# Agenda

**AGENDA for a meeting of the PENSIONS COMMITTEE to be held in COMMITTEE ROOM B, County Hall, Hertford on TUESDAY, 7 MARCH 2017 at 2:00PM**

**MEMBERS OF THE COMMITTEE (10) - QUORUM 3**

C M Hayward (Chairman), R J Henry, J G L King, D E Lloyd, R G Parker, R Sangster, D T F Scudder, A M R Searing, A Stevenson, J D Williams (Vice-Chairman)

**REPRESENTATIVES OF HERTFORDSHIRE DISTRICT / BOROUGH COUNCILS (3) (NON-VOTING)**

J Lloyd, K Ayling, M Freeman

Invitees:

Colm O'Callaghan, District Finance Representative

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

**PART I (PUBLIC) AGENDA**

1. **MINUTES**

   To confirm the minutes (Parts I and II) of the meeting held on 18 November 2016.

2. **RISK AND PERFORMANCE**

   Report of the Director of Resources

3. **INVESTMENT STRATEGY REVIEW**

   Report of the Director of Resources

**4. REVIEW OF VOTING POLICY**

Report of the Director of Resources

**5. FUNDING STRATEGY STATEMENT & CONSULTATION RESPONSE**

Report of the Director of Resources

**6. TREASURY MANAGEMENT STRATEGY FOR PENSION FUND**

Report of the Director of Resources

**7. GOVERNANCE: LGPS INVESTMENT POOLING INTER AUTHORITY AGREEMENT**

Report of the Director of Resources

**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 item of business on the grounds that it involves 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. PENSION FUND – FUNDING AND INVESTMENT REPORT (Formerly PERFORMANCE REPORT) AS AT 31 DECEMBER 2016**

Report of the Director of Resources

**If you require further information about this agenda please contact Stephanie Tarrant, Democratic Services Officer, on telephone no (01992) 555481 or e-mail Stephanie.tarrant@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 Committee

From: Legal, Democratic & Statutory Services
Ask for: Lisa Heaton
Ext: 25456

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**PENSIONS COMMITTEE**
**18 NOVEMBER 2016**

**ATTENDANCE**

**MEMBERS OF THE PENSIONS COMMITEE**

C M Hayward (Chairman), R J Henry, E M Gordon (substitution for J G L King), D E Lloyd, R G Parker, R Sangster, D T F Scudder, A M R Searing, A Stevenson, J D Williams (Vice-Chairman)

**MEMBERS OF HERTFORDSHIRE DISTRICT/BOROUGH COUNCILS (NON-VOTING)**

K Ayling, M Freeman

**OTHER MEMBERS IN ATTENDANCE**

D Devereux (Local Government Pension Scheme (LGPS) Pension Board and Unison Member

Upon consideration of the agenda for the Pensions Committee meeting on 18 November 2016 as circulated, copy annexed, conclusions were reached and are recorded below:

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

**CHAIRMAN'S ANNOUNCEMENT**

The Chairman advised that for ease of reporting item 6 should be heard before item 5 in the proceedings; the order of business was varied accordingly.

**PART I ('OPEN') BUSINESS**

**ACTION**

**1. MINUTES**

1.1 Minutes (Parts I and II) of the meeting of the Pensions Committee held on 27 October 2016 were confirmed as a correct record and signed by the Chairman.

**2. QUATERLY RISK AND PERFORMANCE REPORT**
[Officer Contact: Jolyon Adam, Finance Manager
(Tel: 01992555078)]

2.1 Members received a report the purpose of which was to provide the quarterly update on Risk and Performance for the Pension Fund for the period 1 July to 30 September 2016. The Committee was invited to note the reports to be presented to the December and November meetings of the Local Government Pensions Scheme (LGPS) and the Hertfordshire Fire and Rescue Service (HFRS) Pensions Boards.

2.2 Members attention was drawn to the Risk Register, Current Status and Activity Summary (Table 1) setting out risk control mechanisms aiming to avoid or reduce risk events in relation to the Pension Fund. Main activity changes were highlighted. At Section A the Committee was asked to note that the ACCESS pool was still waiting for it formal letter from Government to proceed with pooling as outlined in the July submission. The Minister for Local Government had requested to meet with ACCESS representatives in November to discuss the submission. A separate report regarding a review of the Investment Strategy would be considered at item 4 of the agenda. At Section B, Members were notified that all Parish & Town Councils had responded to the May 2016 consultations with decisions to remain in the pool for valuation purposes. At Section C, Members were advised hat a risk based approach, developed in conjunction with Hymans, had been adopted for the 2016 valuation. At Section D, Members noted that Hertfordshire was acting as lead administering authority for the procurement of legal advice for the ACCESS pool [also see item 5 below].

