumstances you might need to pay more and what happens if you cease to be an employer in the Fund. Note that the FSS applies to all employers participating in the Fund;
- an Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- a Council Tax payer: you will want to know how your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (**NB** this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

1.6 How do I find my way around this document?

In Section 2 there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In Section 3 we outline how the Fund calculates the contributions payable by different employers in different situations.

In Section 5 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail if you are interested:

A. the regulatory background, including how and when the FSS is reviewed,

B. who is responsible for what,

C. what issues the Fund needs to monitor, and how it manages its risks,

D. some more details about the actuarial calculations required,

E. the assumptions which the Fund actuary currently makes about the future,

F. a glossary explaining the technical terms occasionally used here.

If you have any other queries please contact Bryan Hay (Pensions Manager) in the first instance at e-mail address bryan.hay@orkney.gov.uk or on telephone number 01856 873535 ext. 2108.

2 Basic Funding issues

(More detailed and extensive descriptions are given in Appendix D).

2.1 How does the actuary calculate the required contribution rate?

In essence this is a three-step process:

- Calculate the funding target for that employer, i.e. the estimated amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;
- Determine the time horizon over which the employer should aim to achieve that funding target. See the table in 3.3 and Note (c) for more details;
- Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon, allowing for various possible economic outcomes over that time horizon. See 2.3 below, and the table in 3.3 Note (e) for more details.

2.2 What is each employer's contribution rate?

This is described in more detail in Appendix D. Employer contributions are normally made up of two elements:

a) the estimated cost of benefits being built up each year, after deducting the members' own contributions and including an allowance for administration expenses. This is referred to as the "*Primary rate*", and is expressed as a percentage of members' pensionable pay; plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, payment of the Secondary rate is in respect of benefits already accrued at the valuation date. The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of any higher rate will be taken by the Fund actuary at subsequent valuations, i.e. will be reflected as a credit when next calculating the employer's contributions.

At present all employers within the Fund pay the same contribution rate. This rate is modelled using the same principles and method as described in 2.1 and 3.2. However, the Administering Authority has the discretion to determine specific employer future service and individual past service adjustments according to employer characteristics, as appropriate.

2.3 What different types of employer participate in the Fund?

Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate.

In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: colleges, contractors, housing associations, charities, etc.

The LGPS Regulations define various types of employer as follows:

Scheduled bodies - councils, and other specified employers such as further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

Other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer – **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer – **transferee admission bodies** ("TAB"). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund's admissions policy are not met. (NB The terminology CAB and TAB has been dropped from recent LGPS Regulations, which instead combine both under the single term 'admission bodies'; however, we have retained the old terminology here as we consider it to be helpful in setting funding strategies for these different employers).

2.4 How does the calculated contribution rate vary for different employers?

The Fund has agreed to set contributions for all employers at the same level.

Any costs of non ill-health early retirements must be paid by the employer, see 3.6.

Costs of ill-health early retirements are covered in 3.7 and 3.8.

2.5 How is a funding level calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see Appendix D, section D5, for further details of how this is calculated), to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

It is important to note that the funding level and deficit/surplus are only measurements at a particular point in time, on a particular set of assumptions about the future. Whilst we recognise that various parties will take an interest in these measures, for most employers the key issue is how likely it is that their contributions will be sufficient to pay for their members' benefits (when added to their existing asset share and anticipated investment returns).

In short, deficits and funding levels are short term measures, whereas contribution-setting is a longer term issue.

2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher pension fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;
- Contributions which colleges and universities pay to the Fund will therefore not be available to pay for providing education; and
- Other employers will provide various services to the local community, perhaps through housing, charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services at a reasonable cost.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees;
- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible. However, a recent shift in regulatory focus means that solvency within each generation is considered by the Government to be a higher priority than stability of contribution rates;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result; and
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this balance by allowing all employers in the Fund to pay the same contribution rate.

The Administering Authority will maintain a database which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc.

The Fund actively seeks employer input, including input to its funding arrangements, through various means: see Appendix A.

2.7 What approach has the Fund taken to dealing with uncertainty arising from the McCloud court case and its potential impact on the LGPS benefit structure?

The LGPS benefit structure is currently under review following the Government's loss of the right to appeal two Court of Appeal judgements in December 2018, collectively referred to as the 'McCloud' judgement. The courts have ruled that the 'transitional protections' awarded to some members of public service pension schemes when the schemes were reformed (on 1 April 2015 in the case of the LGPS in Scotland) were unlawful on the grounds of age discrimination. The exact details of the solution to the McCloud judgement have yet to be confirmed. A consultation on this closed on 23 October 2020 and is currently under consideration by the Scottish Public Pensions Agency (SPPA).

