Agenda

AGENDA for a meeting of the LOCAL GOVERNMENT PENSION SCHEME PENSION BOARD to be held in COMMITTEE ROOM C, County Hall, Hertford on TUESDAY, 6 DECEMBER 2016 AT 10.00AM

MEMBERS OF THE BOARD (8) - QUORUM (4)

Employer Representatives - D Ashley (Vice Chairman), G Clay, D Graham, P Neville
Member Representatives - D Devereux, J Digby (Chairman), K Harding, C Roberts

STANDING SUBSTITUTE MEMBERS

Employer Representatives - J Anderton, M Green, T Hone, J Hurley
Member Representative - A Bowen,

Meetings of the Board are open to the public (this includes the press) and attendance is welcomed. However, there may be occasions when the public are excluded from the meeting for particular items of business. Any such items would be taken at the end of the public part of the meeting and listed under “Part Two (‘closed’) agenda”.

Committee Room C is fitted with an audio system to assist those with hearing impairment. Anyone who wishes to use this should contact main (front) reception.

AGENDA

1. MINUTES

To confirm the Part I minutes of the meeting held on 30 September 2016 (attached).

2. PENSIONS BOARD ANNUAL REPORT UPDATE

Report of the Director of Resources

3. PENSION FUND GOVERNANCE AND RISK MANAGEMENT REPORT

Report of the Director of Resources

4. LONDON PENSIONS FUND AUTHORITY
LOCAL GOVERNMENT PENSION FUND ADMINISTRATION REPORT

Report of London Pensions Fund Authority

5. **FORMAL FUNDING VALUATION INITIAL RESULTS 2016**

Report of the Director of Resources

6. **PENSION FUND ASSET POOLING – ACCESS UPDATE**

Report of the Director of Resources

7. **DATES OF FUTURE MEETINGS**

The Board is invited to note the dates of future meetings, as follows:

14 March 2017 at 10am
3 July 2017 at 10am

EXCLUSION OF PRESS AND PUBLIC

The Chairman will move:-

"That under Section 100(A)(4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A to the said Act and the public interest in maintaining the exemption outweighs the public interest in disclosing the information."

PART II ('CLOSED') AGENDA

1. **MINUTES**

To confirm the Part II minutes of the meeting held on 30 September 2016 (attached).

2. **PENSION FUND – FUNDING AND INVESTMENT REPORT (Formerly PERFORMANCE REPORT) AS AT 30 SEPTEMBER 2016**

Report of the Director of Resources

If you require further information about this agenda please contact Theresa Baker, Democratic Services Officer, on telephone no (01992) 556545 or by e-mail to theresa.baker@hertfordshire.gov.uk

Agenda documents are also available on the internet at:
https://cmis.hertfordshire.gov.uk/hertfordshire/Calendarofcouncilmeetings.aspx

For further information about the issues covered in these reports please contact Patrick Towey on 01992 555148.

Minutes

To: All Members of the Pensions Board LGPS, Chief Executive, Chief Officers, All officers named for 'actions'

From: Legal, Democratic & Statutory Services
Ask for: Theresa Baker
Ext: 26545

PENSIONS BOARD LGPS
30 SEPTEMBER 2016

ATTENDANCE

MEMBERS OF THE BOARD

Employer Representatives: G Clay, D Graham, P Neville
Member Representatives: D Devereux, J Digby (Chairman), K Harding,

STANDING SUBSTITUTE MEMBERS

Employer Representatives: T Hone, J Hurley**,**
Member Representatives: C Roberts,

Note: For this meeting only the usual order of business was varied such that the chairman's announcements followed Items 1 & 2: the election of the chairman and vice chairman for 2016 – 2017.

Upon consideration of the agenda for the Pensions Board LGPS meeting on 30 September 2016 as circulated, copy annexed, conclusions were reached and are recorded below:

PART I ('OPEN') BUSINESS

ACTION

1. FORMAL APPOINTMENT OF CHAIRMAN

1.1 The Democratic Services Officer invited Board members to propose a nomination for the position of Chairman. J Digby was nominated by K Harding and seconded by D Devereux. There were no other nominations. J Digby was duly appointed as Chairman for the Pensions Board LGPS.

2 FORMAL APPOINTMENT OF VICE CHAIRMAN

2.1 The Chairman invited Board members to propose a nomination for the position of Vice Chairman. D Ashley was nominated by T Hone and seconded by D Graham. There were no other nominations. D

Ashley (in absentia) was appointed as Vice Chairman.

CHAIRMAN'S ANNOUNCEMENTS

(i) T Hone substituted for D Ashley,
(ii) C Roberts substituted for W Ogley,
(iii) Apologies were received from D Ashley, M Green, J Anderson, A Bowen and W Ogley,
(iv) William (Bill) Ogley had emailed to advise the Board that "*as he has missed a number of meetings, he had decided that it would be in the best interests of the fund and its members for him to resign and to open the way for someone who was better able to fulfil the role.*
In light of this he wished to convey his decision to the Board and thank them for the opportunity. He had enjoyed being part of the Committee and hoped it continued in good health."
(v) The chairman proposed that C Roberts substitute for W Ogley for the meeting, that he become a full member of the board, and that a replacement Member Representative Standing Substitute be recruited to the Board.
(vi) The Board were advised that there would be a review of the operation of the board at the next meeting. C Cook
(vii) The chairman advised the board that there would be a change to the agreed order of proceedings:
There would be break after PART I;
The Member Training Session by Mercers would then follow to accommodate instruction of members who had to leave early.
PART II would then follow.
(viii) The Board agreed that items 4 & 5 be taken together; there were no objections.
(ix) The chairman advised the board that the reports included a PENSION FUND ASSET POOLING – ACCESS UPDATE which had erroneously been left off the agenda and should have been listed as Item 10.
DATES OF FUTURE MEETINGS was therefore Item 11.

Note: No conflicts of interest were declared by any member of the Cabinet Panel in relation to the matters on which conclusions were reached at this meeting.

3. MINUTES PART 1

The Minutes PART1 of the Pensions Board LGPS meeting held on 17 June 2016 were confirmed as a correct record and signed by the Chairman.

4. AUDIT RESULTS REPORT 2015/16 PENSIONS FUND

Report of Ernst & Young.

4.1 The Board considered the Hertfordshire County Council Pension Fund Annual Results Report 2015/2016 of the external auditors.

4.2 Officers advised the Board that EY was very satisfied with the quality of the Pension Fund audit and arrangements and expected to issue an unqualified opinion of the Pensions Fund's financial statement; also to conclude that the Pension Fund's annual report was consistent with the financial statements. The Board welcomed the results and the auditor's comment within the report that it had been a clean and very positive audit.

4.3 Members heard that the key risks discussed within the report were standard for consideration in terms of the pensions fund's audit, rather than being specific to Hertfordshire County Council.

4.4 There were no unadjusted audit differences, however, during the audit, management had identified that due to a timing error the property pooled investment assets had been undervalued by £8.7 million and this adjustment had resulted in an increase in the Fund's net assets to arrive at a total of £3.584 billion.

4.5 The Pensions Committee and Audit Committee had supported the Letter of Representation i.e. the letter confirming that the Council had fulfilled the Pension Fund related issues.

4.6 The Board were pleased to that hear that early completion of the work reflected well on Hertfordshire which was consequently well placed for early closure in 2017/18.

Conclusion:

4.7 The Board noted the Audit Results Report of the Pensions Fund's 2015/16 Statement of Accounts.

5. RESPONSE TO THE AUDIT RESULTS REPORT 2015/16 – PENSION FUND

[Officer Contact: Patrick Towey, Head of Specialist Accounting (Tel: 01992 555148)]

5.1 The Board considered a report which provided a recommended response to the Audit Results Report 2015/16 – Pensions Fund, including the Draft Letter of Representation.

5.2 Officers were pleased to report that there were no recommendations and that the auditors provided an unqualified opinion of the accounts. Members noted that management had identified a small number of disclosure errors during the audit which were subsequently amended, and that the auditor did not consider these significant.

5.3 The chairman noted that the resolution for 4.1 to the report should state that the Committee ‘noted’ the response rather than ‘approved’ it.

5.4 The Board were advised that public sector auditors had been engaged following the demise of the audit commission and that work was underway with the LGA on what the arrangements should be post 2017/18; until that time Ernst &Young would remain the auditors.

Conclusion:

5.5 The Board noted the response to the Audit Results Report 2015/16 Pensions Fund

6. PENSION FUND ANNUAL REPORT AND STATEMENT OF ACCOUNTS 2015/16

[Officer Contact Kate Iles, Senior Accountant
(Telephone: 01992 555385)]

6.1 The Board received the audited Pensions Fund Annual Report and Statement of Accounts for 2015/16. Officers clarified that the report summarised the main features and directed members to Appendix A for the detail of the report and statement of accounts.

6.2 Members were advised that the Pension Fund Statement of Accounts 2015/16 had already gone before the Pensions Committee and the Audit Committee, and that this was being provided to Pensions Board LGPS for information and background on the fund.

6.3 The Board heard that the assets held by the fund had increased by £3.2 million to £3,584.2 million over the year. The -0.2% overall investment return was in line with the 2015/16 benchmark of -0.1%, and that for the year to end 31 March 2016 the number of members in the Pension Fund had increased by 4,539 to 95,995 ; the officer then outlined the main detail of movements in the fund as outlined in the report.
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6.4 In response to discussion of the value for money aspect of the investment management fees for the year of £13.5m and a suggestion to reduce the fee for negative fund delivery, N Sykes from Mercers explained that although there were large variations in market returns year to year, fund managers struggled to make high returns if market returns in general are low.

6.5 In discussion of the type of information shown in the report, officers noted:

- That the Audit Committee and the Pensions Committee had been pleased with the report, a previous report to Pensions Committee comparison had shown a good return from fund managers in comparison to their management costs over a 5 year period. Officers agreed to take on board for future reference reporting of the 5 year fund performance against the bench mark, also earlier circulation of this information to the Board; C Cook, J Adam
- That as the fund was cash positive it did not need to stress income generation, and that this was important only when schemes started to become more mature;
- The request to report figures in £million rather than percentages to give a better understanding of the split assets; C.Cook, J Adam
- The comment that the £3m profit made by the fund was good in comparison to many larger funds which were down, and that that this should be expressed in the report. C Cook J Adam

Conclusion:

6.6 The Board noted the report and commented as above on the audited Report and Accounts for 2015/16.

7. MEMBER TRAINING UPDATE 2016-18

[Officer Contact: Jolyon Adam, Finance Manager (Telephone: 01992 555078)]

7.1 The Board received a report to update them on the proposed training plan to fulfil the requirements set out in the Pensions Act 2004 (amended by the Public Service Pensions Act 2013).

7.2 Officers clarified that the report built on the Pension Fund Business plan, summarised the main legislative requirements, also the knowledge and understanding expected of members of the Pension Board LGPS by the legislation. The CIPFA Technical Framework for Local Pensions Boards Knowledge and Skills would form the basis of the training plan.

7.3 Members heard that officers had been working with the fund actuary Hymans Robertson on a proposed training plan. This proposed a series of sessions over a two year period, covering both the eight main modules identified by CIPFA, and the requirements of the Pensions Regulator Code of Practice 14; Pensions Committee members would also be invited to the sessions. Officers commented that other providers could be used in the future. J Adam

7.4 In response to the chairman's comment that the members of the Fire Pension Board had undertaken to complete the online Pension Regulators course (each module being 30 – 45 minutes), the members of the LGPS Pensions Board agreed to also undertake this online training.

7.5 To address the issue of members' absences from Board meetings (i.e. apologies) officers agreed to keep a matrix of member attendance (including substitutes) at meetings and concomitant completion of associated training sessions, also completion of the online training modules. J. Adam

Conclusion:

7.6 The Pension Board RESOLVED :

- To note the requirements for knowledge and understanding,
- To note the comments as above upon the proposed training plan put forward to meet these,
- To commit to undertake this training (dedicated sessions);
- To commit to undertake the Pension Regulator's online training.

8. PENSION FUND GOVERNANCE AND RISK MANAGEMENT REPORT

[Officer Contact: Jolyon Adam, Finance Manager
(Telephone: 01992 555078)]

8.1 The Board received a quarterly report on governance and risk management of of the Pension Fund covering the period April – June 2016.

In relation to the Risk Register:

8.2 Members noted that ACCESS investment pooling developments would be addressed in a separate report at the end of the meeting.

8.3 In relation to the risk of deterioration to the funding level of the Pension Fund, Officers reported that the 2016 Triennial Valuation, including the consultation on the Parish and Town Councils pooling arrangements and agreement of actuarial assumptions policy consultation, as at 31 March 2016 was being finalised. The associated August extension for the one Parish and One Town Council that had not replied had also passed and the administering authority would take a decision on how to treat this outstanding case before the next update.

8.4 Members heard that the action plan with the LPFA, working with scheme employers, to ensure that Annual Benefit Statements were issued in accordance with statutory deadlines had been 100% successful and the project management approach to this was likely to be repeated in 2017.

8.5 Replying to a question, officers confirmed that in terms of the annual external audit of the Pension Fund's Annual Report and Accounts, no decision had yet been made as to appointment of auditors but it was likely that the national procurement arrangements would be considered; the outcomes of the Triennial Valuation of the Fund would be reported to the 18 November 2016 Pensions Committee so sight of it would be possible prior to the next meeting of the Pensions Board.

8.6 The Board noted that the External Audit of the Accounts had been completed.

8.7 Members were advised that the award for the contract for legal services using the LGPS National Framework to Squires Patton Boggs had now been signed.

<u>In relation to Employer Risk Monitoring (monthly):</u>

8.8 The Board were referred to Appendix B for detail of the monitoring scheme. Members heard that of the 66 employers in the red risk category at 30 June 2016, a review had been undertaken of the age profile of the 33 outstanding admissions agreements (relative to the start of each service contract) whose admission agreements were in progress following the TUPE transfer of staff from existing scheme employers. It was now possible to address these historic cases using the specialist legal services of Squires Paton Boggs.

8.9 In terms of outstanding admission agreements, the practice whereby reporting dates of schemes were only recognised at the point that membership details were agreed with the new scheme (even if this was after the transfer date), had led to an increased number of employers in the 'Red' category. New employers would therefore now be monitored from the start date of the relevant service contract whether or not the Administering Authority had received their member details.

8.10 To concern that 13 of the 33 red risk schemes were over one year old, officers clarified that these cases were being targeted by Squires Paton Boggs to overcome any increased risk. Members requested an update on the outstanding admission agreements in the next Pension Fund Governance and Risk management report. J Adam

8.11 To the suggestion that a similar age breakdown would be useful for J Adam scheme employers in the amber category of the Employer Risk Monitor, officers commented that such employer schemes were generally small admissions from academies and thus small risk, however the risk increased the longer they were not dealt with.

8.12 During discussion of risk in relation to the size of a liability, officers clarified that when scheme employers entered the Pension Fund the assumption was that they were 100% funded, however the exact detail of their liabilities could not be confirmed until the next valuation.

<u>In relation to the Administering Authority Report:</u>

8.13 Officers directed members to Appendix C to the report and confirmed that, as requested at the last meeting, a SIAS (Shared Internal Audit Services) report now formed part of the Administering Authority Report.

8.14 In terms of complaints and internal disputes no internal dispute resolution procedures (IDRPs) or complaints were raised against the Administering Authority in the period.

<u>In relation to Scheme Specific Employer Matters:</u>

8.15 The Board noted that 7 Admission Agreements had been concluded in the quarter, in relation to the TUPE transfer of staff under service contracts for Pre School Learning Alliance and Hertsmere Leisure for multiple children centre contracts. In addition Elior and Carers in Hertfordshire had left the Pension fund.

<u>In relation to the Pensions Committee:</u>

8.16 There were no actions arising for the June 2016 meeting of the Pension Board which required a response from the Pensions Committee.

Conclusion:

8.17 The Pension Board noted the content of the report and commented as above.

9. LONDON PENSIONS FUND AUTHORITY LOCAL GOVERNMENT PENSION FUND ADMINISTRATION REPORT

Report of London Pensions Fund Authority (LPFA)

9.1 The Board received the Quarter 1 report for 2016/17 from Mike Allen and James Wilday of the LPFA to bring them up to date on delivery of the pensions fund administration services in terms of statistics and key performance indicators; projects and key activities; also LGPS regulatory changes, including potential scheme changes.

Statistics and Key Performance Indicators

9.2 The Board were referred to the report for the details of the statistics and key performance indicators. Members noted that in the quarter the LPFA Pensions Administrator had completed processing of 14,871 pension cases and received one service complaint. There were no Administering Authority complaints. The LPFA had supported the Administering Authority with the one IDRP, which related to a historical case as a result of data cleanse of the records using the data matching service, ATMOS; £500 compensation had been paid to the member. Penalties had been incurred for two instances of late payments of contributions by employers (out of approx.1000 payments due); monitoring of such occurrences was ongoing and penalties applied where necessary.

Projects and Key Activities

9.3 Members were advised of the successful completion of the project to produce and dispatch the Annual Benefits Statements on time by 31 August 2016.