2.3 It was noted that overall risk statuses remained unchanged at Amber since last quarter for all four key risks.

2.4 Committee Members were updated on the current status of Employers Risk monitoring, noting that Scheme Employers were monitored on a monthly basis to measure the trend and current status of risk where scheme employers' covenants may have a detrimental impact on the Pension Fund. (Tables 2 and 3 of the report refer). Members were advised that the value of net liabilities for each risk category shown was based on the 2013 valuation and would be updated in the next quarterly report. **Patrick Towey**

2.5 Clarification was sought on how the Employers Risk was quantified. Members heard that employers were risk rated for the 2016 valuation which influenced the level of employer contributions they would need to pay into the fund. This risk assessment took into account the strength of their covenant, which was calculated in terms of a number of factors including whether the employer had a bond of guarantor to cover their liabilities should they default and whether the employer had tax raising powers. The calculated risk score then influenced the minimum level of probability that the fund was willing to take that the employer would be paying a contribution rate which would fully fund their liabilities within a given timeframe. Members were further advised of a second element which was an ongoing risk assessment monitoring employers in terms of the risk they presented to the fund at any one time; this was based on a number of triggers which allocated points to the employer who could be Red rated or Amber rated by virtue of its cumulative score. The number of employers in each category and their assessed liabilities were monitored at the most recent valuation, giving an assessed quantification of the financial risk to the fund of Employer default. The Committee was advised that this method of measuring Employer Risk was considered robust and had been developed with the support of the scheme actuary Hymans.

2.6 Members also heard about the Administering Authority Performance Monitor, detailed at table 4 of the report, where the performance of the Administering Authority and scheme employers in managing and administering the Pension Fund was shown measured against performance indicators set out in the Administration Strategy. Members were apprised that work would shortly commence on the Internal Audit of Pensions Administration as outlined in the 2016/17 Shared Internal Audit Service (SIAS) Audit Plan. This was currently scheduled to commence during quarter 3. It was noted that during the quarter there were two new Local Pensions Fund Authority service complaints, compared to one in the previous quarter. Both of these complaints were resolved within the quarter.

2.7 Members queried the descriptive power of the Red, Amber and Green indicators and considered that more sensitivity within each rating would be helpful. Officers undertook to develop a method of direction indicator to help address this concern in future reports **Patrick Towey**

**<u>Decision</u>**

That the report be noted.

## 3. FORMAL FUNDING VALUATION INITIAL RESULTS 2016

[Officer Contact: Patrick Towey, Head of Specialist Accounting (Telephone 0199 555148)]

3.1 The Pensions Committee considered a report setting out the initial results of the formal valuation of the Hertfordshire Pensions Fund (HPF) at 31 March 2016 recommending the approach, review, consultation and final approval of the Funding Strategy Statement (FSS).

3.2 In compliance with Regulation 62 of the Local Government Pension Scheme Regulations 2013 (the Regulations), Hymans Robertson undertook a valuation of the whole Fund at 31 March 2016 and the detail of these results was presented in Annex A to the report.

3.3 Members attention was drawn to the triennial valuation of 31 March 2016 showing a whole Fund increase in value from 82% to 91%. Individual employer results and contribution rates would be issued from November 2016. There had been a reduction in the reported Fund deficit from £617million to £336million. The actuarial investment experience for Hertfordshire Fund was better than the assumption set by the actuary for investment out performance. This resulted in a 7.1% positive contribution for the Fund. The fall in gilt yields had a negative impact on the Fund by increasing the value of liabilities. Actual inflation experienced during the period was better than assumed inflation giving rise to a positive contribution to the Fund. The Membership experience was also positive with fewer ill health and early retirements along with fewer salary and benefits increases than assumed. The number of pensions in payment ceasing was less than anticipated which increased liability on the fund. In summary the liability position had increased but the assets had increased at a faster rate; as illustrated in the table at paragraph 4.6 of the report.

3.4 Based on common assumptions issued by the Government Actuary Department (GAD) the funding level of the Hertfordshire Fund was at 107%; which was in the top 5 of funds reported to the Scheme Advisory Board (SAB) thus far.