In May 2020, the SPPA set out their expectations for how funds should allow for this uncertainty in the benefit structure as part of their 2020 valuations. The Fund Actuary has included an allowance in the Fund's liabilities in line with SPPA's instructions.

2.8 What approach has the Fund taken to dealing with uncertainty arising from the paused Cost Cap mechanism and its potential impact on the LGPS benefit structure?

As part of the public sector pension scheme reforms in the first half of the 2010s, a mechanism was put in place to protect employers from significant increases in future pension costs. The mechanism is symmetrical in its design – following a Cost Cap valuation carried out by the Government Actuary's Department (GAD), if the scheme is calculated to have a lower/(higher) than intended cost to employers, then action will be taken: improvements/(reductions) in future benefit accrual and/or increases/(reductions) in employee contribution rates.

The first Cost Cap mechanism for LGPS Scotland was as at 31 March 2017, however this has been put on hold until the McCloud judgement is resolved. There is currently no information available about the results of the 2017 Cost Cap valuation and whether a change in the benefit structure and/or employee contribution rates from 1 April 2020 may occur.

The Fund has considered how it will allow for this uncertainty in the approach to setting employer contribution rates, and has decided to make no allowance or adjustment to contribution rates and liabilities at the 2020 valuation. However, once the outcome of the Cost Cap valuation case is known, the Fund may revisit the contribution rates set to ensure they remain appropriate. The Fund reserves the right to increase rates prior to the next valuation in 2023 if deemed necessary.

2.9 When will the next actuarial valuation be?

On 21 January 2020 SPPA issued a consultation seeking views on proposals to amend the LGPS valuation cycle in Scotland from a three year (triennial) valuation cycle to a four year (quadrennial) valuation cycle. This consultation closed on 9 March 2020 and is currently under consideration by SPPA. At the time of writing, we understand that the next valuation is likely to be in 2023.

2.10 What approach has the Fund taken to dealing with uncertainty arising from the Goodwin court case and its potential impact on the LGPS benefit structure

The Goodwin tribunal was raised in the Teachers' scheme. It claimed members, or their survivors, were discriminated against due to their sexual orientation. The claim was because the Teachers' scheme provides a survivor's pension which is less favourable for a widower or surviving male partner, than for a widow or surviving female partner of a female scheme member. On 30 June 2020, the Tribunal found in favour of the claimant and agreed there was discrimination. This finding and remedy is expected to apply across all public service pension schemes, including the LGPS, however this is not certain and the details are not yet known.

The impact, if any, of the Goodwin case on Fund liabilities is expected to be small and will largely be an administrative issue. In the absence of a resolution or any guidance to this case, no allowance has been made for this within the 2020 formal valuation.

3 Calculating contributions for individual Employers

3.1 General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, the Fund's three-step process identifies the key issues:

1. What is a suitably (but not overly) prudent funding target?
2. How long should the employer be permitted to reach that target? This should be realistic but not so long that the funding target is in danger of never actually being achieved.
3. What likelihood is required to reach that funding target? This will always be less than 100% as we cannot be certain of the future. Higher likelihood "bars" can be used for employers where the Fund wishes to reduce the risk that the employer ceases leaving a deficit to be picked up by other employers.

These and associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore, the Administering Authority reserves the right to direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

Section 3.4 onwards deals with various other funding issues which apply to all employers.

3.2 The approach used for setting employer contributions

The Fund permits all employers to pay the same contribution rate. This rate is determined using an approach known as stabilisation.

Stabilisation is a mechanism where employer contribution rate variations from year to year are kept within a pre-determined range, thus allowing those employers' rates to be relatively stable. In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, can demonstrate that stabilising contributions is a prudent longer-term approach.

This stabilisation mechanism allows short term investment market volatility to be managed so as not to cause volatility in employer contribution rates, on the basis that a long term view can be taken on net cash inflow, investment returns and strength of employer covenant.

The current stabilisation mechanism applies to all employers in the Fund. However, the Fund reserves the right to review that approach should any events occur which the Fund deems the employer to become ineligible, e.g. significant reductions in active membership (due to outsourcing or redundancies), or changes in the nature of the employer (perhaps due to Government restructuring), or changes in the security of the employer.

On the basis of extensive modelling carried out for the 2020 valuation exercise (see Section 5), the stabilisation approach adopted is that future contribution rates will move at no more than 0.5% p.a.