Tell Us Once / National Insurance Number Database

9.4 The Board noted that the County Council's LGPS now engaged in monthly sharing of National Insurance Number data with other LGPS pension funds in England, Wales and Scotland:

- to be aware of other such benefits payable where a member may have accrued benefits in more than one fund and thus comply with legal requirements of the LGPS's governing regulation on payment of maximum death benefit;
- to enable HCC to benefit from the Department of Work and Pensions (DWP) 'Tell Us Once' scheme and thus become aware at an earlier stage of any LGPS member's death and thus reduce potential pension overpayments .

Employer Covenant:

9.5 Members heard that Risk identified from the September/October 2016 annual employer surveys would be added and reported to the Country Council Pensions team for further action, also that any risk identified would be added to the risk monitoring register.

GMP Reconciliation

9.6 The LPFA reported that the contracted out status of the County

Council's LGPS had ended in April 2016. To ensure that liabilities were recorded correctly (i.e. to find out what pension rights scheme members had and where) the project to reconcile the GMP data against that held by HMRC had begun. From January 2019 HMRC would no longer provide relevant information to Schemes, in addition statements would be issued to individuals based on the final position recorded at the end of 2018.

9.7 To a question on the time buffer between the project plan and deadline, Members were advised that issues were being dealt with case by case, the project was time limited to the end of 2018 and cases not cleared by then would lead to further issues.

9.8 The Board heard that the effect of the GMP project to date was a reduction to the overall pension payroll of £8,048.00 per annum, that the total overpayment so far had been £38,365.00 and, in response to related question that the annual contingent GMP liability was currently estimated at £806k and would need to be monitored. C.Cook

9.9 James Wilday of LPFA was pleased to report that the project was quite far advanced and the main body of remaining work lay with orphan records, i.e. the 1,762 remaining member records on HMRC's output which were still not matched to the LPFA membership database, also that Hertfordshire were ahead of the other funds on this issue. In response to a question the Board heard that the tolerance between the Council Council's records and HMRC's was £2 for overpayment or underpayment corrections to pensions.

9.10 The Board praised the layout of the online scheme information and statement and queried whether the hard copy pension updates could be displayed in a similar way. In response they heard that there was a proposal to deliver statements as far as possible online in the future.

9.11 Officers clarified that although LPFA had now subcontracted the Local Pension Partnership (LPP) to undertake the administration as part of its restructure, the LPFA were still responsible for the contract, also that the same people in the same place were doing the work and this was undertaken with the agreement of the Administering Authority.

9.12 To positive feedback in relation to the Annual Benefit, officers agreed to bring back information on any proposed changes to the Pension Board in future years. C Cook

<u>LGPS Regulations and Scheme Changes</u>

9.13 A member expressed concern for the impact that the, yet to be released, amended government actuarial department factors for late retirements would have for employees on more modest salaries.

9.14 Responding to a request for a rolling programme to review all communications with LGPS Pension Board members in order to look at changes to potential documents, officers clarified that a key outcome of the meeting was to review the communications strategy. A member also suggested that the communication issue could be addressed as part of a report. To a question from the chairman, all members of the Board present, excepting Kim Harding, confirmed that they received the monthly emails from the LPFA in regard of communications that went to employers. Officers agreed to consult with Kim Harding outside of the meeting. C.Cook

Conclusions:

9.15 The Board noted the contents of the report and commented as above.

10. **PENSION FUND ASSET POOLING – ACCESS UPDATE**

[Officer Contact: Jolyon Adam, Finance Manager
(Telephone: 01992 555078)]

10.1 The Pension Board received an update on the reports presented to the Pensions Committee at the 9 September 2016 meeting and the outcomes of any decisions taken at that meeting.

10.2 Members heard that the proposal for the pooling of assets by ACCESS had been submitted by 15 July 2016; also that the County Council would not commit to actions that would incur significant expense until they had received permission from the government.

10.3 The Board welcomed the decision of the September meeting of the Pensions Committee to endorse the ACCESS chairmen's' recommendation to rent an investment company (operator) from a third party, with the flexibility to move to an owned model if there was case for doing so in the future. To questions officers clarified that the interests of pensioners needed to be balanced against government requirements of investment in infrastructure funds; information on fund managers and asset pools had been shared through interim work with DCLG on the decision making process and governance; Pension Fund strategy would remain the accountability of the Administering Funds. Members welcomed the lower costs of a rental solution and the opportunity to build an operator at a later stage.

Conclusions:

10.4 The Board noted the content of the report and commented on the decision process followed by the Pension Committee.

11. DATES OF FUTURE MEETINGS

11.1 6 December 2017 at 10 am
14 March 2017 at 10am
3 July 2017 at 10am

11.2 The Chairman moved to close the Part I agenda.

12. OTHER PART I BUSINESS

12.1 There was no other PART I business.

EXCLUSION OF PRESS AND PUBLIC

That under Section 100(A)(4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following item/s of business on the grounds that it/they involve/s the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of said Act and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

PART II ('CLOSED') AGENDA

1. MINUTES

1.1 The Minute of this item of business is set out in the separate Part II Minutes.

2. PENSION FUND – FUNDING AND INVESTMENT REPORT (Formerly PERFORMANCE REPORT) AS AT 30 JUNE 2016

2.1 The Minute of this item of business is set out in the separate Part II Minutes.

3. RECAP OF INVESTMENT STRATEGY

3.1 This was a training session by N Sykes of Mercer and hence was not minuted.

KATHRYN PETTITT
CHIEF LEGAL OFFICER **CHAIRMAN**______________________

HERTFORDSHIRE COUNTY COUNCIL

PENSIONS BOARD (LGPS)

TUESDAY, 6 DECEMBER 2016 AT 10:00AM

Agenda Item No:
2

PENSIONS BOARD ANNUAL REPORT UPDATE

Report of the Director of Resources

Author: Jolyon Adam, Finance Manager (Tel: 01992 555078)

1 Purpose of the Report

1.1 The purpose of this report is to provide details of the requirement for Annual Reports from Pensions Board (LGPS) and the way in which it is proposed that this requirement is discharged.

2 Background

2.1 Local Pension Boards were required to have been established by all LGPS Funds by 1 April 2015, and to support the establishment of these Boards the Scheme Advisory Board (SAB) developed guidance on the operation of these boards for Administering Authorities.

2.2 The SAB guidance[1] offers best practice examples of the reporting it would expect to be provided by Boards, including that which they suggest could form the basis of an Annual Report on the activity of the Board[2].

2.3 We have reviewed this guidance to outline the basis of an annual report which will be presented in draft to the February meeting of the Pensions Board.

2.4 It was agreed by Pensions Committee that the operation of the new arrangements for Pensions Boards would be reviewed after the first year of existence. A second report is proposed which reviews the wider implementation of the Pensions Board, one-year-on, and also reflects upon other Authorities experiences, approaches, and best practice. This is proposed to be addressed in a separate one-off report detailed below.

3 Summary

3.1 There are two proposed reports reviewing the activity and operation of the Hertfordshire, and wider, Pensions Boards. Both of these reports will take a different focus.

[1] http://www.lgpsregs.org/index.php/guides/adv-board-guidance
[2] Section 8.6, Local Pension Board Guidance.

3.2 Annual Report of the Pensions Board (LGPS):

This will be a recurring annual report, and its purpose is to provide an update on the year's activity to the stakeholders whom the Pensions Board (LGPS) represents; the primary audience being employers and scheme members in the fund. The report will aim to cover the following areas:

a. A review of membership and the constitution of the board, including changes in membership and evidencing that best practice has been observed.
b. Activity of the Board for the previous year, including a review of the meetings which have been held, key topics which have been discussed and decisions or recommendations which have been made.
c. Forward Plan for the Pension Board, including meeting dates and key topics which will be presented in the coming year. An element of this plan will be subject to change, however there will be a number of items dictated by the annual timetable which will be known in advance.
d. Training Plan for the Pensions Board.

A draft report will be produced by Officers, for review and sign off by members of the Pensions Board, which will then be publicly available on the County Council's website and the Pensions Board area of the Scheme's website.

3.3 Review of the Operation of the Pensions Board – One Year On:

This will be a one-off report, which seeks to feedback to the Pensions Committee on the wider operation of the Pensions Board, following its first year of operation. It will be produced jointly between the Chairman of the Pensions Board and Officers, and draw upon both local and national experiences, issues and best practice which other LGPS Pension Boards have encountered. The aim of this report will be to review and discuss what has gone well, what could be improved, and what may need to be considered as the Pensions Board moves into its second year of operation.

4 Recommendations

4.1 The Pensions Board is invited to note and comment on the proposed content of the two reports, and make suggestions as to additional areas they would consider appropriate.

HERTFORDSHIRE COUNTY COUNCIL

PENSION BOARD (LGPS)

TUESDAY, 6 DECEMBER 2016 AT 10:00AM

Agenda Item No:
3

PENSION FUND GOVERNANCE AND RISK MANAGEMENT REPORT

Report of the Director of Resources

Author of the report: Jolyon Adam, Finance Manager (Tel: 01992 555078)

1. Purpose of the Report

1.1 To provide a quarterly report on governance and risk management of the Pension Fund covering the period July to September 2016.

2. Summary

2.1 This report is set out in four parts:

i. Part 1 provides a report on governance and risk management of the Pension Fund;

ii. Part 2 provides the Administering Authority Report on Performance Indicators for the Administration Strategy;

iii. Part 3 reports on specific Scheme Employer matters; and

iv. Part 4 provides details of any reports that were presented to the previous meeting of the Pensions Committee that are not on the Pension Board agenda. It also provides details of the Pensions Committee's response to any feedback or comments from the Pension Board.

2.2 A separate quarterly report is provided by the London Pensions Fund Authority (LPFA) commenting on the performance of the contracted pension's administration service.

3. Recommendations

3.1 The Pensions Board is invited to comment on and note the content of this report.

PART 1: GOVERNANCE AND RISK MANAGEMENT

4.1 Risk Register

The Risk Register sets out risk control mechanisms that aim to either avoid or reduce the probability and/or impact of any risk event in relation to the Pension Fund.

The quarterly Risk Register monitoring report provided in Appendix A details any activity or event during the quarter that impact on the risk areas. The risk areas and key events and activities are shaded grey on the report at Appendix A and are summarised below:

i. ACCESS investment pooling developments
ii. Proposals for reviewing and producing a revised Investment Strategy for the Fund.
iii. 2016 Triennial Valuation including the initial whole fund results.
iv. Validation checks on membership data
v. Risk based approach for setting funding targets and contribution strategies for the 2016 Valuation.
vi. Procurement exercises for specialist Legal Services under the LGPS National Framework for the ACCESS pool.

4.2 **Employer risk monitoring**

A separate risk monitoring exercise is carried out on a monthly basis to measure the trend and current status of risk associated with scheme employers where their covenant may have a detrimental impact on the Pension Fund.

Further detail on the risk criteria being measured is provided in Appendix B.

Current Status

Scheme employers are rated as:

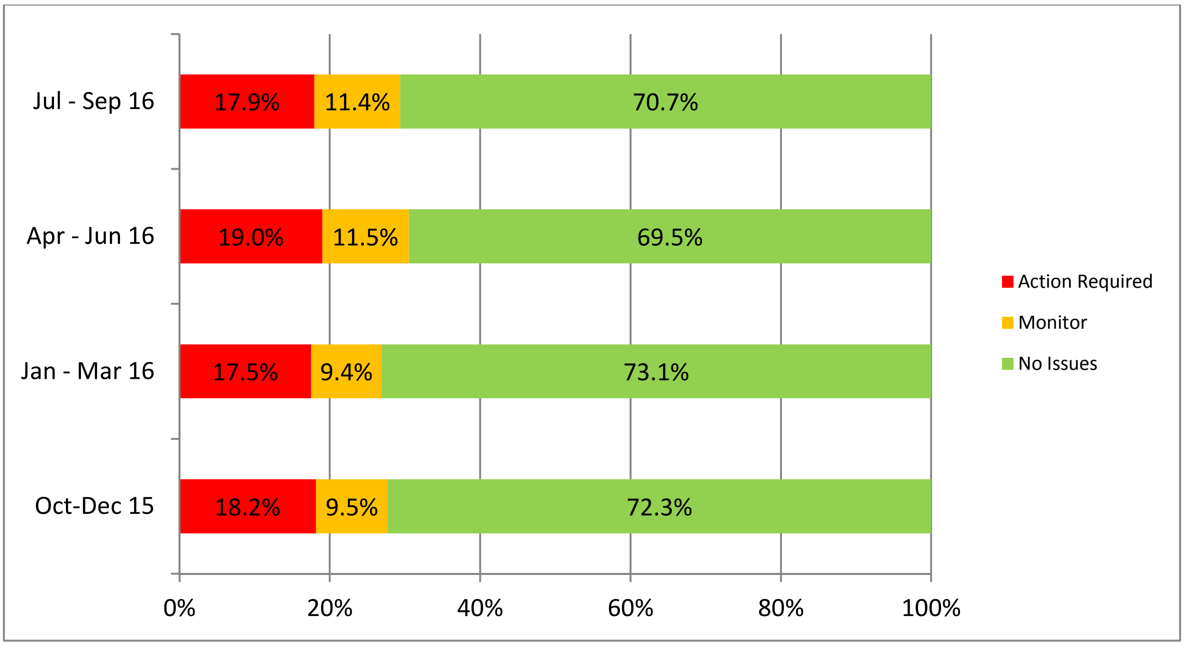
- RED - high risk: This indicates that action is required to mitigate the risks to the Pension Fund where there is a high risk of a scheme employer defaulting on its obligations to the Pension Fund.

- AMBER - medium risk: This indicates that scheme employers require review or ongoing monitoring to determine whether any actions need to be taken to mitigate the risks identified.

- GREEN - low risk: This indicates that there are no immediate issues or actions to be taken.

Table 1 provides a summary of the current position, with comparative data for the previous quarters.

Table 1: Employer Risk Monitor – Current Trend and Status



At 30 September 2016, there was an increase of three scheme employers monitored from 348 at 30 June 2016 to 351 at 30 September 2016. This increase is the result of scheme employers seeking admission to the Pension Fund following the outsourcing of cleaning, catering and IT services contracts from various schools and academies.

Table 2 provides an analysis of the number of scheme employers in each risk category together with the value of net liabilities for each risk category. This analysis is currently based on the results of the 2013 Valuation. The funding levels of scheme employers against the Fund as a whole will be updated when the individual employer results of the 2016 valuation are available towards the end of the 2016.

Table 2: Analysis of Scheme Employers by Risk Category

April – June 2016				Risk Category	July – September 2016			
Scheme Employers		Net Liabilities			Scheme Employers		Net Liabilities	
No.	%	£ m	%		No.	%	£ m	%
66	19.0	14.5	2.4	**Red**	63	17.9	14.4	2.3
40	11.5	87.1	14.1	**Amber**	40	11.4	87.1	14.1
242	69.5	515.4	83.5	**Green**	248	70.7	515.5	83.6
348	**100.0**	**617.0**	**100.0**	**Total**	**351**	**100.0**	**617.0**	**100.0**

Red Risk Category
Since the last quarter, the employers monitored in the red risk category have decreased from 66 as at 30 June 2016 to 63 as at 30 September 2016. The net movement compromised of:

+ 3 New scheme employers whose admission to the Pension Fund is in progress following the TUPE of staff from scheme employers.

- 5 Scheme employers whose admission to the Pension Fund has been completed, as outlined in Part 3 of this report.
- 1 Scheme employer who has ceased following payment of outstanding pension liabilities, as outlined in Part 3 of this report.

\- 3

Net liabilities for the red risk category are £14.4m representing 2.3% of total net liabilities.

Of the 63 scheme employers in the red risk category at 30 September 2016, 31 related to new scheme employers whose admission agreements were in progress following the TUPE transfer of staff from existing scheme employers. The table below shows the age profile of these admission agreements relative to the start date of each service contract.

Time period since transfer	**April – June 2016**	**July – Sept 2016**
	No.	**No.**
0-6 months	6	7
6-12 months	14	14
Over a year	13	10
Total	**33**	**31**

The Pensions Team is working closely with the County Council's legal team to clear the backlog of outstanding admission agreements. Following the recent appointment in August 2016 of specialist legal services under the LGPS framework from Squires Patton Boggs, it is anticipated that the number of historic cases will be addressed utilising this resource. The number of outstanding admission agreements has reduced since the last quarter, which has decreased the number of employers in the 'Red' category.

Amber Risk Category
These scheme employers have been identified as requiring review to determine whether any actions need to be taken to mitigate the risks identified. Over the quarter, the overall number of employers in this category has remained at 40. The net movement compromised of

- 1 Scheme employers whose contract was due to end but the contract was extended for a further 2 years.
+ 1 Scheme employers who no longer have any active members where a cessation valuation may need to be undertaken.

0

Net liabilities in the amber risk category are £87.1m representing 14.1% of total net liabilities.

Green Risk Category
The overall number of scheme employers in the green risk category has increased from 242 as at the 30 June 2016 to 248 as at 30 September 2016, reflecting the movement of scheme employers to the lower risk category as a result of admission agreements being completed and employers ceasing and settling any outstanding deficit as outlined in the sections above.
Net liabilities for the green risk category are £515.5m representing 83.6% of total net liabilities.