3.5 Members were also advised of a review of the Funding Strategy Statement (FSS) (Appendix B) which would take effect from 31 March 2017. Members heard that the FSS was the framework that the Fund's actuary works within to carry out triennial valuations to set Employers Contributions. It also provided recommendations to the Administering Authority for other funding decisions.

3.6 As part of the review process the FSS would be considered by the Pensions Board at its next meeting, subsequent to which it would be circulated to all scheme employers for a short consultation period. Following this review and consultation, the revised FSS would be

**Jolyon Adam/ Theresa Baker/ Democratic**

presented to the February meeting of the Pensions Committee for approval. — Services to note

3.7 The success of the Fund as reported was welcomed as good news by the Committee and appreciation of the good work of all involved was expressed. The prudent nature of the actuarial assumptions was noted.

3.8 Referring to Fund Membership Experience at 4.6 of the report, it was noted that, although there had been a very good result, clarification was needed as to checks and balances against a more negative outcome. Committee Members were advised that the Investment Strategy and asset allocations were regularly reviewed. Indicators currently suggested that interest rates were going to remain low and gilt yields may increase. This would be monitored and officers would report to the Committee should any asset movement be significant.

3.10 Clarification was sought as to whether Government may become more interventionist in Hertfordshire Fund allocations. It was noted that it was not possible to predict future Government strategy but that the upcoming Budget Statement would be carefully reviewed.

3.11 An enquiry was made regarding what happened to any surplus if the Fund were to generate one, and Members were advised that, in this event, the regulations did not permit the refund of a surplus but a continuing and increasing surplus could give rise to reduced contributions for certain employers. .

**Decision**

3.12 The Committee noted:-

(i) the initial results of the 2016 formal Funding valuation; and

(i) 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. — **Patrick Towey/ Democratic Services to note**

**4. INVESTMENT STRATEGY REVIEW**
[Officer Contact: PatrickTowey, Head of Specialist Accounting **(**Telephone 01992 5551480)]

4.1 A report was presented informing the Committee of the process and timetable for the review of the Fund's Investment Strategy. In accordance with Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations (1 November 2016), an Administering Authority (AA) must produce and publish a new investment strategy statement (ISS) by 1st April 2017. This ISS would replace and largely replicate the current Statement of

Investment Principles (SIP). Details of the required areas of action were noted. These included a requirement to invest money in a wide range of investments, the Authority's approach to pooling investments, and the Authority's policy regarding the stewardship of assets, including the exercise of voting rights. (The full list is set out at paragraph 2.2 of the report).

4.2 Referring to the overview at Section 4 at page 2 of the report, key elements were highlighted to the Members. Officers advised that the new regulations transferred investment decisions and their consideration more fully to the AA that there was a more relaxed regulatory framework with less central prescription and limits for asset allocation and pooling, and that, additionally, there was a new safeguard to ensure that AA's acted appropriately; the Secretary of State had power to intervene and issue direction if satisfied of failure to act in accordance with the guidance.

4.3 Fund officers would work with Mercer to review the current investment strategy in light of the new investment regulations and taking into consideration the outcome of the Fund valuation results. A draft revised strategy would be presented to the Committee in February 2017 for consideration. Subject to any further amendments a final investment strategy would be presented to the Pension Committee on 31 March 2017 for approval. As part of the review and approval process, the draft strategy would also be considered by the LGPS Pension Board at its February 2017 meeting

**Jolyon Adam/ Theresa Baker/ Democratic Services to note**

4.4 **Decisions**

The Pensions Committee:

(i) noted the content of the report;
(ii) agreed the plan for the review of the Fund's investment strategy; and
(iii) agreed that a joint Member/Officer Working Group to assist in the preparation of a revised Investment Strategy be established.

**Patrick Towey**

**5. PENSION FUND ASSET POOLING - ACCESS UPDATE**
[Officer Contact: Patrick Towey, Head of Specialist Accounting, Telephone 01992 555148]

5.1 Members were presented with a report providing an update on recent ACCESS pool developments and the ACCESS Chairmen engagement meeting that took place on 13 October 2016.

5.2 Officers advised that the ACCESS pool proposal for the pooling of assets was submitted to Government by the deadline date of 15 July 2016. None of the pools had received any formal decision from the

Government. The Minister was keen to meet elected Members; a deputation from the ACCESS pool were scheduled to meet the Minister on 29 November 2016 and an officer of the Hertfordshire Fund would be present at this meeting.

5.3 The Committee was advised that the development of the governance of the ACCESS pool via a Joint Governance Committee (JGC) to implement pooling required an Inter-Authority Agreement. This would need to be put in place by the end of March 2017 and required sign-off from each Administering Authority.