The stabilisation criteria and limits will be reviewed at the next formal valuation. However, the Administering Authority reserves the right to review the stabilisation criteria and limits at any time before then, on the basis of membership and/or employer changes as described above.

In particular, any revision to benefits following the results of the Cost Cap valuation as discussed in Section 2.8 may require a review of contribution rates.

3.3 What is the funding time horizon

When assessing the suitability of a stabilised contribution rate strategy, the Fund has adopted a 20-year time horizon.

3.4 Likelihood of achieving funding target

Contributions are set such that, combined with the Fund's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum likelihood. A higher required likelihood bar will give rise to higher required contributions, and vice versa.

The required likelihood of success at this valuation is 67%.

The way in which contributions are set using these three steps, and relevant economic projections, is described in further detail in Appendix D.

3.5 Non ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

3.6 Ill health early retirement costs

In the event of a member's early retirement on the grounds of ill-health, a funding strain will usually arise, which can be very large. Such strains will be reflected in the funding position of each employer.

Admitted Bodies will usually have an 'ill health allowance'; Scheduled Bodies may have this also, depending on their agreement terms with the Administering Authority. The Fund reserves the right to monitor each employer's ill health experience on an ongoing basis. If the cumulative cost of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer may be charged additional contributions on the same basis as apply for non ill-health cases.

Individual employers may elect to take external insurance which would provide a lump sum payment equal to the funding strain as determined by the Fund.

3.7 Employers with no remaining active members

Following the payment of any calculated cessation debt (see 4.2 below), receipt of an exit credit or alternative agreement, one of two situations will eventually arise:

a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;

b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the remaining assets would be apportioned pro-rata by the Fund's actuary to the other Fund employers.

In exceptional circumstances the Fund may permit an employer with no remaining active members and a cessation deficit to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases.

4 Employers joining or leaving the Fund

4.1 New admission bodies

All new Admission Bodies will be required to provide some form of security; such as a guarantee from the letting employer, Scottish or UK government; or an indemnity or a bond, as set out in the LGPS Regulations. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a greater than expected rise in liabilities;
- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit.

Any indemnity or bond will be reassessed on an annual basis.

The above approaches reduce the risk, to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

4.2 Admission Bodies ceasing

Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund (NB recent LGPS Regulation changes mean that the Administering Authority has the discretion to defer taking action for up to three years, so that if the employer acquires one or more active Fund members during that period then cessation is not triggered. The current Fund policy is that this is left as a discretion and may or may not be applied in any given case);
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body. All cessations will be carried out on the “low-risk cessation basis” unless otherwise agreed by the Administering Authority.

Where there is a calculated surplus at the date of exit, following the Local Government Pension Scheme (Scotland) Regulations 2018 which came into effect on 1 May 2018, this will normally result in an exit credit payment to the Admission Body.

As discussed in Section 2.7, the LGPS benefit structure from 1 April 2015 is currently under review following the Government's loss of the right to appeal the McCloud and other similar court cases. The Fund has considered how it will reflect the current uncertainty regarding the outcome of this judgement in its approach to cessation valuations. For cessation valuations that are carried out before any changes to the LGPS benefit structure (from 1 April 2015) are confirmed, the Fund's policy is that the actuary will value the employer's liabilities in line with instructions SPPA set out for the 2020 formal valuations.

The Fund Actuary charges a fee for carrying out an employer's cessation valuation which the Fund will recharge to the employer.

The Fund at its absolute discretion reserves the right to enter into an agreement with a ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: secondary contributions would be derived from this cessation debt. This approach would be monitored as part of each formal valuation and secondary contributions would be reassessed as required. The Admission Body may terminate the agreement only via payment of the outstanding debt assessed on the low risk exit basis. Furthermore, the Fund reserves the right to revert to a "low risk cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases.

4.3 Policies on bulk transfers

Each case will be treated on its own merits, but in general:

- Where only active members transfer out, the Fund will not pay bulk transfers greater than the value of the members' liabilities had they opted to transfer on an individual basis (i.e. Cash Equivalent Transfer Values);
- Where the entire membership of the employer (i.e. active, deferred and pensioner members) transfers out, the Fund will not pay a bulk transfer greater than the asset share of the transferring employer;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities; and
- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.

5 Funding strategy and links to investment strategy

5.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles, which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out as part of each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

5.2 What is the link between funding strategy and investment strategy?

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa.

Therefore, the funding and investment strategies are inextricably linked.

5.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The actuary's assumptions for future investment returns (described further in Appendix E) are based on the current benchmark investment strategy of the Fund. The future investment return assumptions underlying each of the fund's three funding bases include a margin for prudence, and are therefore also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the Government (see Appendix A1).