PART 2: ADMINISTERING AUTHORITY REPORT

5. Administering Authority Report on Administration Strategy Performance Indicators

5.1 The performance of the Administering Authority and scheme employers in managing and administering the Pension Fund is measured against performance indicators set out in the Administration Strategy.

5.2 Appendix C provides a summary of the performance indicators and performance against the following:

- the Administering Authority
- Scheme Employers; and
- The contracted pensions administration service provided by the LPFA.

Details of events and activities impacting on the performance indicators are also provided in Appendix C with commentary on progress to mitigate any issues.

PART 3: SPECIFIC SCHEME EMPLOYER MATTERS

6. Specific scheme employers

6.1 **New employers**
Five Admission Agreements have been concluded this quarter in relation to the TUPE transfer of staff under service contracts for the following scheme employers:

a. North Herts District Council outsourced the provision of leisure services for two areas to Stevenage Leisure Ltd. Under the LGPS regulations, a separate admission agreement is required for each service contract.
b. Bishop Hatfield Girls' School outsourced the provision of ICT services from RM education.
c. St Mary's outsourced the provision of children centre services to Allsorts.
d. Hertfordshire County Council outsourced the provision of children centre services to Hertsmere Leisure for the Sopwell & Verulam children centre.

The Admission Agreements set out surety arrangements to secure the Pension Fund from any pension's liabilities that are not met by the contractor. In the event the surety is not sufficient to cover all liabilities then these fall back to the ceding employer according to LGPS regulations.

6.2 **Terminating employers**

During the quarter, Gosling Sports Park left the Fund. In accordance with the Pension Fund's Funding Strategy Statement and Cessation Policy, a valuation was carried out and additional contributions made to ensure assets were sufficient to cover the cost of future benefits in respect of Gosling Sports Park former employees.

PART 4: PENSIONS COMMITTEE

7.1 There were no actions arising from the September 2016 meeting of the Pension Board which required a response from the Pensions Committee.

The Risk Register provides an update on the current risk score compared to the initial risk assessment carried out in April 2014. Risks were scored and then classified in accordance with the Council's Risk Management criteria set out in the following table.

Risk Level	Risk Score Range	Description
Severe	32 - 80	The consequences will have a severe impact on the delivery of a key priority and comprehensive management action is required immediately.
Significant	12 - 24	The consequences of the risk materialising would be significant, but not severe. Some immediate action is required plus the development of an action plan.
Material	5 - 10	Consequences of the risk are not significant and can be managed through contingency plans. Action plans can be developed later to address the risk.
Manageable	1 - 4	Consequences of the risk are considered relatively unimportant. The status of the risk should be reviewed periodically.

This report provides commentary about events that have occurred in the key risk areas with detail provided against the individual control mechanisms. The status column in the table below shows the movement in the overall risk rating in the quarter, according to the key below.

▲	An increase in risk score since last report
◀▶	Risk score has remained unchanged since last report
▼	A decrease in risk score since last report

Risk		Current Risk Rating				Target Score	Status	Quarterly Activity Summary
		2015 Q3	2015 Q4	2016 Q1	2016 Q2			
A	The Pension Fund Investment Strategy does not deliver the long term projected investments returns and does not comply with legislation.	**16**	**16**	**16**	**16**	**16**	◀▶	Government confirmation of ACCESS pooling submission is still awaited. Separate reports on the current activity around ACCESS pooling and proposals for reviewing and producing a revised Investment Strategy Statement is being presented to this meeting (see risk control A1).
B	The funding level of the Pension Fund deteriorates.	**16**	**16**	**16**	**16**	**16**	◀▶	Initial whole fund results are presented to the Committee as a separate item on this agenda. Individual results will be circulated to employers in late November/early December (see risk control B2). All Parish & Town Councils have now responded to the consultation that closed in May 2016 with the final outstanding council choosing to remain in the pool (see risk control B8).
C	Scheme employers default on meeting their obligations to the Pension Fund and LGPS.	**16**	**16**	**16**	**16**	**8**	◀▶	Validation checks on membership data have been carried out as part of the 2015/16 Annual Benefit Statement exercise and 2016 Valuation (see risk control C1). A risk based approach has been adopted for the 2016 valuation which will be used to set the funding targets for each scheme employer given a minimum level of probability (see risk control C4)
D	The Pension Fund and its third party providers do not comply with regulations, statute or procedure.	**4**	**4**	**4**	**4**	**4**	◀▶	Hertfordshire is acting as lead administering authority for the procurement of legal advice for the ACCESS pool (see risk control D6)
	TOTALS	**52**	**52**	**52**	**52**	**44**		

The following table provides a detailed list of the control mechanism and their status. Commentary is also provided about any risk events that have occurred in the last quarter and progress to implement those controls that are under development.

Risk Control Mechanisms		Control Status	Update
A.	**The Pension Fund Investment Strategy does not deliver the long term projected investments returns and does not comply with legislation**		
A.1	Ensure the strategy complies with the Local Government Pension Scheme regulations, Statement of Investment Principles and Investment Management Agreements.	Implemented	An update on the Asset Pooling is provided in a separate report to the Pensions Committee and Board meeting. The ACCESS pool, as well as all other pools, are awaiting the government decision about whether or not to proceed. The Minister for Local Government has requested to meet with ACCESS representatives in November to discuss the submission. A separate paper on Investment Strategy is being presented to this meeting of the Pensions Board which will outline the proposal for reviewing and producing a revised Strategy which will take effect from April 2017.
A.2	Diversify investment across asset classes and markets to reduce the impact of financial market volatility including setting a limit on the proportion of Fund's assets held in illiquid asset classes such as private equity and property.	Implemented	No issues to report
A.3	Monitor and provide a quarterly report to the Pensions Committee on Investment Manager's performance against benchmark.	Implemented	Performance reports are provided as a separate agenda item to quarterly Pensions Committee and Board meetings.
A.4	Monitor Investment Managers compliance with the investment restrictions and limits laid out in the Pension Fund's Statement of Investment Principles and Investment Management Agreements and report any cases of non-compliance	Implemented	No issues to report
A.5	Set the Investment Strategy in light of the risk and return objectives of the Pension Fund and review at regular intervals to ensure the Strategy is still appropriate.	Implemented	The Fund’s appetite for risk will be reviewed against its investment objectives as part of the current investment strategy review and will set an appropriate risk budget.

	Risk Control Mechanisms	Control Status	Update
B.	**The funding level of the Pension Fund deteriorates**		
B.1	Set investment out-performance targets at the triennial valuation with reference to the Pension Fund's current investment strategy and on a relatively prudent basis to reduce the risk of under-performing against anticipated returns. At the same time, review and agree the other actuarial assumptions such as salary increases, discount rates, longevity etc.	Implemented	No issues to report
B.2	Provide the Pensions Committee with quarterly actuarial reports that monitor the funding position of the Pension Fund and the sensitivity of this to changes in general market conditions.	Implemented	Initial whole fund results for the 2016 Valuation are now available and are presented to the Board as a separate item on this agenda. Individual results will be circulated to employers in late November/early December Certificate submitted to the Scheme Advisory Board confirming the Pension Fund's funding level as at 31 March 2016 on SAB's standardised assumptions of 107%.
B.3	Undertake annual data validation checks to identify any discrepancies or errors in the data with our third party administrator.	Implemented	Validation checks on membership data carried out as part of the 2015/16 Annual Benefit Statement exercise and 2016 Valuation.
B.4	Monitor and ensure scheme employers pay the extra capital/strain cost of non ill-health retirements following each individual decision and in the year the decision is made.	Implemented	No issues to report
B.5	Monitor each scheme employer's ill-health experience on an ongoing basis against the "ill health budget" set for each scheme employer at the triennial valuation and require them to make additional contributions to the Fund where budgets are exceeded.	Implemented	Scheme employers' ill health experience will be reviewed as part of the 2016 Valuation and reflected in scheme employers' individual funding positions and employer contribution rate.
B.6	Monitor cash flows at a whole fund level and individual scheme employer level and certify cash deficit contributions for those with reducing payrolls as identified at the triennial valuation.	Implemented	No issues to report

	Risk Control Mechanisms	Control Status	Update
B.	**The funding level of the Pension Fund deteriorates**		
B.7	At each triennial valuation, assign any liabilities relating to ceased transferee admission bodies to the original ceding scheme employer.	Implemented	The ceding scheme employer for any transferee admission bodies that have ceased since the last valuation have been identified as part of the 2016 Valuation. The liabilities of these ceased employers with the pooled with the ceding employer for the purpose of setting employer contributions rates.
B.8	Monitor the 'characteristics' and individual funding position of pool members to ensure pooling is still appropriate. Require members of the Schools or Parish and Town Council pool to sign a pooling agreement which sets certain conditions and requirements for scheme employers' participation in the pool.	Implemented	All Parish & Town Councils have now responded to the consultation that closed in May 2016 with the final outstanding council choosing to remain in the pool. Pool will remain active for the following valuation period and will be reviewed at the 2019 Triennial Valuation.
B.9	Monitor the covenant of scheme employers and review their ability to meet ongoing liabilities.	Implemented	Employer Risk Monitoring framework implemented and quarterly reports provided to the Pensions Committee and Board. Risk based approach adopted for the 2016 Valuation with scheme employers categorised as low, medium or high risk. Ratings will be used to set the funding target for each scheme employer given a minimum level of probability.
B.10	Set deficit recovery plans after taking into account the particular characteristics of each type of scheme employer and the future working lifetime of its employees. Use shorter deficit recovery periods for organisations with a limited "life" in the Pension Fund or without statutory tax raising powers.	Implemented	The maximum time horizons for recovering deficits have been reviewed as part of the 2016 Valuation and are set out in the draft Funding Strategy Statement which is provided as a separate report to the Board.
C.	**Scheme employers default on meeting their obligations to the Pension Fund and LGPS**		
C.1	Develop further data quality controls with the Pension Fund's third party pension's administration service to monitor membership data submitted by scheme employers to ensure it is accurate and up to date.	Implemented	Validation checks on membership data carried out as part of the 2015/16 Annual Benefit Statement exercise and 2016 Valuation.

Risk Control Mechanisms		Control Status	Update
C. Scheme employers default on meeting their obligations to the Pension Fund and LGPS			
C.2	Develop a risk evaluation approach to identify covenant risk, categorising scheme employers as low, medium or high. Establish a set of risk criteria and monitor scheme employers against this. Engage with scheme employers at an early stage to address funding issues.	Implemented	Employer Risk Monitoring framework implemented and quarterly reports provided to the Pensions Committee and Board.
C.3	Monitor contributions to ensure that scheme employers are paying the correct employer contribution rate.	Implemented	No issues to report
C.4	Do not allow unsupported employers to be admitted to the Pension Fund. Require all community admission bodies and transferee admission bodies to obtain a bond or guarantor from the Scheme employer. Revalue bonds every three years to ensure the risk cover is still appropriate.	Implemented	Risk based approach adopted for the 2016 Valuation with scheme employers categorised as low, medium or high risk. Ratings will be used to set the funding target for each scheme employer given a minimum level of probability. Unsupported scheme employers allocated a higher risk rating therefore giving rise to higher required contributions.
C.5	Carry out regular financial checks on participating employers, especially non-tax raising bodies.	Implemented	Employer Risk Monitoring framework implemented and quarterly reports provided to the Pensions Committee and Board.
C.6	Carry out an annual employer survey to identify any changes in funding stream for scheme employers.	Implemented	No issues to report
C.7	Pool the contributions for scheme employers with similar characteristics to allow sharing of risk amongst scheme employers	Implemented	Implemented for the Schools Pool and Parish and Town Council Pool during the 2016 Valuation.
C.8	Carry out cessation valuations on a more prudent gilts basis to ensure the payment calculated when a scheme employer's liabilities are crystallised is sufficient to meet the future payment of benefits made by the Pension Fund.	Implemented	No issues to report
D. The Pension Fund and its third party providers do not comply with regulations, statute or procedure			
D.1	Review the Custodians and Investment Managers internal control report to identify any concerns over controls and processes in place.	Implemented	No issues to report.

Risk Control Mechanisms		Control Status	Update
D. The Pension Fund and its third party providers do not comply with regulations, statute or procedure			
D.2	Ensure the Custodian undertakes monthly reconciliations with the Pension Fund's Investment Managers to ensure all assets are correctly accounted for and holdings agree.	Implemented	No issues to report
D.3	Allow only authorised personal, as set out on the authorised signatory list, to authorise payments to and out of the Fund.	Implemented	No issues to report
D.4	Require all large scheme employers in the Pension Fund to provide an Annual Assurance Certification that payroll systems are compliant and have been tested by the scheme employers' internal auditors	Implemented	No issues to report.
D.5	Engage internal and external audit reports to regularly test that appropriate controls are in place over the payment of benefits and expenses and collection of contributions and that they are working.	Implemented	No issues to report.
D.6	Work in conjunction with the Strategic Procurement Group to ensure all procurements are carried out in accordance with HCC contract and EU regulations.	Implemented	A procurement exercise has been completed for legal services using the LGPS National Framework. The contract for legal services using the LGPS National Framework has been awarded to Squires Patton Boggs and work has started to be commissioned through them. Hertfordshire acting as lead administering authority for the procurement of legal advice for the ACCESS pool. Tender documentation is in the process of being drafted in conjunction with Hymans Robertson and the Strategic Procurement Group to secure a resource for the pool which will support with the legal considerations involved with planning and procurement of the operator of the Collective Investment Vehicle (CIV).
D.7	Review the Pension Fund SORP and Code of Practice in preparing the Statement of Accounts to ensure compliance and engage external audit to review the Pension Fund accounts each year.	Implemented	No issues to report

Risk Control Mechanisms		Control Status	Update
D. The Pension Fund and its third party providers do not comply with regulations, statute or procedure			
D.8	Manage performance of the Pension Fund's third party administration service through a service level agreement and monitor against Key Performance Indicators.	Implemented	LPFA Performance provided as separate agenda item to quarterly Pensions Board meetings
D.9	Work closely with the Pension Fund's third party administration service to ensure it complies with current regulations and is alert to and can implement any changes to scheme benefits.	Implemented	No issues to report
D.10	Ensure the Pension Fund's third party administration service has a robust programme in place to test controls on the membership benefit system and that they are fully compliant and up to date.	Implemented	No issues to report

APPENDIX B SCHEME EMPLOYER RISK MONITORING

Table 3 provides details about all of the risk criteria being monitored and the total number of scheme employers that fall into each criteria. These risk criteria have been allocated a risk level of red or amber, depending on their potential impact and whether immediate action is required.

Scheme employers are assessed and allocated a score against each risk criteria. Their total score is then used to determine an overall classification of red (high risk), amber (medium risk) or green (low risk).

Scheme employers will therefore be classified as high risk either by falling into at least one of the red risk criteria outlined below, or by having three or more risk criteria at the amber level which overall raises concern over the scheme employer's ability to meet their obligations to the Pension Fund in the future.

Table 3: Summary of Risk Criteria Monitored

Risk Criteria	Risk Level	Description
No admission agreement in place	Red	This relates to the admission of scheme employers to the Pension Fund where a legal process is carried out to agree and execute Admission Agreements. The Admission Agreement is a contract between the scheme employer, ceding scheme employer and Administering Authority; It defines the scheme employers' legal responsibilities and financial liabilities in the Pension Fund, the surety arrangements in place and the staff who are eligible to be in the Pension Fund. At 30 September 2016, 31 admission agreements were in progress.
No bond or guarantor	Red	At 30 September, 31 admitted bodies were identified as having no form of indemnity. Of these, four related to scheme employers who are required to have a bond under the terms of their admission agreement but whose bonds have expired. The bond values for these scheme employers have been re-assessed by the Actuary and the bond agreements are in progress with legal services. 28 of these related to long standing scheme employers who were not required to obtain a bond or guarantor when they were admitted to the Pension Fund many years ago. Under the LGPS regulations, the liabilities associated with these scheme employers would fall back to the Pension Fund if they were unable to meet their financial liabilities to the Pension Fund. Surety arrangements for these historical scheme employers are under review and will be further considered as part of the 2016 Valuation exercise to ensure that an appropriate contribution strategy is agreed.