5.4 The Committee was further advised that Legal Officers representing the Funds in the ACCESS pool had been working to establish an inter-authority agreement. Eversheds had been appointed to provide the first initial draft for discussion and agreement by Fund legal officers prior to the next ACCESS Chairmen meeting in December 2016. The draft agreement would be put before the Committee at its meeting on the 24 February 2017, prior to being presented to full Council for approval at its meeting on 21 March 2017.

**Patrick Towey/ Elaine Shell/ Democratic Services to note**

5.5 Members heard that The ACCESS Chairmen meeting on 13 October considered the establishment of an independent non-voting Chairman to sit on the JGC. The proposal was rejected by 9 votes to 2. Hertfordshire and one other Authority were in favour of an independent Chairman who would provide expertise and continuity during member changes; officers would continue to support the Authority's preference for an independent Chairman.

5.6 Members also noted that ACCESS officers would hold engagement days with potential operators in November 2016 to understand the depth of the operator marketplace and to inform the specification for the OJEU procurement. The Hertfordshire Fund was leading on the procurement of a legal advisor to assist the ACCESS pool with specific advice on the procurement of the operator and the implementation of tax efficient sub-funds. The legal advisor would 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 would take up to 8 weeks.

**<u>Decision</u>**

5.7 That the report be noted.

**6. EXCLUSION OF PRESS AND PUBLIC**

**<u>Decision</u>**

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 ANNUAL INVESTMENT MANAGER COSTS REPORT**

**Decision**

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

**2 PENSION FUND - FUNDING & INVESTMENT REPORT (FORMERLY PERFORMANCE REPORT) AS AT 31 MARCH 2016**

**Decision**

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

**3 SWITCHING GLOBAL EQUITY MANAGERS**

**Decision**

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

**KATHRYN PETTITT**
**CHIEF LEGAL OFFICER** **CHAIRMAN**______________________

HERTFORDSHIRE COUNTY COUNCIL

PENSIONS COMMITTEE
TUESDAY, 7 MARCH 2017 AT 2:00PM

| Agenda Item No: |
| --- |
| 2 |

# RISK AND PERFORMANCE

*Report of the Director of Resources*

Author: Jolyon Adam, Finance Manager, Resources
(Telephone: 01992 555078)

## 1. Purpose of the Report

1.1 To provide the quarterly update on Risk and Performance for the Pension Fund for the period 1 October to 31 December 2016.

## 2. Summary

2.1 The report provides an update on the following matters:

- summary of reports to be presented to the February/March meeting of the Pensions Boards;
- current status of risk and governance matters that are monitored as part of the Risk Register;
- current status of risk monitoring of Scheme Employers; and
- performance of the Administering Authority measured against performance indicators set out in the Administration Strategy.

## 3. PENSION BOARD REPORTS

3.1 The Pensions Committee are invited to note the following reports related to risk and performance that the LGPS and Fire Pension Boards will receive at their March and February meetings respectively:

**LGPS Board**

- **Risk and Governance Report:**
  - Providing a detailed quarterly update on the governance and management of the Pension Fund.
- **London Pensions Fund Authority Administration Report:**
  - Providing a quarterly update on the performance of the administration service for the Local Government Pensions Scheme.
- **Annual Report on the Activity of the Pensions Board:**
  - This will be the first instance of an ongoing annual report to outline the key activities and topics that the board has addressed in the previous.

- **LGPS Pensions Boards – One Year On:**
  - This report will be a one off review of the implementation and operation of the Hertfordshire Pension Board.
- **Funding Strategy Statement:**
  - As presented to the Pensions Committee.

<u>**Fire Board**</u>

- **London Pensions Fund Authority Administration Report** providing a quarterly update on the performance of the administration service for the Firefighters' Pension Scheme
- **Internal Dispute Resolution Process (IDRP) Policy** outlining the policy relating to the processing and response to complaints and grievances submitted by members of the scheme
- **HFRS Pension Scheme Accounts & Annual Governance Report (AGR)** covering the period 1 April 2015 to 31 March 2016
- **Risk Management Report** providing an overview of the key risks in relation to the HRFS
- **Governance Compliance Statement Review** to refresh and review the Fire Board's Terms of Reference

## 4. RISK REGISTER

4.1 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. Risks are classified using the following criteria.