In the short term – such as the assessments at formal valuations – there is the scope for considerable volatility in asset values. However, the actuary takes a long term view when assessing employer contribution rates and the contribution rate setting methodology takes into account this potential variability

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

5.4 How does this apply to employers?

The Actuary has developed four key measures which capture the essence of the Fund's strategies, both funding and investment:

Prudence - the Fund should have a reasonable expectation of being fully funded in the long term;

Affordability – how much can employers afford;

Stewardship – the assumptions used should be sustainable in the long term, without having to resort to overly optimistic assumptions about the future to maintain an apparently healthy funding position; and

Stability – employers should not see significant moves in their contribution rates from one year to the next, to help provide a more stable budgeting environment.

The key problem is that the key objectives often conflict. For example, minimising the long term cost of the scheme (i.e. keeping employer rates affordable) is best achieved by investing in higher returning assets e.g. equities. However, equities are also very volatile (i.e. go up and down fairly frequently in fairly large moves), which conflicts with the objective to have stable contribution rates.

Therefore, a balance needs to be maintained between risk and reward, which has been considered by the use of Asset Liability Modelling: this is a set of calculation techniques applied by the Fund's actuary to model the range of potential future solvency levels and contribution rates.

The Actuary was able to model the impact of these four key areas, for the purpose of setting a stabilisation approach (see 3.2). The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes as described in 3.2 , struck an appropriate balance between the above objectives. In particular the stabilisation approach currently adopted meets the need for stability of contributions without jeopardising the Administering Authority's aims of prudent stewardship of the Fund.

5.5 Does the Fund monitor its overall funding position?

The Administering Authority monitors the relative funding position, i.e. changes in the relationship between asset values and the liabilities value, annually. It reports this to the regular Pensions Committee meetings, and also to employers through newsletters and Employers Forums.

6 Statutory reporting and comparison to other LGPS Funds

6.1 Purpose

Under Section 13(4)(c) of the Public Service Pensions Act 2013 ("Section 13"), the Government Actuary's Department must, following each triennial actuarial valuation, report to the Scottish Public Pensions Agency (SPPA) acting on behalf of Scottish Ministers, on each of the LGPS Funds in Scotland. This report will cover whether, for each Fund, the rate of employer contributions are set at an appropriate level to ensure both the solvency and the long term cost efficiency of the Fund.

This additional SPPA oversight may have an impact on the strategy for setting contribution rates at future valuations.

6.2 Solvency

For the purposes of Section 13, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

(a) the rate of employer contributions is set to target a funding level for the Fund of 100%, over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds); and either

(b) employers collectively have the financial capacity to increase employer contributions, and/or the Fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or

(c) there is an appropriate plan in place should there be, or if there is expected in future to be, a material reduction in the capacity of fund employers to increase contributions as might be needed.

6.3 Long Term Cost Efficiency

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long term cost efficiency if:

i. the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual,

ii. with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, SPPA may have regard to various absolute and relative considerations. A relative consideration is primarily concerned with comparing LGPS pension funds with other LGPS pension funds. An absolute consideration is primarily concerned with comparing Funds with a given objective benchmark.

Relative considerations include:

1 the implied deficit recovery period; and

2 the investment return required to achieve full funding after 20 years.

Absolute considerations include:

1 the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;

2 how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy; and

3 the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual Fund experience.

SPPA may assess and compare these and other metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

Appendices

Appendix A – Regulatory framework

A1 Why does the Fund need an FSS?

The purpose of the FSS is:

*"to establish a **clear and transparent fund-specific strategy** which will identify how employers' pension liabilities are best met going forward;*

*to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**; and*

*to take a **prudent longer-term view** of funding those liabilities."*

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

The requirement to maintain and publish an FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2016) and to its Statement of Investment Principles.

This is the framework within which the Fund's actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to "consultation with such persons as the authority considers appropriate", and should include "a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers".

In practice, for the Fund, the consultation process for this FSS was as follows:

a) A draft version of the FSS was issued to all participating employers on 22nd February 2021 for comment;

b) Comments were requested within 18 days;

c) Following the end of the consultation period the FSS was updated where required and then published, in [DATE].

A3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website, at https://www.orkney.gov.uk/Service-Directory/S/pension-fund-sub-committeepension-board.htm.
- A copy sent by e-mail to each participating employer in the Fund;
- A full copy linked from the annual report and accounts of the Fund.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Pensions Committee and would be included in the relevant Committee Meeting minutes.