Risk Criteria	Risk Level	Description
Deficit recovery	Red	This relates to 11 scheme employers who have no active contributing members in the Scheme where work is in progress to agree lump sum payments in lieu of contributions or cessation repayment plans or scheme employers where repayment plans have been agreed but which are outside of the standard deficit recovery periods set out in the Pension Fund's Funding Strategy Statement. These plans have been negotiated with scheme employers in the interests of affordability but where there is an increased risk that the Pension Fund will not recover all outstanding liabilities from the scheme employer.
Non-payment of contributions or lump sum deficit repayments	Red	Scheme employers are monitored for non-payment of contributions and deficit lump sums. Where cases are identified, action will be taken in accordance with the Pension Fund's Administration Strategy and where significant reported to the Pensions Regulator in accordance with the Pensions Fund's policy on reporting breaches of the law. At 30 September, there were no issues to report.
Funding Level	Amber	21 scheme employers had a funding level of less than 82% as at the 2013 Valuation with net pension liabilities of £66.2m. This is the funding level of the overall fund and the basis on which the Pension Fund's risk and return objectives and investment strategy is set. The same Investment Strategy is applied to all scheme employers. Where a scheme employer has a different liability profile and lower funding level than that of the overall Pension Fund, there is a risk that the investment strategy may not deliver and achieve the funding objectives for that individual employer. A further 78 scheme employers had funding levels of less than 82%. However, these are considered to be long term secure employers who are required under the regulations to provide access to the LGPS for their employees, for example the County Council and Academies. These employers have been assessed as having a strong employer covenant and therefore their overall risk score has been adjusted to reflect this and consequently this group has moved to a green rating. This analysis is currently based on the results of the 2013 Valuation. The funding levels of scheme employers against the Fund as a whole will be updated when the individual employer results of the 2016 valuation are available towards the end of the 2016.

Risk Criteria	Risk Level	Description
Contract or bond end Dates/No active members	Amber	This relates to scheme employers who provide service contracts to scheduled bodies (normally Councils or Schools) where the service contract and/or bond is due to cease within nine months or scheme employers who no longer have any active members. Where necessary the Actuary will be instructed to undertake a cessation valuation or undertake a bond renewal to ensure appropriate indemnity arrangements are in place. At 30 September, there were twenty-three scheme employers that have been contacted to determine their future participation in the scheme. This group had a net surplus at the 2013 Valuation of £3.7m.
Payroll	Amber	Monitoring of changes in payroll may identify scheme employers at risk of worsening their funding level or increasing their pension's liabilities. At 30 September, 24 scheme employers were identified as having had a material change in payroll since the valuation date. Four of these scheme employers are under review to assess the impact that this may have on scheme employers funding levels and contribution strategies at the 2016 Valuation. The net liabilities of these four employers were £55.4m.
Ill health liabilities	Amber	At each valuation, scheme employers are allocated an annual ill health budget which is reflected in the contribution rate for that employer. Where the strain cost of scheme employers' ill health retirements exceed the budget, employers will be making insufficient contributions to cover the additional strain arising from these retirements. At September 2016, eight scheme employers had exceeded their cumulative ill health budget for financial years 2013/14 and 2014/15. Scheme employers ill health experience over the inter-valuation period will be reviewed as part of the 2016 Valuation and reflected in scheme employers individual funding positions and employer contribution rate. The Pension Funds policy for charging scheme employers who exceed their ill health budget will be discussed as part of the 2016 valuation to agree appropriate funding strategies.

APPENDIX C ADMINISTERING AUTHORITY REPORT ON ADMINISTRATION STRATEGY PERFORMANCE INDICATORS

1 Administering Authority Performance Indicators

The Administering Authority's performance is measured against compliance with statutory requirements placed on administering authorities for the administration of pension funds. This is measured by:

- Periodic internal audit reviews and the annual external audit carried out by Ernst and Young; and
- The number of complaints and internal disputes raised against the Administering Authority.

1.1 Audit Reviews

The Internal Audit of Pensions Administration as outlined in the 2016/17 Shared Internal Audit Service (SIAS) Audit Plan, will shortly commence.

1.2 Complaints and Internal Disputes

1.2.1 During the quarter there were two new LPFA service complaints, compared to one in the last quarter. Both of these complaints were resolved within the quarter.

1.2.2 One related to tax deductions on a significant pension payment. The individual's pension was due to go into payment 18 months previously, but the completed forms were only recently received. This resulted in 18 months of arrears being paid within the first payment, and a subsequent deduction of a large amount of tax. LPFA advised the member to contact HMRC to resolve this as they would not speak to LPFA regarding individual member's affairs.

1.2.3 The second complaint was regarding the transfer of a member's benefits from Enfield Borough Council. Despite repeated chasers, LB Enfield did not provide the required information on time due to recent changes in regulations and GAD factors. The information has now been received and the complaint closed.

1.2.4 During the quarter to 30 September 2016, two Internal Dispute Resolution Processes (IDRP's) were raised against the Administering Authority, and one carried forward IDRP was responded to.

1.2.5 Both new IDRP's related to members challenging the reduction of their pension following Guaranteed Minimum Pension (GMP) reconciliation.

1.2.6 The carried forward IDRP related to the implementation of a Pension Sharing Order (PSO) following divorce proceedings, and an overpayment of pension which had occurred between this order being put in place, and the changes to the member's pension record being effected by the LPFA. Overpayments commonly occur in cases where pension is already in payment - which have to be subsequently reclaimed - and the IDRP was dismissed as statutory timescales were met.

2 Scheme Employer Performance Indicators

Scheme employer performance is measured against compliance with performance targets for the administration of the LGPS which are set out in the Administration Strategy. This is measured by the number of:

- charges levied against scheme employers; and
- scheme employers who fail to made payment of contributions by the 19th day of each month.

2.1 **Penalty Charges**
There were 13 penalty charges raised for the period to 30 September 2016 against 12 scheme employers for late payment of contributions or late return of monthly contribution forms.

2.2 **Late Payments**
There were 14 incidents of late payment by scheme employers in the quarter to 30 September 2016. Details of these late payments are reported in the LPFA's quarterly Administration Report which is a separate item on this meeting's agenda.

3 LPFA Administration Service Performance Indicators

3.1 Performance of the LPFA's administration service is measured against compliance with performance targets set out in the Service Level Agreement for the service. This is monitored as part of the contract management arrangements and measured by two key indicators:

- the number of complaints raised against the LPFA; and
- the efficiency of the service against Service Level Agreement targets.

3.2 The LPFA's quarterly Administration Report provides detailed information about performance against service level targets and details of any complaints. The Report is presented as a separate item on this meeting's agenda. Key issues that are impacting on the service are:

- Officers are working with the LPFA to address the backlog of Deferred Benefit cases, and develop the action plan already in place to continue to reduce this backlog in light of the one-off increases arising from year-end processes.

- Recruitment is underway to replace leavers and a project plan is being maintained to clear the backlog of cases.

Agenda Item No:

4

LONDON PENSIONS FUND AUTHORITY
LOCAL GOVERNMENT PENSION FUND ADMINISTRATION REPORT

Author: Mike Allen – Director of Pensions (LPFA)

Purpose of the report

This report is provided by the London Pensions Fund Authority (LPFA) giving a quarterly update on the delivery of the pensions fund administration services in the following sections.

Section 1: Statistics and key performance indicators
Section 2: A progress report on projects and key activities
Section 3: An update on LGPS regulatory changes, including the latest news on the potential scheme changes

Recommendations

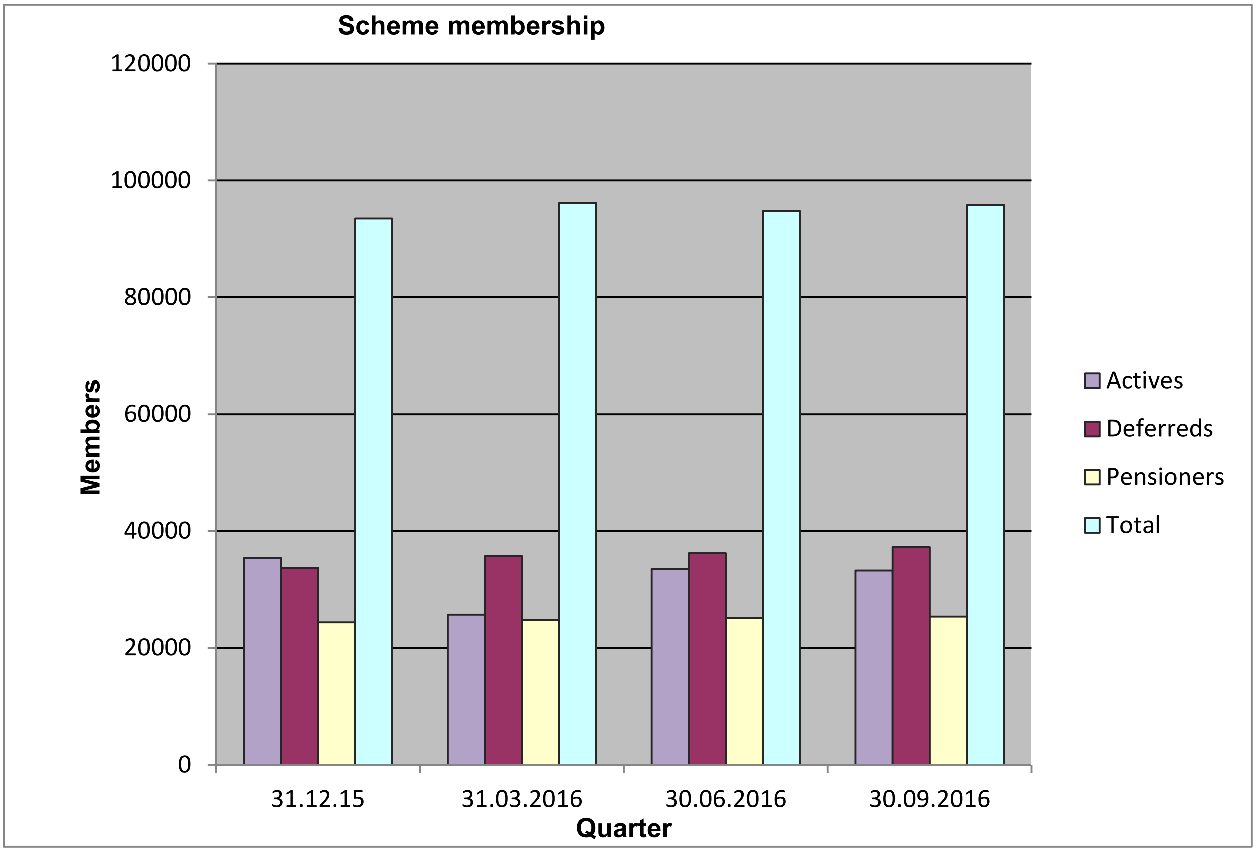
That the Board notes the contents of this report.

SECTION 1 STATISTICS AND KEY PERFORMANCE INDICATORS

1.1 Pensions Fund Statistics

Scheme Membership: The following graph provides an analysis of total membership to the Scheme which shows active membership has decreased by 299 members, pensioners have increased by 261 and deferred members have increased by 1,035 during Quarter 2 2016/17.

The changes in numbers of deferred members have resulted from processing year end returns for Scheme Employers where they did not notify LPFA during the year of leavers during the year. We are actively working with Scheme Employers to address the issue of timely notification of membership changes.



Scheme Employers: The total number of active scheme employers in the Pension Fund has increased by 8 during the last quarter. There are currently 261 active employers and a further 146 employers with deferred and pensioner liabilities.

1.2 Performance Indicators

Performance of the Pension Fund is measured in the following key areas:

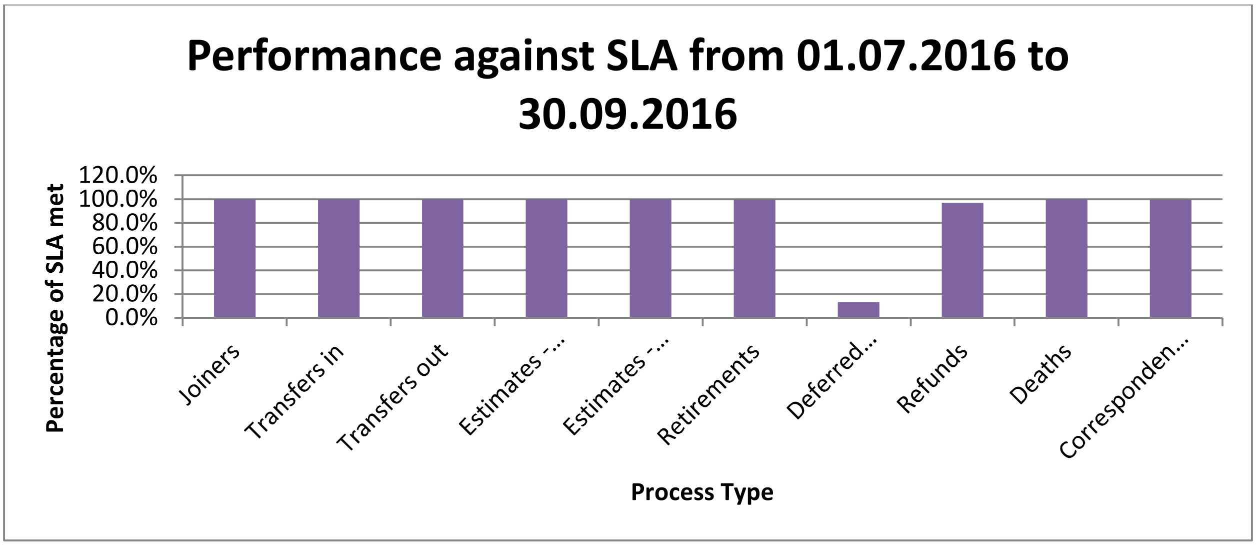
- The LPP Pensions Administration Services is measured against key performance indicators that measure compliance, efficiency and effectiveness of the service. See Section 1.3.
- Scheme Employers' performance is measured against requirements set out in the Administration Strategy. See Section 1.4; and
- The Pension Fund is measured against statutory requirements and the effectiveness of its management and governance of the Fund. Separate quarterly reports providing

commentary on key governance and risk management issues are provided to the Pensions Committee summarising performance in the Risk and Performance Report with a detailed report provided to the Pension Board in the Governance and Risk Management Report.

1.3 Performance for the LPFA Pensions Administration Service

Service Level Agreement and Volumes: The following graphs provide a quarterly review of key areas and performance achieved. Performance overall during the period was over 72%. Excluding the processing of Deferred Benefits cases which is impacted by the increased volumes of cases discussed in section 1.1, the on-time processing is in excess of 99%.

During the period 1 January 2016 to 30 September 2016, 6134 Deferred Benefit cases were received. This is over 50% increase from the same period in 2015. Currently, 1599 Deferred Benefit cases are in progress, of which 862 are outside of the 20 working day SLA and 737 have future due dates. 860 of the Deferred Benefits were received in 2016. There is one case from 2013 and one case from 2015 where more information was required from the employer and has recently been received. The backlog has been ring-fenced and will be worked on over the next three months during overtime to complete an additional 287 cases per month completing this project by 28 February 2017. This issue will continue to be discussed with officers at Hertfordshire County Council on an ongoing basis.



The overall level of cases completed in the previous four quarters is shown in the following table. The variation across the quarters reflects normal annual volume fluctuations across all case types except for deferreds, joiners and refunds where additional cases have been identified through year end processing discussed in section 1.1.

Key Processes Completed	01.10.2015 to 31.12.2015	01.01.2016 to 31.03.2016	01.04.2016 to 30.06.2016	01.07.2016 to 30.09.2016
Joiners	848	1125	786	581
Transfers in	197	304	482	513
Transfers out	196	259	195	175
Estimates - member	564	597	585	527
Estimates - employer	174	208	205	99
Retirements	814	876	809	991
Deferred benefits	1,456	1,510	1,759	2,665

Refunds	404	668	772	325
Deaths	205	355	261	222
Correspondence	1,325	1,377	9,017	1,729
Total Key Processes Completed	**6,183**	**7,279**	**14,871**	**7,827**

LPP Pensions Administration Service Complaints: The quality and effectiveness of the service is, in part, measured against the number of complaints received about the pension administration service. The following chart provides a summary of the status of complaints and those that are now being reviewed under the Internal Dispute Resolution Procedure (IDRP).

In the quarter 7,827 cases were completed and 2 complaints received.

Complaints and Internal Dispute Resolution Procedures	**Oct – Dec 2015**				**Jan–Mar 2016**				**Apr – June 2016**				**Jul – Sept 2016**			
	BBF Previous Quarter	New	Completed - Upheld	Completed - Not Upheld	BBF Previous Quarter	New	Completed - Upheld	Completed - Not Upheld	BBF Previous Quarter	New	Completed - Upheld	Completed - Not Upheld	BBF Previous Quarter	New	Completed - Upheld	Completed - Not Upheld
LPP Service Complaints	1	3	4	0	1	3	1	0	2	1	3	0	0	2	2	0
Administering Authority Complaints	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Administering Authority IDRPs	0	1	0	0	1	1	1	0	1	0	0	1	0	3	0	2
Total	1	4	4	0	1	1	1	0	3	0	0	0	0	3	2	0

LPFA Service Complaints:

- A complaint was received from a pensioner due to a large amount of tax being deducted on their first payment. Their pension was due to go into payment 18 months previously but the completed forms were not returned until recently. This resulted in 18 months of arrears being paid within their first payment which in turn meant a large amount of tax was deducted. LPFA wrote to the member explaining that HMC guidelines had been followed and advised the member contacted HMRC personally to resolve the issue as they will not speak to LPFA regarding individual member tax queries. This complaint is now closed.

- A complaint was received from a member regarding the transfer of benefits from Enfield Borough Council. Despite our regular chaser letters to Enfield they had not been timely in responding to us due to the recent changes in regulations and GAD factors. The information has now been received and the complaint has now been closed.