| Risk Level | Description |
|---|---|
| **Severe** | The consequences will have a severe impact on the delivery of a key priority and comprehensive management action is required immediately. |
| **Significant** | 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** | 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** | Consequences of the risk are considered relatively unimportant. The status of the risk should be reviewed periodically. |

4.2 Table 1 provides the risk current status of the four key risks and a summary of activities undertaken during the quarter to September 2016. The risk status key is shown in the following chart.

| | |
|---|---|
| ▲ | An increase in risk status since the previous quarter |
| ◀▶ | Risk status has remained unchanged since the previous quarter |
| ▼ | A decrease in risk status since the previous quarter |

**Table 1: Risk Register – Current Status and Activity Summary**

| Risk | | Risk Level | Change in Risk Status | Quarterly Activity Summary |
|---|---|---|---|---|
| A | The Pension Fund Investment Strategy does not deliver the long term projected | **Amber** | ◀▶ | Government approval of ACCESS pooling submission is still awaited, at the point of writing negotiations are still ongoing between the Minister for |

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| | investments returns and does not comply with legislation. | | | Local Government and ACCESS representatives. A separate report on the current activity around ACCESS pooling is being presented to this meeting.<br><br>As confirmed at the previous meeting of the Pension Committee a cross-party working group has been meeting to review and revise the Fund's Investment Strategy. An update on the progress of this review is being provided to the Committee. |
| B | The funding level of the Pension Fund deteriorates. | **Amber** | ◀▶ | Individual results were circulated to the majority of employers in December.<br><br>The results of the Triennial Valuation report show that the whole Fund funding level has increased from 84% as at 31 March 2013 to 91% as at 31 March 2016 with an overall reduction in the deficit from £617m to £336m.<br><br>The Funding Strategy Statement (FSS) has been updated for the 2016 Valuation, and the consultation period for this has now closed. A separate report to this Committee will summarise the feedback received and present the final FSS for approval. |
| C | Scheme employers default on meeting their obligations to the Pension Fund and LGPS. | **Amber** | ◀▶ | The process for the 16/17 Annual Benefit Statement exercise has now commenced, and as is being conducted on a project basis as adopted for 15/16. At this stage, an initial communication regarding acknowledgement of responsibilities has been sent to all employers in the fund.<br><br>A risk based approach has been adopted for the 2016 valuation which has been reflected in the results schedules sent to employers. These risk categories have been used to set the funding targets for each scheme employer given a minimum level of probability.<br><br>The Pensions Team have been |

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| | | | | responding to queries from employers, with most concern in regards to the general increase in employer contribution rates. |
| D | The Pension Fund and its third party providers do not comply with regulations, statute or procedure. | **Green** | ◀▶ | Hertfordshire is acting as lead administering authority for the procurement of legal advice for the ACCESS pool. The tender was issued in December with a deadline for responses of 27th January 2017. Responses will be evaluated in February. |

## 5. SCHEME EMPLOYERS RISK MONITORING

5.1 Scheme Employers are monitored on a monthly basis to measure the trend and current status of risk where scheme employers' covenants may have a detrimental impact on the Pension Fund.

5.2 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 2 provides a summary of the current position, with comparative data for previous quarters.