A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Statement of Investment Principles, Administration Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the web https://www.orkney.gov.uk/Service-Directory/S/pension-fund-sub-committeepension-board.htm.

Appendix B – Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to each play their part.

B1 The Administering Authority should:

- operate the Fund as per the LGPS Regulations;
- effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
- collect employer and employee contributions, and investment income and other amounts due to the Fund;
- ensure that cash is available to meet benefit payments as and when they fall due;
- pay from the Fund the relevant benefits and entitlements that are due;
- invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles (SIP) and LGPS Regulations;
- communicate appropriately with employers so that they fully understand their obligations to the Fund;
- take appropriate measures to safeguard the Fund against the consequences of employer default;
- manage the valuation process in consultation with the Fund's actuary;
- provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 6);
- prepare and maintain a FSS and a SIP, after consultation;
- notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
- monitor all aspects of the fund's performance and funding and amend the FSS and SIP as necessary and appropriate.

B2 The Individual Employer should:

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- have a policy and exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
- notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

B3 The Fund Actuary should:

- prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
- provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 6);
- provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);

- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
- assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
- advise on the termination of employers' participation in the Fund; and
- fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties:

- investment advisers (either internal or external) should ensure the Fund's SIP remains appropriate, and consistent with this FSS;
- investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the SIP;
- auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
- governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
- legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures; and

the SPPA/Scottish Ministers (assisted by the Government Actuary's Department) and the Scottish LGPS Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

Appendix C – Key risks and controls

C1 Types of risk

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

- financial;
- demographic;
- regulatory; and
- governance.

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities and contribution rates over the long-term.	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc. Analyse progress at three yearly valuations for all employers. Inter-valuation monitoring of liabilities between valuations at whole Fund level.
Inappropriate long-term investment strategy.	Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes. Chosen option considered to provide the best balance; reviewed at least every three years.
Active investment manager under-performance relative to benchmark.	Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.
Pay and price inflation significantly more than anticipated.	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Inter-valuation monitoring, as above, gives early warning. Some investment in bonds also helps to mitigate this risk. Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.

Risk	Summary of Control Mechanisms
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	An explicit stabilisation mechanism has been agreed as part of the funding strategy. Other measures are also in place to limit sudden increases in contributions.
Orphaned employers give rise to added costs for the Fund	The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future. If it occurs, the additional cost will be met by the Fund's remaining employers.

C3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer, thus increasing cost to Fund.	Set mortality assumptions with some allowance for future increases in life expectancy. The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.
Deteriorating patterns of early retirements	Employers are charged the extra cost of non ill-health retirements following each individual decision. Employer ill health retirement experience is monitored, and insurance is an option.
Reductions in payroll causing insufficient deficit recovery payments	In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows: Employers in the stabilisation mechanism may be brought out of that mechanism to permit appropriate contribution increases . For other employers, review of contributions is permitted in general between valuations and may require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.

C4 Regulatory risks

Risk	Summary of Control Mechanisms
Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.
Time, cost and/or reputational risks associated with any SPPA/Scottish Ministers intervention triggered by the Section 13 analysis (see Section 5).	Take advice from Fund Actuary on proposed valuation approach relative to anticipated Section 13 analysis.
Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies.	The Administering Authority considers all consultation papers issued by the Government and comments where appropriate. Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.

C5 Governance risks

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data. The Actuary may revise the Rates and Adjustments Certificate to increase an employer's contributions between triennial valuations Deficit contributions may be expressed as monetary amounts.
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way	The Administering Authority maintains close contact with its specialist advisers. Advice is delivered via formal meetings involving Elected Members, and recorded appropriately. Actuarial advice is subject to professional requirements such as peer review.
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.	The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.

Risk	Summary of Control Mechanisms
	Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.
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, where-ever possible. Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. Vetting prospective employers before admission. Where permitted under the regulations requiring a bond to protect the Fund from various risks. Requiring new Community Admission Bodies to have a guarantor. Reviewing bond or guarantor arrangements at regular intervals. Reviewing contributions well ahead of cessation if thought appropriate.
An employer ceasing to exist resulting in an exit credit being payable by the Fund	The Administering Authority monitors admission bodies coming up to cessation The Administering Authority invests in liquid assets to ensure that exit credits can be paid when required.

Appendix D – The calculation of Employer contributions

In Section 2 there was a broad description of the way in which contribution rates are calculated. This Appendix considers these calculations in much more detail.