Administering Authority Complaints:

- None

Administering Authority IDRPs:

- A stage 1 appeal received during Q1 was responded to from a member contesting an overpayment of pension following the implementation of a pension sharing order. The appeal was dismissed by the Administering Authority, as statutory timescales for setting up the order were met, and reclaiming the overpayment was therefore justified.

- A stage 1 appeal has been received following the correction of GMP payment uncovered as part of the continuing GMP Project. The pensioner objected to the reduction in pension and requested that monies are reinstated. This appeal has not been upheld by Hertfordshire County Council.

- A stage 1 appeal has been received following the correction of GMP payment uncovered as part of the continuing GMP Project. The pensioner objected to the reduction in pension and requested that monies are reinstated. LPP are assisting Hertfordshire County Council with their response as required.

1.4 Scheme Employer Performance Indicators

The Administration Strategy sets out the quality and performance standards expected of the Pension Fund and its scheme employers. The Strategy also sets out the potential sanctions that will apply in the event of failure to comply.

Penalties for Late Payment of Contributions: There were 14 instances of late payments being made by employers during the period July 2016 to September 2016 out of approximately 1000 payments due, and details are provided in the attached table at Appendix 1. A summary of payment performance over the last 6 months is also included showing the total instances of late payments, together with cumulative totals for days late and amount payable for all relevant employers.

The team continues to take a proactive approach to monitoring late payers and officers at Hertfordshire County Council are provided with a monthly report of late payers so that penalties may be applied where applicable.

SECTION 2 PROJECTS AND KEY ACTIVITIES

1. Employer Covenant

The LPFA and Hertfordshire County Council Pension Team meet on a monthly basis to monitor the progress of Scheme Employer admissions and terminations. This includes a risk review of Scheme Employers and imminent changes that may affect their funding position or ongoing admission to the Pension Fund. Risk monitoring for Scheme Employers is in place via risk scoring, and seeks to provide a mechanism for early identification of issues. An update is provided to the Pensions Committee as part of the quarterly Risk and Governance Report.

The annual employer surveys will not be issued this year as HCC will be focussed on the 2016 valuation results. Any risks identified will continue to be added to the risk monitoring register.

2. GMP Reconciliation

In April 2016, contracting out status for all UK defined Benefit schemes will end. From January 2019, HMRC will no longer provide relevant information to Schemes and statements will be issued to individuals based on the final position recorded at the end of 2018. Before this happens all schemes will need to reconcile their GMP data against that held by HMRC to ensure that correct liabilities are recorded and to avoid pensions being over/under paid or being faced with the burden of paying a GMP for members who are no longer in their Scheme..

The project to address this work is now underway and appropriate resources have been put in place to ensure the project is delivered on time and to the agreed budget.

The current position of the HCC GMP reconciliation project is as follows:

- Payroll Revisions
  - A total of 639 pensioner records have been reviewed with 142 pension revisions having now been passed to payroll.
  - The overall impact of the pensions payroll of these revisions amounts to a reduction of £21,786 per annum.
  - The total overpayment amount calculated so far amounts to £134,717
  - These revisions have been split over the August to November payroll runs.

- Contracted-out Dates and GMP queries
  - All queries arising from the analysis relating to Contracted-out Dates or GMP amounts for the deferred and pensioner members have now been investigated and uploaded to HMRC

- “Multiple Record” Members
  - The manual reconciliation of the members with either multiple Altair records or multiple lines of data on HMRC’s output has now been completed.
  - Queries arising from this reconciliation have also been uploaded to HMRC.
  - Pensioner records that have been identified as requiring revision will form part of the next phase of the reconciliation project.

- Outstanding “Not in Scheme” Queries
    - The majority of HCC’s “Not in Scheme” queries have now been investigated and query listed have been uploaded to HMRC.
    - The majority of the records remaining are due to insufficient information being available to adequately prove to HMRC that the liability for the GMP does not reside with HCC.
    - The LPP will be attending a meeting held by the PLSA on 17th November where HMRC will be present to discuss the issues that Schemes are facing with the reconciliation process and we can hopefully agree on a way forward with the remaining records.

SECTION 3 LGPS REGULATIONS AND SCHEME CHANGES

1. Amended Government Actuarial Department Factors – Late Retirement

The Government Actuary's Department has released revised factors for retirements for those who delay their retirement beyond State Pension Age (SPA).

The changes come into effect from 4 January 2017 and are significantly reduced form those in place previously.

The factors for actuarial increase have been reduced from 0.014% to 0.01% for annual pension (for each day worked past SPA) and from 0.007% to 0.001% in respect of lump sums.

Whilst this will affect a relatively small number of scheme members, LPP will be discussing with HCC whether they may wish to inform and such members of this potential reduction.

2. HMT Regulations - £95k cap on redundancy and exit payments

Exit Cap
There will be a further consultation this autumn on regulations for the £95,000 exit payment cap; the regulations will therefore not be in force in October as originally anticipated. Following this consultation it is hoped that regulations will be published and in force early next year.

Exit Payment Recovery
The recovery regulations for those earning £80,000 or more who leave public sector employment and return within a year are expected to be published and in force this year, subject to being passed by both Houses of Parliament under the affirmative process.

Government response to the further consultation on exit payment reform
The government has recently responded to the further consultation on exit payments confirming that it intends to proceed with plans for further reform.

Summary of the proposals:

- A maximum tariff for calculating exit payments of three weeks' pay per year of service. Employers could apply tariff rates below these limits
- A ceiling of 15 months on the maximum number of months' salary that can be paid as a redundancy payment. Where employers distinguish between voluntary and compulsory redundancies there may be a case for maintaining a differential by applying a lower limit. Likewise, where employers offer voluntary exit packages that are not classed as redundancies there may be a case for applying a different maximum. Employers could apply lower limits, as some do at present.
- A maximum salary on which an exit payment can be based. As a starting point the government will expect this to align with the existing NHS scheme salary limit of £80,000
- A taper on the amount of lump sum compensation an individual is entitled to receive as they get closer to their normal pension age
- Action to limit or end employer-funded early access to pension within exit packages. As part of an overall package the government will consider proposals appropriate to each workforce, including action to:
- Cap the amount of employer funded pension 'tops ups' to no more than the amount of the redundancy lump sum to which that individual would otherwise be entitled
- Remove the ability of employers to make such top ups altogether, or offer greater flexibility to employers as to the circumstances in which they are available

- Increase the minimum age at which an employee is able to receive an employer funded pension top up, so that this minimum age is closer to or otherwise linked more closely with the individual's normal pension age in the scheme in which they are currently accruing pension benefits or to which they would be entitled to belong if they were accruing benefits

Who is in scope?

- Current and future public sector employees
- The major workforces covered by existing statutory compensation schemes and other contractual exit arrangements. These are the Civil Service, NHS, Local Government, Teachers, Police, Firefighters and (taking account of the unique nature of the occupation) Armed Forces
- Those covered by any new compensation schemes set up for public sector employees
- In other areas, and for smaller public sector workforces, the government would encourage reforms consistent with the principles set out in this response
- Devolution: the policy would extend to all employments where compensation policy and practice is within the competence of the UK government. The Scottish government, Welsh government and Northern Ireland Executive would determine if and how they wanted to take forward similar arrangements in relation to devolved bodies and workforces.

Transitional arrangements

The government will consider the case for protection for those with exits formally agreed on terms that applied before new workforce exit compensation arrangements come into effect. The government expects the details of such protection will form part of the agreements reached by the relevant department with each workforce in scope of the reforms.

Timing

The response confirms that the government expects departments to produce packages consistent with the framework above and consult on these where appropriate.

The government will expect departments to produce these proposals within three months of the publication of the response (i.e. by 26 December 2016) and to have completed negotiations and made the necessary amendments to exit arrangements within nine months of the publication of the government response (i.e. by 26 June 2017). Given that the compensation arrangements and employer-funded early access to pension are both contained within statutory instruments for the LGPS this will be a challenging timetable.

HERTFORDSHIRE COUNTY COUNCIL

PENSION BOARD (LGPS)

TUESDAY, 6 DECEMBER 2016 AT 10:00AM

Agenda Item No:
5

FORMAL FUNDING VALUATION INITIAL RESULTS 2016

Report of the Director of Resources

Author: Patrick Towey, Head of Specialist Accounting (Tel: 01992 555148)

1. Purpose of the Report

1.1 To provide the Pension Board with the initial results of the formal valuation of the Hertfordshire Pension Fund at 31 March 2016. These results were shared with the Pension Committee at its meeting on 18 November 2016.

1.2 To recommend the approach for the review, consultation and final approval of the Funding Strategy Statement.

2. Summary

2.1 The Hertfordshire Pension Fund is formally valued by the Fund's actuary Hymans Robertson every three years, triennial valuation. The Fund when last valued at 31 March 2013 was valued at 82%. The report attached as appendix A, shows the initial results for the valuation at the 31 March 2016. The interim results show that the Funding level at 31 March 2013 was valued at 91%. Please note that these results are whole Fund results and that individual employer results including employer contribution rates will be issued from November. Individual employer results will also report different funding levels due to the nature of the characteristics of their member profiles, cash flows, and funding level at the last valuation.

2.2 As part of the Valuation process the Administering Authority is required to prepare a Funding Strategy Statement (FSS). The FSS is prepared every three years in collaboration with the Fund's actuary Hymans and after consultation with the Fund's employers. The FSS must be agreed and approved by the 31 March 2017.

3. Recommendations

3.1 That the Pension Board notes

a. the initial results of the 2016 formal Funding valuation.

b. the process for the review of the Funding Strategy Statement, consultation with employer bodies and final agreement by the Pension Committee at its meeting on 24 February 2017

4. Initial Valuation results

4.1 The Local Government Pension Scheme (LGPS) regulations require that a formal valuation of the Fund takes place every three years, known as the triennial valuation. The report attached as appendix A sets out the initial results for the Fund as a whole. The main headline to report to this Committee is that there has been an overall improvement in the Funding level of the Fund and a reduction in the reported Fund deficit; this is a very positive result for the Hertfordshire Fund. The table below compares the Funding level and deficit position for the Fund at 31 March 2013 and at 31 March 2016.

Valuation Date	Funding Level (%)	Surplus/Deficit (£m)
31 March 2013	82	(617)
31 March 2016	91	(336)

4.2 As part of the valuation process the actuary will agree with the administering authority a set of assumptions for investment returns, gilts and inflation, and membership experience. The investment consultant Mercer will also take part in this conversation particularly when setting the assumption for asset out performance i.e. investment return. The results set out in appendix A compare the actual experience against the assumptions agreed with the actuary back in 2013. The actuarial assumptions for this valuation were agreed by this Committee at its meeting on 10 June 2016.

4.3 **Investment experience**
For the period 2013 to 2016 the actual investment experience for the Hertfordshire Fund was greater than the assumption set by the actuary and AA, this was a **positive** contribution for the Fund.

Investment returns	Expected	Actual	Difference
Over 3 years	15.1%	22.2%	7.1%

4.4 **Gilts and inflation**
The fall in gilt yields during the period which is used as part of the discount rate to discount liabilities had a negative impact on the Fund in that it increased the value of the liabilities. Actual inflation experience during the period was better than assumed and was another **positive** contribution to the funding value.

Assumption/measure	2013	2016	Difference
Long-dated gilt yields p.a.	3.0%	2..2%	(0.8%)
Expected inflation	3.3%	3.2%	(0.1%)

4.5 **Membership experience**

Membership experience during the period was overall a **positive** contribution to the improvement in funding level in that there were fewer ill health and early retirements than assumed. Salary and benefits increases were also less then assumed. However, the number of pensions in payment ceasing was less than than expected which reflects the improvement in life expectancy but increases the liability on the fund.

4.6 In summary, although the liability position has increased over this period the assets have also increased and at a faster rate than the liabilities which is illustrated in the table below.

Valuation date	**31 March 2013**	**31 March 2016**
Liabilities	£3,525m	£3,920m
Assets	£2,908m	£3,584m
Surplus/(Deficit)	(£617m)	(£336m)
Funding level	82%	91%

5. Scheme Advisory Board results

5.1 The Fund's actuary is also now required to submit valuation results to the Scheme Advisory Board (SAB) which are based on common assumptions issued by the Government Actuary Department (GAD). This allows the SAB and GAD to compare Funds on a like for like basis. Based on the assumptions used by GAD, the funding level of the Hertfordshire Fund is 107%, the results reported by GAD so far (28 out of 89 LGPS Funds) show a range from between 78% to 123% in funding levels. The Hertfordshire Fund is in the top 5 of reported funds.

6. Funding Strategy Statement

6.1 Administering Authorities are required to maintain and publish a Funding Strategy Statement (FSS). The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies such as the Statement of Investment Principle (Investment Strategy Statement wef. 1 April 2017). It is a regulatory requirement for each Fund to have a FSS and it is reviewed every three years during the valuation process. The FSS applies to all employer bodies participating in the Fund. The draft FSS, attached as appendix B, has been prepared in conjunction with the scheme actuary, Hymans and sets out how the Administering Authority has balanced the conflicting aims of:

a. Affordability of employer contributions;
b. Transparency of processes;
c. Stability of employers' contributions; and
d. Prudence in the funding basis.

6.2 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. The pension benefits accrued by employees through their participation in the LGPS 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. The balance for the payment of accrued and future benefits is met by employee and employer contributions. The contributions made by employees are fixed under the regulations and therefore, the employers need to pay the balance of the cost of delivering the benefits to members and their families. The FSS 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.

6.3 As part of the review process of the FSS, this document is shared with members of the the Pension Board for review and comment and will then be circulated to all scheme employers for a consultation period of eight weeks. Following this review and consultation, the revised FSS will come back to the Pension Committee for final approval at its meeting on 24 February 2017.

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HYMANS ROBERTSON

2016 Formal Funding Valuation Initial Results

Agenda item 5
Appendix A

Hertfordshire County Council Pension Fund

Barry McKay Julie West

For and on behalf of Hymans Robertson LLP

6 October 2016

HYMANS ROBERTSON LLP

Executive Summary

Initial results

The initial draft whole fund results of the valuation are set out below based on your agreed funding basis: The results at the 2013 formal valuation are shown for comparison.

Valuation Date	31 March 2013	31 March 2016
Past Service Liabilities	**(£m)**	**(£m)**
Employees	1,277	1,279
Deferred Pensioners	690	873
Pensioners	1,558	1,768
Total Liabilities	**3,525**	**3,920**
Assets	**2,908**	**3,584**
Surplus / (Deficit)	**(617)**	**(336)**
Funding Level	**82%**	**91%**

Assumptions

The key financial and demographic assumptions agreed and adopted for the 2016 valuation are set out below:

	31 March 2013	31 March 2016
Financial		
Discount rate	4.8%	4.0%
Benefit increases	2.5%	2.1%
Salary increases	3.8%	2.2%
Demographic		
Baseline Longevity	Club Vita	Club Vita
Future Improvements	CMI2010, Peaked, 1.25% p.a. long term	CMI2013, Peaked, 1.25% p.a. long term

Solvency

The funding level on your agreed funding basis has improved from 82% in 2013 to 91% in 2016. Additionally, the funding deficit has decreased. The main reasons for the change in the funding level over the period were better than anticipated investment returns, deficit contributions and positive membership experience.

Contribution rates

Every employer has their own tailored funding plan and valuation results will vary depending on their own membership, funding plan and experience since the last valuation (or since they joined the Fund). The change in the financial assumptions will put upward, on the cost of future service, however, positive membership experience should help to reduce deficit contributions. However, each employer will have a contribution rate calculated which will be dependent on their timeframe in the Fund and their risk categorisation. This will mean changes in contribution rates will vary by employer as we develop more bespoke contribution strategies.

Next steps

The purpose of this report is to present the initial whole fund solvency results and summarise the experience over the intervaluation period. This report is useful to identify any areas of potential risk that the Fund may want to consider and explore possible avenues of risk mitigation during the valuation process.

The next milestone in the valuation process is preparation of the draft individual employer results.

Contents

1. Introduction

We have been commissioned by Hertfordshire County Council ("the Administering Authority") to carry out a full actuarial valuation of the Hertfordshire County Council Pension Fund ("the Fund") as at 31 March 2016 as required under Regulation 62 of the Local Government Pension Scheme Regulations 2013 ("the Regulations"). This report has been prepared to communicate the initial results of the 2016 valuation at whole fund level. It sets out the following:

- an analysis of Fund experience over the valuation period;
- your agreed funding assumptions;
- whole Fund valuation results; and
- analysis to help inform the Fund's understanding of its risk exposure.

This report is addressed to Hertfordshire County Council in its role as Administering Authority to the Hertfordshire County Council Pension Fund. It should not be shared with any third parties without our prior written consent. Where consent is given, the report should be supplied in full including any related reliances and limitations.

Please note that Hymans Robertson LLP accept no liability to any third parties. The reliances and limitations in the body and appendices of this report apply equally to all users of this report.

2. Intervaluation Experience

Since the previous valuation, various events have taken place which affect the funding position of the Fund.