**Table 2: Employer Risk Monitor – Current Trend and Status**

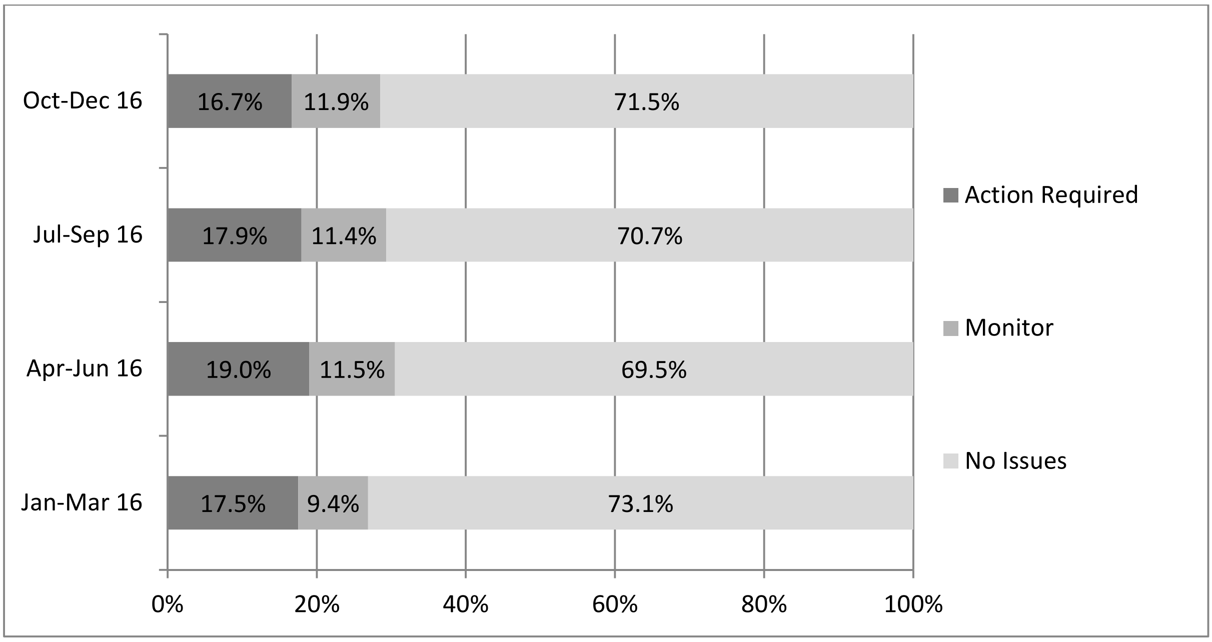


Table 3 provides an analysis of the number of scheme employers in each risk category together with the value of net liabilities (based on the 2013 Valuation) for each risk category with a comparison to the previous quarter.

**Table 3: Analysis of Scheme Employers by Risk Category**

| July – September 2016 | | | | | Risk Category / Risk Score | October – December 2016 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Scheme Employers | | Net Liabilities | | Risk Score [1] | | Scheme Employers | | Net Liabilities | | Risk Score [1] |
| No. | % | £ m | % | | | No. | % | £ m | % | |
| 63 | 17.9 | 14.4 | 2.3 | 12.02 | Red (9+) | 59 | 16.6 | 14.5 | 2.4 | 12.22 |
| 40 | 11.4 | 87.1 | 14.1 | 4.80 | Amber (4-8) | 42 | 11.9 | 87.1 | 14.1 | 4.76 |
| 248 | 70.7 | 515.5 | 83.6 | 0.67 | Green (0-3) | 253 | 71.5 | 515.4 | 83.5 | 0.66 |
| **351** | **100.0** | **617.0** | **100.0** | **3.18** | **Total** | **354** | **100.0** | **617.0** | **100.0** | **3.07** |

## 6. ADMINISTERING AUTHORITY PERFORMANCE MONITORING

6.1 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. This section also includes information about treasury management performance against the annual Treasury Management Strategy.

[1] Calculated as an average of the individual risk scores across all employers within the category, and in total.

6.2 Table 4 provides the current status and commentary on the performance indicators. The performance status key is shown in the following chart.

| | |
|---|---|
| ▲ | A deterioration in performance since the previous quarter |
| ◀▶ | Performance has remained unchanged since the previous quarter |
| ▼ | An improvement in performance since the previous quarter |

**Table 4: Administering Authority Performance Monitor**

| Indicator | Change in Performance Status | Commentary |
|---|---|---|
| Audit Reviews | ◀▶ | The Internal Audit of Pensions Administration as outlined in the 2016/17 Shared Internal Audit Service (SIAS) Audit Plan has commenced and a draft report is expected in quarter 4. Once finalised the report will be presented to the Pension Committee & Pensions Board.<br><br>Planning has commenced for the 16/17 external audit of the Pension Funds Annual Accounts, and timetables have been amended to take account of requirements to prepare for and comply with the early closure of HCC's overall accounts, which will be coming into force for the 17/18 financial year. These will require certification and publication of HCC's final accounts by 31st May and 31st July respectively. |
| Complaints and Internal Disputes | ◀▶ | **Complaints:**<br><br>During the quarter there were three new LPFA service complaints, compared to two in the last quarter. Two of these complaints were resolved within the quarter.<br><br>One complaint was received in regards to a Third Tier Ill Health Pension ceasing. The regulations state the Third Tier Ill Health Pension should cease after three years unless it has been uplifted to the Second Tier. LPFA previously awaited instruction from employers to cease Third Tier Ill Health Pensions which has resulted in over payments so the process has been amended to cease all Third Tier Ill Health Pensions after three years and inform the employer. This complaint was carried forward into Q4 as the LPFA are awaiting further information.<br><br>Another complaint was received for delays in processing a leaver. This is due to employers not submitting the leaver form or responding to queries.<br><br>The third complaint was received regarding the late payment of a refund of contributions. The member was in employment for less than three months which means that it is the employer's responsibility to refund |