As discussed in Section 2, the actuary calculates the required contribution rate using a three-step process:

1 Calculate the funding target, i.e. the estimated amount of assets it should hold in order to be able to pay all its members' benefits. See Appendix E for more details of what assumptions we make to determine that funding target;

2 Determine the time horizon over which the Fund should aim to achieve that funding target.;

3 Calculate the employer contribution rate such that it has at least a given likelihood of achieving that funding target over that time horizon, allowing for various possible economic outcomes over that time horizon.

The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix E.

Employer contributions are normally made up of two elements:

a) the estimated cost of ongoing benefits being accrued, referred to as the "Primary contribution rate" (see D2 below); plus

b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "Secondary contribution rate" (see D3 below).

D2 How is the Primary contribution rate calculated?

The Primary element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members' **future** service in the Fund. This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

The Primary rate is calculated such that it is projected to:

1 meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets,

2 within the determined time horizon, and

3 with a sufficiently high likelihood.*

The projections are carried out using an economic modeller (the "Economic Scenario Service") developed by the Fund's actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. Further information about this model is included in Appendix E. The contributions are calculated such that the proportion of outcomes meeting the employer's funding target (at the end of the time horizon) is equal to the required likelihood.

The approach includes expenses of administration to the extent that they are borne by the Fund, and includes allowances for benefits payable on death in service and on ill health retirement.

D3 How is the Secondary contribution rate calculated?

The Fund have determined the total contribution rate in accordance with their stabilisation strategy (see Section 3.2). The secondary rate is the contribution rate required such that the sum of the calculated primary rate and secondary rate equal the agreed total contribution rate.

D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

1. past contributions relative to the cost of accruals of benefits;
2. different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
3. the effect of any differences in the funding target, i.e. the valuation basis used to value the employer's liabilities at the end of the time horizon;
4. the difference between actual and assumed rises in pensionable pay;
5. the difference between actual and assumed increases to pensions in payment and deferred pensions;
6. the difference between actual and assumed retirements on grounds of ill-health from active status;
7. the difference between actual and assumed amounts of pension ceasing on death; and/or
8. the additional costs of any non ill-health retirements relative to any extra payments made.

D5 How is each employer's asset share calculated?

The Administering Authority does not operate separate bank accounts or investment mandates for each employer. Therefore, it cannot account for each employer's assets separately. Instead, the Fund Actuary must apportion the assets of the whole Fund between the individual employers.

The Fund adopts a 'cashflow approach' in which an employer's assets are tracked over time allowing for cashflows paid in (contributions, transfers in etc.), cashflows paid out (benefit payments, transfers out etc.) and investment returns on the employer's assets.

The Fund Actuary tracks employer assets on an annual basis. Starting with each employer's assets from the previous year end, cashflows paid in/out and investment returns achieved on the Fund's assets over the course of the year are added to calculate an asset value at the year end. The approach has some simplifying assumptions in that all cashflows and investment returns are assumed to have occurred uniformly over the course of the year. As the actual timing of cashflows and investment returns are not allowed for, the sum of all employers' asset values will deviate from the whole fund asset total over time (the deviation is expected to be minor). The difference is split between employers in proportion to their asset shares at each triennial valuation.

D6 How does the Fund adjust employer asset shares when an individual member moves from one employer in the Fund to another?

Under the cashflow approach for tracking employer asset shares, the Fund has allowed for any individual members transferring from one employer in the Fund to another, via the transfer of a sum from the ceding employer's asset share to the receiving employer's asset share. This sum is equal to the member's Cash Equivalent Transfer Value (CETV) as calculated by the Fund's actuary.

Appendix E – Actuarial assumptions

E1 What are the actuarial assumptions used to calculate employer contribution rates?

As set out in section 3.2, the Fund currently operates a stabilisation policy where contribution modelling is carried out in respect of the whole Fund to set a single contribution rate which is payable by all employers. Within this contribution modelling, the methodology and assumptions described below have been applied across the whole Fund as one pooled entity (as opposed to individual employers being modelled separately).

These are expectations of future experience used to place a value on future benefit payments ("the liabilities") and future asset values. Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants' benefits.