Investment returns	Expected	Actual	Difference	Impact
Over 3 year period	15.1%	22.2%	7.1%	Positive
Annual	4.8%	6.9%	2.1%	Positive

Assumption/measure	2013	2016	Difference	Impact
Long-dated gilt yields (p.a.)	3.0%	2.2%	(0.8%)	Negative
Expected inflation	3.3%	3.2%	(0.1%)	Positive

Investment returns

The Fund has experienced better than anticipated investment returns. The return in excess of the 2013 valuation discount rate serves to 'pay back' a greater portion of the deficit than expected (all other things being equal). Therefore, all other things being equal, this improves the funding position. Investment returns in excess of discount rate were anticipated when setting contributions for some employers at the last valuation.

Gilts and inflation

There has been a significant drop in gilt yields over the inter-valuation period which is reflected in a reduction in anticipated investment returns and therefore a reduction in the discount rate used to place a value on the liabilities. This increases the liabilities and puts upwards pressure on employer contribution rates.

Long term expectations for Retail Prices Inflation (RPI) and Consumer Price Inflation (CPI) have fallen slightly since 2013. This will offset some of the increases caused by the fall in gilt yields.

Fund expenses

The Fund's expenses (in relation to non-investment activities) over the last 3 years have totalled £7.046m. This figure is equivalent to 0.5% when expressed as a percentage of pensionable pay and an allowance for 0.4% was made at the last valuation. Unless otherwise instructed, we propose to make allowance for the Fund's expenses by adding an allowance of 0.5% of pay to employer contribution rates payable from 1 April 2017.

Membership experience

The areas of membership experience that have had the greatest effect on the results of the valuation are set out below:

	Expected	Actual	Difference	Impact
Pre-retirement experience				
Early leavers (no.of lives)	15,323	14,084	(1,239)	Positive
Ill-health retirements* (no.of lives)	369	171	(198)	Positive
Salary increases (p.a.)	4.3%	2.8%	(1.5%)	Positive
Post-retirement experience				
Benefit increases (p.a.)	2.5%	1.3%	(1.2%)	Positive
Pensions ceasing (£m)	8.3	8.0	(0.3)	Negative

**Tier1 and Tier 2 ill-health retirements only*

The impact of fewer members withdrawing than expected depends on the age and liability distribution of withdrawing members. Although in number terms there were fewer withdrawals than expected, the impact on the funding position was slightly positive for the Fund as there were more leavers than expected at older ages (where members will have greater liabilities).

The pensioner mortality experience has been very close to expectations due to the Fund's use of Club Vita to inform the longevity assumption.

Membership experience overall has been positive over the intervaluation period. The most significant items of experience to note are:

- Salary increases have been less than assumed;

- Pension increases have been less than assumed;
- Ill-health retirements have been slightly less than assumed; and
- 50/50 take-up has been significantly lower than expected.

Regulatory experience

The Fund is subject to risks beyond its control. In particular, since 2013:

- A new benefit structure has come into force;
- Funds have come under greater scrutiny from the Government Actuary's Department, the Scheme Advisory Board and the Department for Communities and Local Government (DCLG); and
- Cost controls may alter member benefits (but will have no effect on the 2016 valuation).

3. Data and Assumptions

Data

We have relied on the data provided by the Administering Authority when carrying out our calculations. The accuracy of our results is limited by the quality of the data provided. We have carried out validations on the data provided to ensure it is fit for the purpose of the valuation. Further details can be found in our paper entitled "Data report for 2016 valuation", which will follow shortly. We believe the membership data is of a good standard and is fit for the purposes of this valuation.

Financial assumptions

Your agreed financial assumptions are set out below, along with the assumptions adopted for the 2013 formal valuation:

Financial assumptions	31 March 2013	31 March 2016
Discount rate		
Return on long-dated gilts	3.0%	2.2%
Asset Outperformance Assumption	1.8%**	1.8%***
Discount rate	**4.8%**	**4.0%**
Benefit increases		
Retail Prices Inflation (RPI)	3.3%	3.2%
Assumed RPI/CPI* gap	(0.8%)**	(1.0%)***
Benefit increase assumption (CPI)	**2.5%**	**2.1%**
Salary increases		
Retail Prices Inflation (RPI)	3.3%	3.2%
Increases in excess of RPI	0.5%**	(0.9%)***
Salary increase assumption	**3.8%**	**2.2%**

** Consumer Prices Index*

*** Arithmetic addition*

**** Geometric addition*

Longevity assumptions

Your agreed longevity assumptions result in the following typical future life expectancies from age 65 (figures for 2013 shown for comparison):

	31 March 2013	31 March 2016
Male		
Pensioners	22.3 years	22.5 years
Non-pensioners	24.3 years	24.1 years
Female		
Pensioners	24.5 years	24.9 years
Non-pensioners	26.7 years	26.7 years

Non-pensioners are assumed to be aged 45 at 31 March 2016

Additional assumptions

Retirement age pattern

We have adopted the retirement age pattern assumption as specified by the Scheme Advisory Board for preparing Key Performance Indicators. Further details about this assumption are available on request.

50/50 option

Following analysis of both the Fund's actual take up rate, and national statistics, the Fund has assumed that 2% of members will take up the 50/50 option in the future.

Other assumptions

All other assumptions have been updated to reflect the latest experience of LGPS funds. Further details regarding the assumptions adopted are set out in the 2016 valuation toolkit and were agreed by Pensions Committee following presentation of our paper "2016 Formal Valuation: Setting the Funding Target" dated 23 May 2016.

4. Initial Results - Solvency

The solvency of the Fund as at 31 March 2016 based on your agreed assumptions is set out below. The results at the 2013 formal valuation are shown for comparison.

Valuation Date	31 March 2013	31 March 2016
Past Service Liabilities	**(£m)**	**(£m)**
Employees	1,277	1,279
Deferred Pensioners	690	873
Pensioners	1,558	1,768
Total Liabilities	**3,525**	**3,920**
Assets	**2,908**	**3,584**
Surplus / (Deficit)	**(617)**	**(336)**
Funding Level	**82%**	**91%**

We have valued the benefits defined under the Regulations based on the assumptions outlined earlier. These results are sensitive to the underlying financial and demographic assumptions as well as the quality of the underlying data.

Liabilities

The liabilities have grown substantially since 2013 mainly as a result of the change in the financial assumptions. The change in the net discount rate (essentially the difference between the discount rate and the assumed rates of increase of salaries, deferred pension revaluation or pensions in payment) results in a higher value being placed on the liabilities.

Assets

The assets have also grown substantially over the inter-valuation period. This is a result of much better than assumed asset returns. This strong investment return has more than offset the increase in liabilities.

Funding level/deficit

The overall result has been an improvement in the reported funding level of the Fund alongside a reduction in the funding deficit.

Analysis of change in solvency

The table below illustrates the various factors that have led to the change in funding position between the 2013 and 2016 valuations.

Analysis		(£m)
Surplus / (deficit) at 31 March 2013		**(617)**
Interest on surplus / (deficit)	(93)	
Investment returns greater than expected	209	
Contributions greater than cost of accrual	99	
Membership experience over the period	163	
Change in demographic assumptions	9	
Change in mortality assumption	37	
Change in financial assumptions	(179)	
Impact of LGPS 50/50 take up	(21)	
Other experience items	57	
Surplus / (deficit) at 31 March 2016		**(336)**

Comment on employers

Every employer is valued separately based on their own membership data as part of the valuation and their change in funding position will therefore vary compared to that of the whole fund.

5. Initial Results – Contributions

Changes to terminology

The Regulations have introduced new terminology in respect of contribution rates. We have set out our interpretation of these terms below based on CIPFA guidance on preparing a Funding Strategy Statement.

Primary Contribution Rate

This refers to the cost of new benefits being earned by members. This was previously referred to as the Future Service Rate.

Secondary Contribution Rate

This refers to the contributions required to repair an employer's deficit (surplus). This was previously referred to as Deficit Recovery Contributions.

Common Contribution Rate

The Regulations no longer require the reporting of the Common (Whole Fund) Contribution Rate. This has been replaced by Whole Fund Primary and Secondary Contribution Rates calculated as the payroll weighted average of the Primary and Secondary Contribution Rates for employer. These rates will be calculated and disclosed in the final valuation report.

Typical employer results

The fall in the net discount rate will place upwards pressure on primary contribution rates. Employer deficit results are more difficult to predict due to the variable changes in funding levels. Therefore, we anticipate for most employers that there will be upward but manageable pressure on employer contribution rates for the majority of employers in the Fund.

Employer categorisation

Every employer in the Fund is different. For instance, they have different funding levels, sources of funds for paying contributions, covenants, maturity profiles, and timeframes for their participation in the Fund.

As a result, when setting contribution rates, employers are categorised based on their individual characteristics in order to build a credible funding plan that fits their own needs while recognising the risk they pose the Fund and other participating employers.

Setting credible funding plans

Set a funding target

For the vast majority of employers, the target is to be fully funded on the Fund's ongoing funding assumptions. There may be instances where alternative assumptions are used such as where an employer is approaching cessation.

Choosing an appropriate time horizon

Once a target has been chosen, the time employers are given to reach that target needs to be determined. For long-term secure employers, this is up to 20 years. For employers that pose a greater risk to the Fund, this may be much shorter. In general, a shorter time horizon results in more volatile contributions compared to employers with longer time horizons.

Probability of reaching the target

The final stage involves determining the probability required for each employer to reach its funding target within its time horizon. In general, higher probabilities of success are achieved by paying higher contributions and relying less on volatile investment returns. The probability required of each employer is largely based on each employer's assessed covenant. For instance, a lower probability of success (e.g. 66%) may be required for a secure body as they may be considered to be able to pay higher contributions (or current rates for longer) should they not reach their funding target over their time horizon.

6. Risk Analysis

The valuation results depend critically on the actuarial assumptions that are made about the future of the Fund. If all of the assumptions made at this valuation were exactly borne out in practice then the results presented in this document would represent the true cost of providing benefits from the Fund as it currently stands at 31 March 2016.

However, no one can predict the future with certainty and future experience will not exactly match all of our assumptions. The future therefore presents a variety of risks to the Fund which should be **identified** and, where possible, the financial significance should be **quantified**. Thereafter the Fund can assess how (or if) these risks can then be **controlled** or **mitigated** and put in place **monitoring** to assess whether any mitigation is actually working.

Financial risks

The two main areas of financial risk of interest to your Fund are the investment performance and level of benefit increases. To help understand the impact of these two factors being different from assumed, we have shown the effects on the solvency measure of varying the discount rate (investment performance) and benefit increase assumptions below.

Discount Rates	Benefit Increases: 1.9%	2.1%	2.3%	
4.2%	(114) 97%	(224) 94%	(338) 91%	(Deficit) Funding Level
4.0%	(222) 94%	(336) 91%	(453) 89%	(Deficit) Funding Level
3.8%	(334) 91%	(451) 89%	(572) 86%	(Deficit) Funding Level

The above analysis focuses on financial risk to the solvency level. Our approach to setting contribution rates at the 2016 valuation seeks to recognise the uncertainty around future investment returns and benefit increases. Further information about this method will be present with the employer results.

Demographic assumptions

The main area of demographic risk is people living longer than expected. We have shown below the high level impact of people living longer than currently expected by using a more prudent assumption for future longevity improvements. The more prudent assumption assumes that the rate of future improvements continues to increase ('non-peaked'). The valuation assumption assumes that the rate of future improvements have peaked.

	Peaked improvements	Non-peaked improvements
(Deficit)	(336)	(425)
Funding Level	91%	89%

Other risks to consider

There are other risk factors which would have an impact on the funding position. Examples of these include the level of ill health retirements, withdrawals from the scheme and take up of the 50:50 option. These are probably unlikely to change in such a way that would rank them as amongst the highest risks facing the Fund and therefore we have not sought to provide further quantification of their risk.

Other events

Since carrying out the valuation, the United Kingdom held a referendum on its participation as a full member of the European Union. The result was a mandate to leave the European Union. At this time, it is difficult to predict the long term effect of this possible course of action. We have made no allowance for the referendum result in preparing this report.

7. Next Steps

The purpose of this report is to present the initial whole fund solvency results and summarise the experience over the intervaluation period. This report is useful to identify any areas of potential risk that the Fund may want to consider and explore possible avenues of risk mitigation during the valuation process.

The next steps in the process are as follows.

- All parties to ***understand the whole fund results*** and the assumptions on which they are based, discuss any questions or issues before moving on to the next stage of the valuation process. This includes the Fund ***identifying any areas of risk*** that it is concerned about and wishes to explore further and understand how the risk can be identified, quantified, mitigated and monitored.
- Once all parties are happy with the whole fund results, we will quantify the ***valuation results for each individual employer*** that participates in the Fund. When we present you with these results, we will set out the contribution rates that each employer should pay for the next three years from 1 April 2017 based on the funding principles previously discussed.
- For some employers, the contribution rate that they should pay in principle may be different to what they will actually pay in practice. Any deviation will be based on their own circumstances and a range of factors including (amongst other things) their perceived security, whether they are going to be pooled with other employers or any budgetary constraints that they may be bound by. We expect there to be a consultation period where you gather together all of these issues and ***come back to us with a set of final agreed contribution rates for each employer.***
- We understand that you may require additional input from us before agreeing the final contribution rates. Some employers may accept their proposed contribution rates quite readily whilst others may want to explore their options. You may want us to look at the viability of ***different contribution strategies*** that are proposed by individual employers.
- Once a set of final contribution rates have been agreed for all employers, we will provide you with a ***final valuation report*** which will clearly set out the final valuation results and will meet all the relevant regulatory requirements. Included in this report will be the Certificate of Rates and Adjustments, which will certify the minimum contribution rates to be paid by each employer for the three year period beginning on 1 April 2017. This final valuation report must be provided to you no later than 31 March 2017.

Appendix – Reliances and limitations

This document has been requested by and is provided to Hertfordshire County Council in its capacity as Administering Authority to the Hertfordshire County Council Pension Fund. It has been prepared by Hymans Robertson LLP to support a discussion on funding strategy with the Fund as part of the 2016 funding valuation.

This document should not be released or otherwise disclosed to any third party (including Fund employers) without our prior written consent, in which case it should be released in its entirety. Hymans Robertson LLP accepts no liability to any other party unless we have expressly accepted such liability

Reliances and limitations

This document has been prepared for the purpose of communicating the initial results of the 2016 valuation at whole fund level. Nothing contained within it affects any member's benefits. Furthermore, none of the figures should be used for accounting purposes (e.g. under FRS102 or IAS19) or for any other purpose (e.g. a termination valuation).

The valuation results are wholly dependent on the data provided to us and the assumptions that we use in our calculations. We have previously issued a separate report confirming that the data provided is fit for the purposes of this valuation and have commented on our perception of the quality of the data provided. The data used in our calculations will be set out in our data report to follow.

It is possible that as part of our ongoing discussions you may find that there is additional information you should provide us with. In a similar way, you may feel that one or more of the assumptions is no longer not suitable for the Fund and you may wish to explore the use of alternatives. Until both of these areas are definitively agreed by all relevant parties, the results in this document will remain "initial" and could be subject to change before the final valuation report is signed off.

This document is a "component report" of the eventual final aggregate valuation report due to be completed by 31 March 2017.

The results contained in this document are for the Fund as a whole. It does not set out the valuation results for individual employers, which will be derived at a later date. Employers come in different shapes and sizes and their valuation results are not uniform. We would advise against extrapolating the results contained in this document to predict possible contribution rates for employers at this stage.

The figures in this report are based on our understanding of the benefit structure of the LGPS as at 31 March 2016.

Actuarial Standards

The following Technical Actuarial Standards[1] are applicable in relation to this report and have been complied with where material:

- TAS R – Reporting;
- TAS D – Data;
- TAS M – Modelling; and
- Pensions TAS.

[1] Technical Actuarial Standards (TASs) are issued by the Financial Reporting Council (FRC) and set standards for certain items of actuarial work.

AGENDA ITEM 5:
APPENDIX B

FUNDING STRATEGY STATEMENT

November 2016

Hertfordshire Pension Fund
Local Government Pension Scheme

Hertfordshire

Contents

1 Introduction

1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the Hertfordshire Pension Fund ("the Fund"), which is administered by Hertfordshire County 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 31 March 2017.

1.2 What is the Hertfordshire Pension Fund?

The Fund is part of the national 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 of the UK. The Administering Authority runs the Hertfordshire Fund, in effect the LGPS for the Hertfordshire 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 LGPS Regulations. 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 A.

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.

The requirement to maintain and publish an FSS is also contained in the LGPS Regulations, as set out in Appendix B.

The FSS is a summary of the Fund's approach to funding its liabilities and when other funding decisions are required, for example when employers join or leave the Fund. It is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the LGPS Regulations;
- 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;
- the Fund's policies on admissions and cessations;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Investment Strategy Statement (see section 4 Funding strategy and links to investment strategy
-

Further details on the Pension Fund's policies and strategies can be found on the Pension Fund's website at: http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx

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, that these are fair by comparison to other employers in the Fund, and in what circumstances you might need to pay more. 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: 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, including:

- 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;
- 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 4 we show how the funding strategy is linked with the Fund's investment strategy.