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| | | pension contributions at point of leaving. LPFA discussed the process with the employer who then insisted that they were unable to pay the refund as they had closed their payroll for the year. LPFA then contacted the members and followed the normal process to pay the refund directly from the fund.<br><br>During the quarter to 31 December 2016, one IDRP's was raised against the Administering Authority with three brought forward from the previous quarter. Two of these IDRP's were responded to within the quarter.<br><br>**IDRP:**<br><br>The new IDRP related to members challenging overstated pension benefits in their option letter. This IDRP was responded to within the quarter.<br><br>One of the brought forward IDRP's was responded to in the quarter and related to a stage 1 appeal received from a member contesting an overpayment following the implementation of a pension sharing order. The appeal was dismissed, and the original decision upheld.<br><br>The carried forward IDRPs related to an under paid added years appeal and an unsuccessful stage 2 appeal regarding member claims that their pension should have been put into payment, however this was not agreed by the employer. |
| Scheme Employer Late Payments and Penalty Charges | ◀▶ | There were 8 penalty charges raised for the period to 31 December 2016 against 7 scheme employers for late payment of contributions or late return of monthly contribution forms.<br><br>There were 9 incidents of late payment by scheme employers in the quarter to 31 December 2016. Details of these late payments are reported in the LPFA's quarterly Administration Report which is presented to the Pensions Board. |
| LPFA Administration Service Performance Indicators | ◀▶ | Officers are working with the LPFA to address the backlog of Defined 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.<br><br>Recruitment has been undertaken to replace leavers and a project plan is being maintained to clear the backlog of cases.<br><br>Proposals put forward by the Pensions Board are being considered to implement a charge on employers for late notification of leavers due to the additional |

| | | |
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| | | administration and peaks in workload that this creates. |
| Treasury Management | ◀▶ | The average size of the portfolio at 31 December 2016 was £17.0m increasing from £12.2m in the previous quarter. This is below the cap of £35m.<br>Interest earned in the quarter to 31 December 2016 was £12.1k increasing from £11.9k in the previous quarter.<br>The rate of return was 0.29% decreasing from 0.39% in the previous quarter. This was 0.06% above the benchmark of the average 7 day London Interbank Bid (LIBID) rate of 0.23%<br><br>The Treasury Management Strategy (TMS) for the funds held and administered by Hertfordshire County Council's Treasury Team for liquidity and cash flow operations of the Pension Fund has been reviewed. The proposed TMS for 17/18 is presented to the Committee for approval in a separate paper. |

**HERTFORDSHIRE COUNTY COUNCIL**

**PENSIONS COMMITTEE**
**TUESDAY, 7 MARCH 2017 AT 2:00PM**

| Agenda Item No: |
| --- |
| **3** |

# INVESTMENT STRATEGY REVIEW

*Report of the Director of Resources*

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

## 1. Purpose of the Report

1.1 To inform the Pension Committee of the work of the investment strategy working group (ISWG) in the review of the Fund's investment Strategy.

## 2. Summary

2.1 It was anticipated that an initial draft of the new investment strategy would be brought to this Pension Committee meeting for review and comment; however, the working group of officers/members has only had an opportunity to have two meetings to discuss the strategy since the last Pension Committee and the draft investment strategy will now come to this Committee at its meeting of 31 March 2017.

2.2 The investment strategy working group met for the first time on the 19 December 2016 and at this meeting the working group reviewed:

- The current risk and return objectives of the Fund
- How the funding level of the Fund had progressed since the investment strategy was last reviewed in 2010/11; and
- Whether 65/35 growth/defensive strategy was still reasonable.

The Mercer investment strategy update, attached at appendix A, provides some additional information on the working group discussion and strawmen portfolios that were considered at the meeting of this working group on the 8 February 2017. A verbal update from this meeting on the progress in the work to deliver the revised investment strategy will be provided at this Pension Committee meeting.

2.3 The next meeting of the ISWG will take place on the 7 March 2017. A draft investment strategy will come to this Committee on 31 March 2017 for review and approval. The Fund is required to have a new investment strategy in place by 1 April 2017.