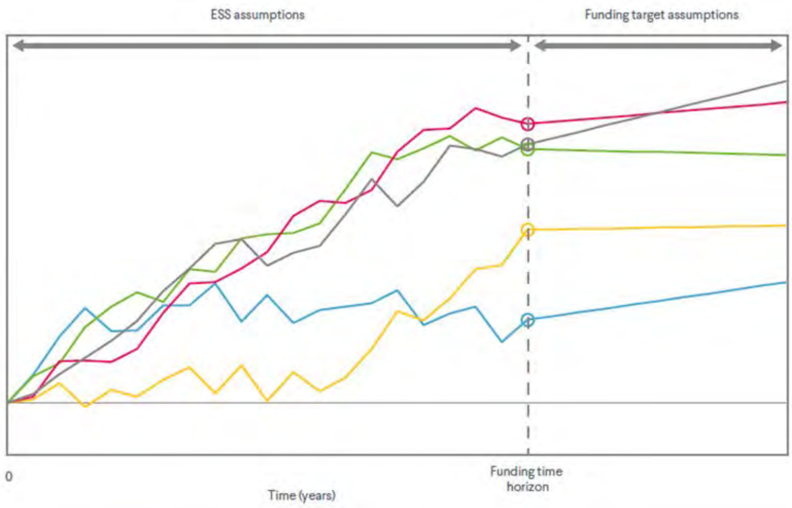
Changes in assumptions will affect the funding target and required contribution rate. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The actuary's approach to calculating employer contribution rates involves the projection of each employer's future benefit payments, contributions and investment returns into the future under 5,000 possible economic scenarios. Future inflation (and therefore benefit payments) and investment returns for each asset class (and therefore employer asset values) are variables in the projections. By projecting the evolution of an employer's assets and benefit payments 5,000 times, a contribution rate can be set that results in a sufficient number of these future projections (determined by the employer's required likelihood) being successful at the end of the employer's time horizon. In this context, a successful contribution rate is one which results in the employer having met its funding target at the end of the time horizon.

Setting employer contribution rates therefore requires two types of assumptions to be made about the future:

1 Assumptions to project the employer's assets, benefits and cashflows to the end of the funding time horizon. For this purpose the actuary uses Hymans Robertson's proprietary stochastic economic model - the Economic Scenario Service ("ESS").

2 Assumptions to assess whether, for a given projection, the funding target is satisfied at the end of the time horizon. For this purpose, the Fund has three different funding bases.



Details on the ESS assumptions and funding target assumptions are included below (in E2 and E3 respectively).

E2 What assumptions are used in the ESS?

The actuary uses Hymans Robertson's ESS model to project a range of possible outcomes for the future behaviour of asset returns and economic variables. With this type of modelling, there is no single figure for an assumption about future inflation or investment returns. Instead, there is a range of what future inflation or returns will be which leads to likelihoods of the assumption being higher or lower than a certain value.

The ESS is a complex model to reflect the interactions and correlations between different asset classes and wider economic variables. The table below shows the calibration of the model as at 31 March 2020. All returns are shown net of fees and are the annualised total returns over 5, 10 and 20 years, except for the yields which refer to the simulated yields at that time horizon.

		Annualised total returns									
		Cash	Index Linked Gilts (medium)	Fixed Interest Gilts (medium)	UK Equity	Overseas Equity	Property	A rated Corporate Bonds (medium)	Inflation	17 year real yield	17 year yield
5 years	16th %'ile	-0.6%	-3.0%	-2.9%	-5.3%	-5.2%	-3.7%	-2.1%	1.3%	-2.7%	0.2%
	50th %'ile	0.2%	0.0%	-0.3%	3.7%	3.9%	2.1%	1.3%	2.8%	-1.8%	1.3%
	84th %'ile	1.0%	3.0%	2.5%	13.6%	13.4%	8.7%	4.5%	4.3%	-0.9%	2.5%
10 years	16th %'ile	-0.4%	-2.5%	-2.0%	-2.1%	-2.1%	-1.8%	-1.1%	1.4%	-2.2%	0.6%
	50th %'ile	0.6%	-0.4%	-0.5%	4.3%	4.3%	2.5%	0.8%	2.9%	-0.9%	2.0%
	84th %'ile	1.7%	1.8%	1.0%	10.7%	10.5%	7.2%	2.6%	4.6%	0.3%	3.8%
20 years	16th %'ile	0.2%	-1.5%	-0.6%	0.6%	0.8%	0.2%	0.2%	1.4%	-1.6%	1.2%
	50th %'ile	1.6%	0.2%	0.2%	5.2%	5.3%	3.6%	1.3%	2.9%	0.1%	3.1%
	84th %'ile	3.3%	1.9%	1.0%	9.9%	10.0%	7.4%	2.4%	4.5%	1.9%	5.7%
	Volatility (Disp) (1 yr)	0%	7%	8%	27%	28%	14%	10%	1%		

E3 What assumptions are used in the funding target?