In the Appendices we cover various issues in more detail:

A. The responsibilities of key parties

B. The regulatory framework, including how and when the FSS is reviewed,

C. The calculation of employer contributions

D. The Actuarial assumptions which the Fund Actuary currently makes about the future,

E. Key risks and controls for the Fund ,

F. Glossary

If you have any other queries please contact the Pensions Team at Pensions.Team@hertfordshire.gov.uk.

2 Basic Funding issues

2.1 How does the actuary measure the required contribution rate?

In essence this is a three-step process:

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

2. Determine the time horizon over which the employer should aim to achieve that funding target. See the table in section 3.3 and Note (c) for more details;

3. Calculate the employer contribution rate such that it has at least a given probability of achieving that funding target over that time horizon, allowing for different likelihoods of various possible economic outcomes over that time horizon. See 2.4 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 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, if the employer has a pensions deficit, payment of the Secondary rate will aim to return the employer to full funding over an appropriate period (the "time horizon"). 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 (http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx). Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Any additional contributions over and above the certified rate will be considered by the Fund actuary at subsequent valuations, i.e. will be reflected as a credit when next calculating the employer's contributions.

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. There are currently more employers in the Fund than ever before, largely a result of schools transferring to academy status and services being outsourced from scheme employers such as Councils.

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.

The LGPS Regulations define various types of employer as follows:

- **Scheduled bodies** - councils, and other specified employers such as academies and 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 Pension Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

  It is now possible for Local Education Authority schools to convert to academy status, and for other forms of school (such as Free Schools) to be established under the academies legislation. All such academies (or Multi Academy Trusts), as employers of non-teaching staff, become separate new employers in the Fund. As academies are defined in the LGPS Regulations as "Scheduled Bodies", the Administering Authority has no discretion over whether to admit them to the Fund, and the academy has no discretion whether to continue to allow its non-teaching staff to join the Fund. There has also been guidance issued by the DCLG regarding the terms of academies' membership in LGPS Funds.

- **Designating employers** - employers such as town and parish councils are able to participate in the LGPS via a resolution (and the Fund cannot refuse them entry where the resolution is passed). These employers can designate which of their employees are eligible to join the scheme.

- 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. 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 as we consider it to be helpful in setting funding strategies for these different employers.

2.4 How does the contribution rate vary for different employers?

All three steps outlined in section 2.1 are considered when setting contributions (more details are given in Section 3 and Appendix D).

1. The **funding target** is based on a set of assumptions about the future, (e.g. investment returns, inflation, pensioners' life expectancies). An employer's individual funding target is set so that that there are sufficient assets to pay for all accrued benefits at the end of its participation in the Fund and that the employers liabilities do not fall on other employers in the Fund in the future;

2. The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and

3. The **probability of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

2.5 How is a deficit (or surplus) 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 ratio 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 deficit/surplus and funding level 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. However, this is balanced against the following considerations:

- 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;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;
- 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;
- 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.

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 through various techniques which affect contribution increases to various degrees, as discussed in section 3. In deciding which of these techniques to apply to any given employer, the Fund will consider a risk assessment of that employer using a knowledge base 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. This helps the Fund establish a picture of the financial standing of the employer, i.e. its ability to meet its long term Fund commitments. To ensure that the information is kept up to date, employers are required to completed an annual survey to confirm the accuracy of information held on the database.

Where an employer is considered relatively low risk then the Fund will permit options such as stabilisation (see 3.3 Note (b)), a longer time horizon relative to other employers, and/or a lower probability of achieving their funding target. Such options will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

An employer whose risk assessment indicates a less strong covenant i,e their assessed financial strength in regards to their ability to pay for pension obligations in the long run, will generally be required to pay higher contributions (for instance, with a higher funding target, and/or a shorter deficit recovery period relative to other employers, and/or a higher probability of achieving the target). This is because of the higher probability that at some point it will fail or be unable to meet its pension contributions, with its deficit in the Fund then falling to other Fund employers, or because the employer has less time to meet its obligations to the Fund.

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 probability is required to reach that funding target? This will always be less than 100% as we cannot be certain of future market movements. Higher probability "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 may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

3.2 The effect of paying contributions below the measured level

There are a number of methods which the Administering Authority may permit, in order to improve the stability of employer contributions. These include, where circumstances permit:

- capping of employer contribution rate changes within a pre-determined range ("stabilisation");
- the use of extended time horizons;
- adjusting the required probability of meeting the funding target;
- the phasing in of contribution rises or reductions;
- the pooling of contributions amongst employers with similar characteristics; and/or
- the use of some form of security or guarantee to justify a lower contribution rate than would otherwise be the case.

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than the measured contribution rate. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the choice of method,
- lower contributions in the short term will be assumed to incur a greater loss of investment returns on the deficit. Thus, deferring a certain amount of contribution may lead to higher contributions in the long-term, and
- it may take longer to reach their funding target, all other things being equal.

Section 3.3 summarises how the main funding policies differ for different types of employer, followed by more detailed notes where necessary. Section 3.4 onwards deals with funding issues which apply to all employers.

3.3 The different approaches used for different employers

Type of employer	**Scheduled Bodies**			**Designating Employers**	**Community Admission Bodies**		**Transferee Admission Bodies**	
Sub-type	**Local Authorities & Police**	**Academies**	**Other scheduled bodies**	**Parish & Town Councils**	**Open to new entrants**	**Closed to new entrants**		
Funding Target Basis used	Ongoing, assumes long-term Fund participation (see Appendix C)				Ongoing, but may move to "gilts basis" - see note (a)		Ongoing, assumes fixed contract term in the Fund (see Appendix C)	
Primary rate approach	(see Appendix D, section D.2)							
Stabilised contribution rate?	Yes see note (b)	Yes see note (b)	No	No	No	No	No	
Maximum time horizon see note (c)	20 years	20 years	20 years	TBC	Future working lifetime of members	Future working lifetime of members	Outstanding contract term	
Secondary rate ***see*** **note (d)**	% of payroll or monetary amount	% of payroll	% of payroll or monetary amount	% of payroll	% of payroll or monetary amount	Monetary amount	% of payroll or monetary amount	
Treatment of surplus	Covered by stabilisation arrangement	Covered by stabilisation arrangement	Preferred approach: contributions kept at future service rate. However, reductions may be permitted by the Admin. Authority				Reduce contributions by spreading the surplus over the remaining contract term	
Probability of achieving target see note (e)	66%	66%	TBC	TBC	TBC	TBC	TBC	TBC
Phasing of contribution changes	Covered by stabilisation arrangement	Covered by stabilisation arrangement	Max 3 years	Max 3 years	Max 3 years	Max 3 years	Max 3 years	None
Review of rates see note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations						Particularly reviewed at regular intervals in last 3 years of contract	
New employer	n/a	see note (g)	n/a	See section 2.3	See note (h)		See notes (h) & (i)	
Cessation of participation: cessation debt payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring, the cessation debt principles applied would be as per Note (j).				Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (j).		Participation assumed to expire at the end of the contract. Cessation debt calculated on ongoing basis. Awarding Authority liable for future deficits and contributions arising.	

Note (a) Basis for CABs closed to new entrants

In the circumstances where:

- the employer is an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor for future deficits and contributions, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may set a higher funding target (e.g. using a discount rate set equal to gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Admission Bodies whose admission agreement is open or where there is no immediate expectation that the admission agreement will cease, where there is no guarantor for future deficits and contributions, or where the strength of covenant is considered to be weak.

Note (b) 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, believes that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been "stabilised" (and may therefore be paying less than their theoretical contribution rate) should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

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.

In general, stabilisation will only be considered for employers who are:

- Scheduled bodies that have tax raising powers, or are part of a pool
- Open to new entrants
- Have a long term time horizon in the Fund
- Have been assessed as having a strong employer covenant so as to protect the Fund and the other employers in the Fund against the risk of the employer defaulting in relation to its liabilities.

The current stabilisation mechanism applies if:

- the employer satisfies the eligibility criteria set by the Administering Authority, as set out above and;
- there are no material events which cause 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).

On the basis of extensive modelling carried out for the 2016 valuation exercise (see Section 4), the stabilisation parameters have been set allowing for increases/decreased of 0% to 1.5% of pay.

The stabilisation criteria and limits will be reviewed at the 31 March 2019 valuation, to take effect from 1 April 2020.

Note (c) Maximum time horizon

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2017 for the 2016 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative time horizons, for example where there were no new entrants.

Note (d) Secondary rate

For employers where stabilisation is not being applied, the Secondary contribution rate for each employer covering the three year period until the next valuation will often be set as a percentage of salaries. However, the Administering Authority reserves the right to amend these rates between valuations and/or to require these payments in monetary terms instead, for instance where:

- the employer is relatively mature, i.e. has a large Secondary contribution rate (e.g. above 15% of payroll), or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed the Fund to new entrants.

Note (e) Probability of achieving funding target

Each employer has their funding target calculated, and a relevant time horizon over which to reach that target. Contributions are set such that, combined with the employer's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum probability. A higher required probability bar will give rise to higher required contributions, and vice versa.

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

Different probabilities are set for different employers depending on their nature and circumstances: in broad terms, a higher probability will apply due to one or more of the following:

- the Fund believes the employer poses a greater funding risk than other employers,
- the employer does not have tax-raising powers;
- the employer does not have a guarantor or other sufficient security backing its funding position; and/or
- the employer is likely to cease participation in the Fund in the short or medium term.

Note (f) Regular Reviews

The Fund reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between Valuations. Such reviews may be triggered by significant events including but not limited to: significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

Note (g) New Academy conversions

At the time of writing, the Fund's policies on academies' funding issues are as follows:

i. The new academy will be regarded as a separate employer in the scheme in its own right.

ii. The new academy's past service liabilities on conversion will be calculated based on its active Fund members on the day before conversion. For the avoidance of doubt, these liabilities will include all past service of those members, but will exclude the liabilities relating to any ex-employees of the school who have deferred or pensioner status;

iii. The new academy will be allocated an initial asset share from the ceding council's assets in the Fund. This asset share will be calculated using the estimated funding position of the ceding council at the date of academy conversion. The share will be based on the active members' funding level, having first allocated assets in the council's share to fully fund deferred and pensioner members. The asset allocation will be based on market conditions and the academy's active Fund membership on the day prior to conversion;

iv. Schools that convert to Academy status who are already in the Schools & Academies Pool will continue to pay the prevailing rate of the pool until the next Triennial Valuation, at which they have the opportunity to opt out if they wish to have an individual employer contribution rate calculated;

The Fund's policies on academies are subject to change in the light of any amendments to DCLG guidance. Any changes will be notified to academies, and will be reflected in a subsequent version of this FSS. In particular, policies (iv) and (v) above will be reconsidered at each valuation.

Note (h) New Admission Bodies

With effect from 1 October 2012, the LGPS 2012 Miscellaneous Regulations introduced mandatory new requirements for all Admission Bodies brought into the Fund from that date. Under these Regulations, all new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity, or a bond. 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 fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit.

Any security must be to the satisfaction of the Administering Authority and where applicable to the letting employer, and will be reassessed at regular intervals. See also Note (i) below

The Fund will only consider requests from "CAB's" or other similar bodies to join the Fund if they are sponsored by a scheduled body with tax raising powers who will guarantee the liabilities of the body and supplemented, where appropriate, by the provision of a form of security as above.

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.

Note (i) New Transferee Admission Bodies

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council or academy) to another organisation (a "contractor"). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor can seek admitted body status in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees' Fund benefits. The quid pro quo is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see Note (j).

Employers who "outsource" have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

- Pooling: Under this option the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer, which may be under a stabilisation approach.
- Letting employer retains pre-contract risks: Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor's contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.
- Fixed contribution rate agreed: Under this option the contractor pays a fixed contribution rate and does not pay any cessation deficit. Any surplus or deficit present at the end of the contract period falls back to the letting employer.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to their decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from:

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above; and
- redundancy and early retirement decisions.

Note (j) 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. However, this 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.

In the case of a transferee admission body, participation is assumed to expire at the end of the contract.

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; where there is a surplus it should be noted that under current legislation there is no mechanism to refund payment to the Admission Body.

For transferee admission bodies, the cessation valuation will normally be calculated using the ongoing basis, in line with the basis on which they were admitted to the Fund. The original letting/outsourcing employer will then be liable for future deficits and contributions arising.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

a) Where there is a guarantor for future deficits and contributions, the cessation valuation will normally be calculated using the ongoing basis as described in Appendix C;

b) Alternatively, it may be possible to simply transfer the former Admission Body's liabilities and assets to the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee;

c) Where a guarantor does not exist for future deficits and contributions then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a "gilts cessation basis", which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required.

Any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible then the Fund would look to any bond, indemnity or guarantee in place for the employer.

In the event that the Fund is not able to recover the required payment in full, then the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the 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: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a “gilts cessation basis” and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases, as the Body would have no contributing members.

3.4 Pooled contributions

From time to time, with the advice of the Actuary, the Administering Authority may set up pools for employers with similar or complementary characteristics. This will always be in line with its broader funding strategy.The exceptions are Transferee admission bodies and community admission bodies that are deemed by the Administering Authority to have closed to new entrants. The current pools in place within the Fund are as follows:

- Hertfordshire maintained schools, academies, free schools, university technical colleges and studio schools; and
- Parish and Town Councils

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

Employers who participate in a pool, will be required to comply with the conditions and requirements set out in the pooling policy applicable to that Pool, which can be found at: http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx.

Employers will be advised of their individual funding positions as well as that of the pool at each Valuation. In paying a pooled contribution rate, Pool Members must acknowledge that they may be paying a rate that is more or less than the employer contribution rate that would have been payable if the employer contribution rate had been determined on an individual employer basis. Pool Members may wish to consider making additional payments to the Pension Fund to improve their funding/balance sheet position, particularly where their funding level is lower than that of the rest of the pool.

3.5 Additional flexibility in return for added security

At its discretion, the Administering Authority may permit greater flexibility to the employer’s contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended time horizon, or permission to join a pool with another body (e.g. the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer’s deficit;
- the amount and quality of the security offered;
- the employer’s financial security and business plan; and
- whether the admission agreement is likely to be open or closed to new entrants.

3.6 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). Note the relevant age may be different for different periods of service, following the benefit changes from April 2008 and April 2014. Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. Strain costs are payable in full in the year of retirement. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

3.7 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 are currently met by each employer, although individual employers may elect to take external insurance (see 3.8 below).

Employers will usually have an 'ill health allowance' as calculated at each Valuation. The Fund monitors 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 will be charged additional contributions on the same basis as apply for non ill-health cases, as outlined in the Fund's Administration Strategy and in the case of admission bodies, in each separate Admission Agreement.

3.8 External Ill health insurance

If an employer provides satisfactory evidence to the Administering Authority of a current external insurance policy covering ill health early retirement strains, then:

- the employer's contribution to the Fund each year is reduced by the amount of that year's insurance premium, so that the total contribution is unchanged, and
- there is no need for monitoring of allowances.

The employer must keep the Administering Authority notified of any changes in the insurance policy's coverage or premium terms, or if the policy is ceased.

3.9 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis (see 3.3, Note (j)) and consequently have no further obligation to the Fund. Thereafter it is expected that 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.

In exceptional circumstances the Fund may permit an employer with no remaining active members 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, as the employer would have no contributing members.

3.10 Policies on bulk transfers

The Fund will consider bulk transfers on a case by case basis, but in general:

- The Fund will not pay bulk transfers greater than the lesser of (a) the asset share of the transferring employer in the Fund, and (b) the value of the past service liabilities of the transferring members;
- 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.

4 Funding strategy and links to investment strategy

4.1 What is the Fund's investment strategy?

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

The Investment strategy is set by the administering authority, and after taking investment advice. The precise mix, manager make up and target returns are set out in the Investment Strategy Statement, which is accessible from the Fund's website: http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx

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.

4.2 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.

4.3 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 asset outperformance assumption contained in the discount rate (see Appendix C3) is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the UK Government (see Appendix B1).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

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

4.4 How does this differ for a large stable employer?

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 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 3.3 Note (b)). The modelling demonstrated that retaining the present investment strategy, coupled with constraining employer contribution rate changes as described in 3.3 Note (b), 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.

Whilst the current stabilisation mechanism is to remain in place until 2020 and will be reviewed as part of the 2019 valuation.

4.5 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, on a quarterly basis and reports this to Pensions Committee and to the LGPS Board.

5 Statutory reporting and comparison to other LGPS Funds

5.1 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 Department of Communities & Local Government (DCLG) on each of the LGPS Funds in England & Wales. This report will cover whether the rate of employer contributions for each fund are set at an appropriate level to ensure both the solvency and the long term cost efficiency of the Fund.

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

5.2 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.

5.3 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:

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

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

In assessing whether the above condition is met, DCLG may have regard to various absolute and relative measures. DCLG may assess and compare these metrics on a suitable standardised market-related basis, for example where the local funds' actuarial bases do not make comparisons straightforward.

Relative measures are primarily concerned with comparing the Fund with other LGPS Funds and include:

- the implied deficit recovery period (the estimated period until the Fund reaches a 100% funding level); and
- the investment return required to achieve full funding after 20 years.

Absolute measures are primarily concerned with comparing the Fund with a given objective benchmark and include:

- the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;
- how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy;
- the extent to which contributions actually paid have been in line with the expected contributions based on the extant rates and adjustment certificate; and
- 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.

Appendix A – Responsibilities of key parties

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

A1 The Administering Authority should:-

1. Operate the Fund in accordance with the LGPS Regulations;
2. Effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
3. Collect employer and employee contributions, and investment income and other amounts due to the Fund;
4. Ensure that cash is available to meet benefit payments as and when they fall due;
5. Pay from the Fund the relevant benefits and entitlements that are due;
6. Invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Investment Strategy Statement (ISS) and LGPS Regulations;
7. Communicate appropriately with employers so that they fully understand their obligations to the Fund;
8. Take appropriate measures to safeguard the Fund against the consequences of employer default;
9. Manage the valuation process in consultation with the Fund's actuary;
10. Provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
11. Prepare and maintain a FSS and an ISS, after consultation;
12. Notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
13. Monitor all aspects of the fund's performance and funding and amend the ISS as necessary and appropriate.

A2 The Individual Employer should:-

1. Deduct contributions from employees' pay correctly;
2. Pay all contributions, including their own as determined by the actuary, promptly by the due date;
3. Establish and exercise a discretions policy within the regulatory framework;
4. Make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
5. Notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.
6. In the case of admission bodies, ensure completion of admission agreements prior to contract commencement.

A3 The Fund Actuary should:-

1. 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;
2. Provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see Section 5);
3. 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);
4. Prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
5. Assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
6. Advise on the termination of employers' participation in the Fund; and
7. Fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

A4 Other parties:-

1. Investment advisers (either internal or external) should ensure the Fund's ISS remains appropriate, and consistent with this FSS;
2. Investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the ISS;
3. 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;
4. Governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
5. 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;
6. The Department for Communities and Local Government (assisted by the Government Actuary's Department) and the Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

Appendix B – Regulatory framework

B1 Why does the Fund need an FSS?

The Department for Communities and Local Government (DCLG) has stated that 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 a 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 Investment Strategy Statement.

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.

B2 Consultation and review

The LGPS Regulations requires the Fund to consult on its FSS. 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 in November 2016 for comment;

b) Comments were requested within 60 days;

c) There was an Employers Forum on 30 January 2017 at which questions regarding the FSS could be raised and answered;

d) Following the end of the consultation period the FSS was updated where required, approved by the Fund's Pensions Committee in February 2017 then published in March 2017.

B3 How is the FSS published?

The FSS is made available through the following routes:

- Published on the website, at: http://www.yourpension.org.uk/Hertfordshire/Fund-information/Policy-statements.aspx;
- A full copy is included in the annual report and accounts of the Fund http://www.yourpension.org.uk/Hertfordshire/Fund-information/Annual-reports.aspx;

B4 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 in 2019.

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.

B5 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 Investment Strategy Statement, Governance Compliance Statement and Communications Strategy Statement. 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 at: http://www.yourpension.org.uk/Hertfordshire/Fund-information/Introduction.aspx

Appendix C - Actuarial assumptions

C1 What are the actuarial assumptions?

These are expectations of future experience used to place a value on future benefit payments ("the liabilities"). 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 measured funding target. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the "basis". A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower funding targets and lower employer costs. A more prudent basis will give higher funding targets and higher employer costs.

C2 What basis is used by the Fund?

The Fund's standard funding basis is described as the "ongoing basis", which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term, a more prudent basis applies: see Note (a) to 3.3.

C3 What assumptions are made in the ongoing basis?

a) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund's investments. This "discount rate" assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds ("gilts"). There is, however, no guarantee that Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2016 and setting contribution rates effective from 1 April 2017, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.8% per annum greater than gilt yields at the time of the valuation (this is the same as that used at the 2013 valuation). In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

b) Salary growth

Pay for public sector employees is currently subject to restriction by the UK Government until 2020. Although this “pay freeze” does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards. Based on long term historical analysis of the membership in LGPS funds, and continued austerity measures, the salary increase assumption at the 2016 valuation has been set to 0.9% below the retail prices index (RPI) per annum. This is a change from the previous valuation, which assumed 0.5% above RPI.

c) 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 this valuation, we propose a reduction of 1.0% per annum. This is a larger reduction than at 2013, when a reduction of 0.8% was applied to the RPI assumption. This will serve to reduce the funding target (all other things being equal). (Note that the reduction is applied in a geometric, not arithmetic, basis).

d) 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.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with the 2013 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.25% per annum minimum underpin to future reductions in mortality rates. This is the same methodology as was adopted for the 2013 Valuation, but with updates to the underlying mortality tables.

e) General

The same financial assumptions are adopted for most employers, in deriving the funding target underpinning the Primary and Secondary rates: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

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 D - The calculation of Employer contributions

In Section 2 a broad description of the way in which contribution rates are calculated was provided. This Appendix considers these calculations in much more detail. The calculations involve actuarial assumptions about future experience, and these are described in detail in Appendix C.

D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

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 C2 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 C3 below).

The contribution rate for each employer is measured as above, appropriate for each employer's funding position and membership. The whole Fund position, including that used in reporting to DCLG (see section 5), is calculated in effect as the weighted sum of all the individual employer rates. DCLG currently only regulates at whole Fund level, without monitoring individual employer positions.

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 the cost of current employees' future benefit payments as they accrue. 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 separately for all the employers, although employers within a pool will pay the contribution rate applicable to the pool as a whole. 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 (see note 3.3 Note (c) for further details),

3. with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

* The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The projections are carried out using an economic modeller 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. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (by the end of the time horizon) is equal to the required probability.

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 operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see Section 3). The Secondary rate is calculated as the balance over and above the Primary rate, such that the total is projected to:

1. meet the required funding target relating to past and future service benefit accrual
2. within the determined time horizon (see 3.3 Note (c) for further details)
3. with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see 3.3 Note (e) for further details).

Therefore, when an employer is in deficit, the secondary rate will set out the additional contributions that are required to achieve a 100% funding level within an appropriate time horizon and with a sufficiently high probably. The secondary rate may be expressed as a percentage of pay or as a monetary amount per annum.

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;
4. any different time horizons;
5. the difference between actual and assumed rises in pensionable pay;
6. the difference between actual and assumed increases to pensions in payment and deferred pensions;
7. the difference between actual and assumed retirements on grounds of ill-health from active status;
8. the difference between actual and assumed amounts of pension ceasing on death;
9. the additional costs of any non ill-health retirements relative to any extra payments made; and/or
10. differences in the required probability of achieving the funding target.

D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus".

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

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

1. the actual timing of employer contributions within any financial year;
2. the effect of the premature payment of any deferred pensions on grounds of incapacity.

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

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification but not to audit standard. The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

Appendix E – Key risks and controls

The Fund has an active risk management programme in place. Key risks are incorporated in the Fund's risk register which is monitored on an ongoing basis and reported to the Pensions Committee and LGPS Board on a quarterly basis.

Risk	Summary of Control Mechanisms
The Pension Fund Investment Strategy does not deliver the long term projected investments returns and does not comply with legislation	Ensure the investment strategy complies with the Local Government Pension Scheme regulations, Investment Strategy Statement and Investment Management Agreements.
	Set the Investment Strategy in light of the Fund's solvency target and risk and return objectives and review at regular intervals to ensure the Strategy is still appropriate
	Diversify investment across asset classes and markets to reduce the impact of financial market volatility including setting a limit for the proportion of the Pension Fund's assets held in illiquid asset classes such as private equity and property and and keep the Fund's diversification policy under review.
	Establish limits for the maximum percentage of the total value of all investments in particular investments or classes of investment, within a prudential framework and after taking proper advice.
	Monitor and provide a quarterly report to the Pensions Committee on Investment Managers' performance against benchmark.
	Regularly review any assets that the Fund has previously determined should be held outside of the ACCESS pool, ensuring this continues to demonstrate value for money
	Monitor Investment Managers' compliance with the investment restrictions and limits laid out in the Pension Fund's Investment Strategy Statement and Investment Managers' Agreements and report any cases of non- compliance
The funding level of the Pension Fund deteriorates	Set investment out-performance targets at the triennial valuation with reference to the Pension Fund's current Investment Strategy and on a relatively prudent basis to reduce the risk of under-performance against anticipated returns. At the same time, review and agree the other actuarial assumptions such as salary increases, discount rates, longevity etc.
	Provide the Pensions Committee with quarterly actuarial reports that monitor the funding position of the Pension Fund and the sensitivity of this to changes in general market conditions.
	Monitor and ensure scheme employers pay the extra capital/strain cost of non ill-health retirements following each individual decision and in the year the decision is made.
	Monitor each scheme employer's ill-health experience on an ongoing basis against the "ill health budget" set for each employer at the triennial valuation and require them to make additional contributions to the Pension Fund where budgets are exceeded.
	Monitor cash flows at a whole Pension Fund level and an individual scheme employer level and certify secondary contributions as a monetary amount for those with reducing payrolls as identified at the triennial valuation.

Risk	Summary of Control Mechanisms
	At each triennial valuation, assign any liabilities relating to ceased transferee admission bodies to the original ceding scheme employer.
	Monitor the 'characteristics' and individual funding position of pool members to ensure pooling is still appropriate. Require members of the Schools or Parish and Town Councils Pools to sign a pooling agreement which sets certain conditions and requirements for scheme employers' participation in the pool.
	Set maximum time horizons after taking into account the particular characteristics of each type of scheme employer and the future working lifetime of its employees. Use shorter deficit recovery periods for organisations with a limited "life" in the Pension Fund or without statutory tax raising powers.
	Monitor the covenant of scheme employers and use a risk based approach for setting contribution strategies for employers.
Scheme employers default on meeting their obligations to the Pension Fund and LGPS	Develop data quality controls with the Pension Fund's third party pension's administration service to monitor membership data submitted by scheme employers to ensure it is accurate and up to date.
	Develop a risk evaluation approach to identify covenant risk, categorising scheme employers as low, medium or high. Establish a set of risk criteria and monitor scheme employers against this. Engage with scheme employers at an early stage to address funding issues.
	Monitor contributions to ensure that scheme employers are paying the correct employer contribution rate to agreed deadlines.
	Do not allow unsupported employers to be admitted to the Pension Fund. Require all community admission bodies and transferee admission bodies to obtain a bond or guarantor from a scheme employer. Revalue bonds every three years to ensure the risk cover is still appropriate.
	Carry out regular financial checks on participating scheme employers, especially non-tax raising bodies.
	Carry out an annual employer survey to identify any changes in funding stream for scheme employers.
	Pool the contributions for scheme employers with similar characteristics to allow sharing of risk amongst scheme employers.
	Carry out cessation valuations on a more prudent gilts basis to ensure the payment calculated when a scheme employer's liabilities are crystallised is sufficient to meet the future payment of benefits made by the Pension Fund.
The Pension Fund and its third party providers do not comply with regulations, statute or procedure	Review the Custodian's and Investment Managers' internal control reports to identify any concerns over controls and processes in place
	Ensure the Custodian undertakes monthly reconciliations with the Pension Fund's Investment Managers to ensure all assets are correctly accounted for and holdings are agreed.
	Require all large employers in the Pension Fund to provide an Annual Assurance Certification that payroll systems are compliant and have been tested by the scheme employers' internal auditors

Risk	Summary of Control Mechanisms
	Take advice from Fund Actuary on position of Fund as at prior valuation, and consideration of proposed valuation approach relative to anticipated Section 13 analysis.
	Engage data matching service to receive earlier notifications of entitlement changes.
	Take proper advice to ensure a regulatory compliant asset pool in operation by statutory deadlines.
	Work in conjunction with the Strategic Procurement Group to ensure all procurements are carried out in accordance with HCC contract and EU regulations.
	Review the Pension Fund SORP in preparing the Statement of Accounts to ensure compliance and engage external audit to review the Pension Fund accounts each year.
	Manage performance of the Pension Fund’s third party pension’s administration service through a service level agreement and monitor against Key Performance Indicators.
	Work closely with the Pension Fund’s third party pension’s administration service to ensure it complies with current regulations and is alert to and can implement any changes to scheme benefits.
	Ensure the Pension Fund’s third party pension’s administration service has a robust programme in place to test controls on the membership benefit system and that they are fully compliant and up to date.
	Engage internal and external audit reports to regularly test that appropriate controls are in place over the payment of benefits and expenses and collection of contributions and that they are working effectively. Implement any recommendations resulting from both these audits.

Appendix F – Glossary

Actuarial assumptions/basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of the funding target. The main assumptions will relate to the discount rate, salary growth, pension increases and longevity. More prudent assumptions will give a higher target value, whereas more optimistic assumptions will give a lower value.
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.
Designating Employer	Employers such as town and parish councils that are able to participate in the LGPS via resolution. These employers can designate which of their employees are eligible to join the Fund.
Discount rate	The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day. This is necessary to provide a funding target which is consistent with the present day value of the assets. A lower discount rate gives a higher target value, and vice versa. It is used in the calculation of the Primary and Secondary rates.
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.
Funding target	The actuarially calculated present value of all pension entitlements of all members of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the deficit. It is calculated on a chosen set of actuarial assumptions.
Gilt	A UK Government bond, ie 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 their main use in funding is as an objective measure of solvency.
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, but can sometimes be another type of employer such as an Academy.
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 101 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, ie 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 least every three years 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 three year period until the next valuation is completed.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, universities, academies, 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, university lecturers).
Secondary contribution rate	The difference between the employer's actual and Primary contribution rates. In broad terms, this relates to the shortfall of its asset share to its funding target.

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. Different methods may involve: probability-based modelling of future market movements; longer deficit recovery periods; higher discount rates; or some combination of these.

Valuation An actuarial investigation to calculate the liabilities, future service contribution rate and common contribution rate for a Fund, and usually individual employers too. This is normally carried out in full every three years (last done as at 31 March 2016), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date also.

HERTFORDSHIRE COUNTY COUNCIL

PENSION BOARD (LGPS)

TUESDAY, 6 DECEMBER 2016 AT 10:00AM

Agenda Item No:
6

PENSION FUND ASSET POOLING – ACCESS UPDATE

Report of the Director of Resources

Author: Patrick Towey, Head of Specialist Accounting (Tel: 01992 555148)

1. Purpose of the Report

1.1 To provide the Pensions Board with an update on recent ACCESS pool developments and the ACCESS Chairmen engagement meeting that took place on 13 October 2016.

2. Summary

2.1 The ACCESS pool proposal for the pooling of assets was submitted to Government by the deadline date of the 15 July 2016. The Government was expected to review all pool submissions and inform all pools of their decision in September; however, at the time of writing this report none of the pools have received any formal decision from the Government.

2.2 At a National cross pool meeting held on the 20 October a representative from the Department for Communities and Local Government (DCLG) informed the pools that the Minister for Local Government, Marcus Jones MP, would like to meet representatives from each pool to discuss their pool submission, the timetable and progress to delivery of the pool, and the political buy-in to each pool. The Minister, in particular, is keen to meet elected Members; a deputation from the ACCESS pool will meet the Minister at some time in November, and a representative of the Hertfordshire Fund will be present at this meeting. A verbal briefing will be provided to members of this Board if this meeting takes place before this Pension Board meeting.

2.2 Following the decision by all ACCESS Funds to rent an operator, with the option to build in the future, the main focus of work by ACCESS has been the development of the governance of the pool and how local Fund asset allocation decisions will be implemented through the pool operator via a Joint Governance Committee (JGC). To enable this JGC to implement local Fund asset allocations, an Inter Authority Agreement will need to be put in place by the end of March 2017 and this will require sign off by each administering authority through their individual constitutional process. The deadline is considered challenging as this change will require approval by full Council, and most of the ACCESS Councils will only have their February budget meetings to agree this constitutional change.

2.3 Legal officers representing the Funds in the ACCESS pool have been involved in the process for establishing an inter authority agreement. Eversheds have been appointed to provide the first draft of the heads of terms for this agreement, for discussion and agreement by Fund legal officers prior to the next ACCESS Chairmen meeting in December. The inter authority agreement will be put before the Pension Committee at its meeting on the 24 February 2017 for comment and to recommend its approval by full Council at its meeting on 21^{t} March 2017.

2.4 At the most recent ACCESS Chairmen meeting on 13 October, the ACCESS Chairmen during its governance discussion considered the establishment of an independent non-voting Chair to sit on the joint governance committee. This was put to a vote by the meeting and the proposal was rejected by 9 votes to 2. Hertfordshire were one of the only two authorities in favour of an independent Chair.

2.5 ACCESS officers will hold engagement days with potential operators in November to understand the depth of the operator marketplace and to inform the specification for the Official Journal of the European Union (OJEU) procurement. The Hertfordshire Fund is leading on the procurement of a legal advisor to assist the ACCESS pool in the procurement of a regulated third party provider, the operator, and specific legal advice on the establishment of tax efficient sub-funds for the management of Fund assets. The legal advisor will also be asked to provide advice on new or replacement contracts with investment managers and transition plans for the phased transfer of assets to the pool. The procurement process will take up to 8 weeks.

3. Recommendations

3.1 That the Pensions Board notes the content of this report.