At the end of an employer's funding time horizon, an assessment will be made – for each of the 5,000 projections – of how the assets held compare to the value of assets required to meet the future benefit payments (the funding target). Valuing the cost of future benefits requires the actuary to make assumptions about the following financial factors:

- Benefit increases and CARE revaluation
- Salary growth
- Investment returns (the "discount rate")

Each of the 5,000 projections represents a different prevailing economic environment at the end of the funding time horizon and so a single, fixed value for each assumption is unlikely to be appropriate for every projection. For example, a high assumed future investment return (discount rate) would not be prudent in projections with a weak outlook for economic growth. Therefore, instead of using a fixed value for each assumption, the actuary references economic indicators to ensure the assumptions remain appropriate for the prevailing economic environment in each projection. The economic indicators the actuary uses are future inflation expectations and the prevailing risk free rate of return (the yield on long term UK government bonds is used as a proxy for this rate).

The Fund has two funding bases which will apply to different employers depending on their type. Each funding basis has a different assumption for future investment returns when determining the employer's funding target.

Funding basis	Ongoing participation basis*	Low risk exit basis
Employer type	All employers except Transferee Admission Bodies and closed Community Admission Bodies	Community Admission Bodies that are closed to new entrants
Investment return assumption underlying the employer's funding target (at the end of its time horizon)	Long term government bond yields plus an asset outperformance assumption (AOA) of 1.4% p.a.	Long term government bond yields with no allowance for outperformance on the Fund's assets

*as applies to current pooled stabilisation policy for all employers

E4 What other assumptions apply?

The following assumptions are those of the most significance used in both the projection of the assets, benefits and cashflows and in the funding target.

a) Salary growth

The salary increase assumption at the 2020 valuation has been set to be a blended rate combined of:

1 2% p.a. until 31 March 2023, followed by

2 0.5% above the consumer prices index (CPI) thereafter.

This gives a single "blended" assumption of CPI plus 0.5%. This is a change from the previous valuation, which assumed a flat assumption of RPI less 0.6% per annum.

b) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the "formula effect" of the difference between RPI and CPI. At the previous valuation we assumed CPI would be 1.0% lower than RPI on overage. At the 2020 valuation, we have assumed that CPI will be 0.9% per annum lower than RPI on average, which will serve to increase the funding target (all other things being equal). (Note that the reduction is applied in a geometric, not arithmetic, basis).

c) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of “VitaCurves”, produced by the Club Vita’s detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

Allowance has been made in the ongoing valuation basis for future improvements in line with the 2019 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.5% per annum minimum underpin to future reductions in mortality rates. This results in slightly lower life expectancies than was assumed at the 2017 valuation.

The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members’ benefits.

d) General

The same financial assumptions are adopted for most employers (on the ongoing participation basis identified above).

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

Appendix F – Glossary

Funding basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of the funding target at the end of the employer's time horizon. The main assumptions will relate to the level of future investment returns, salary growth, pension increases and longevity. More prudent assumptions will give a higher funding target, whereas more optimistic assumptions will give a lower funding target.
Administering Authority	The council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
Admission Bodies	Employers where there is an Admission Agreement setting out the employer's obligations. These can be Community Admission Bodies or Transferee Admission Bodies. For more details (see 2.3).
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Employer	An individual participating body in the Fund, which employs (or used to employ) **members** of the Fund. Normally the assets and **funding target** values for each employer are individually tracked, together with its **Primary rate** at each **valuation**.
Gilt	A UK Government bond, i.e. a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but are also used in funding as an objective measure of a risk-free rate of return.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's **covenant** to be as strong as its guarantor's.
Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority.

LGPS The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 100 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.

Maturity A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.

Members The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).

Primary contribution rate The employer contribution rate required to pay for ongoing accrual of active members' benefits (including an allowance for administrative expenses). See Appendix D for further details.

Profile The profile of an employer's membership or liability reflects various measurements of that employer's **members**, i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its **maturity** also.

Rates and Adjustments Certificate A formal document required by the LGPS Regulations, which must be updated at the conclusion of the formal **valuation**. This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the period until the next valuation is completed.

Scheduled Bodies Types of employer explicitly defined in the LGPS Regulations, whose employees must be offered membership of their local LGPS Fund. These include Councils, colleges, some universities, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers).

Secondary contribution rate The difference between the employer's actual and **Primary contribution rates**. See Appendix D for further details.

Stabilisation Any method used to smooth out changes in employer contributions from one year to the next. This is very broadly required by the LGPS Regulations, but in practice is particularly employed for large stable employers in the Fund.

Valuation A risk management exercise to review the **Primary and Secondary contribution rates,** and other statutory information for a Fund, and usually individual employers too.