## 3. Recommendations

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

## 4. Background

4.1 At the Pension Committee of 24 November 2016, the Committee agreed to establish a cross party working group of members to work with officers and the Fund's investment consultant Nick Sykes, Mercer to review the current investment strategy of the Fund and develop a new investment strategy which will meet the requirements of the new Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

4.2 The guidance from Government requires Funds to look at a number of areas when reviewing and putting in place its new Investment Strategy and these are as follows:

- Investment strategy and the process for ensuring suitability of investments;
- Risk measurement and management;
- Approach to asset pooling;
- Social, environmental and corporate governance policy; and
- Policy of the exercise of rights (including voting rights) attaching to investments.

4.3 All Funds are required to have in place a revised investment strategy by the 1 April 2017.

## 5. Future meetings of the Investment Strategy Working Group review

5.1 The ISWG will meet on the 7 March 2017 to review the environmental, social and governance (ESG) policy for the Fund, and finalise any outstanding work from its meeting of the 8 February 2017.

5.2 The draft investment strategy will come to this Committee on the 31 March 2017 for final review and agreement.

References:
Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016.

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# INVESTMENT STRATEGY UPDATE

## HERTFORDSHIRE COUNTY COUNCIL PENSION FUND (THE 'FUND')

### 1. Introduction

Following the initial results of the 2016 actuarial valuation, a Working Group formed of members of the Pensions Committee has been established to review the Fund's current investment strategy and to determine whether any changes to the investment strategy should be considered by the Pensions Committee. This brief document serves as an update on the discussions that the working group has had to date.

### 2. Investment Strategy Review

The actuary's initial valuation results showed an improvement in the Fund's funding level from 82% in 2013 to 91% in 2016. Whilst there would have been an expectation of a marginal improvement of the Funding level as a result of deficit contributions, the actual improvement was greater than anticipated.

Given the improvement in the funding level it was agreed that the investment strategy review should investigate whether there was an opportunity to reduce the levels of investment risk the Fund is running currently, thus reducing any potential deterioration in the funding level which the Fund has worked hard to improve. The review should also ensure that the Fund has a high probability of achieving long term funding objectives i.e. being 100% funded in a suitable timescale and in making sure that contribution rates remain affordable in the future.

The Working Group had its first meeting in December to review the current investment strategy and also the final investment strategy agreed in 2011 which the Fund was moving towards before the quarterly switching from equities to bonds was suspended because of low gilt yields.

At the meeting it was agreed that the 'return' objective should be to have a strong probability of being fully funded over a 21 year time period (i.e. seven actuarial valuations hence), in effect the same funding objective set at the 2010/11 strategy review. Following the improvement in funding level at the 2016 valuation, it was agreed that the 'risk' objective should be 'improved' to that of having a low probability (1 in 10) of being below 75% at the next actuarial valuation (previously 65%). With these slightly revised objectives in mind, it was agreed that some other possible 'strawman' portfolios should be considered with reduced allocations to equities and increased allocations to bonds and/or 'real assets'.

## 3. Strawmen for Review

The proposed strawman portfolios which are being considered at the working group meeting on Wednesday 8 February are detailed below:

| Asset Class | Current Allocation (25/75) | Target Allocation (35/65) Bonds | Target Allocation (35/65) Real assets | Target Allocation (45/55) Bonds and real assets |
|---|---|---|---|---|
| UK Equity | 16.0 | 10.0 | 10.0 | 5.0 |
| Global Equity | 34.2 | 30.0 | 30.0 | 25.0 |
| Bonds | 25.0 | 35.0 | 25.0 | 35.0 |
| Property | 8.0 | 8.0 | 8.0 | 8.0 |
| HLV, Infrastructure Debt, PRS | - | - | 10.0 | 10.0 |
| Alternatives | 10.8 | 11.0 | 11.0 | 11.0 |
| Private Equity | 5.0 | 5.0 | 5.0 | 5.0 |
| Residual Assets/Cash | 1.0 | 1.0 | 1.0 | 1.0 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** |

## 4. Next Steps

The strawman portfolios detailed above are being discussed at the 8 February meeting. At this stage the portfolios demonstrate what is possible for the Fund and are for consideration and refining. The final investment strategy which will be brought to the Pension Committee for consideration, could well differ from the proposed portfolios above.

Further updates will be issued as the investment strategy review progresses.

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**Nick Sykes**
February 2017

HERTFORDSHIRE COUNTY COUNCIL

**Agenda Item No: 4**

PENSIONS COMMITTEE
TUESDAY, 7 MARCH 2017 AT 2:00PM

# REVIEW OF VOTING POLICY

*Report of the Deputy Chief Executive*

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

## 1. Purpose of the Report

1.1 To advise the Committee of the results of the review of the Fund's voting policy over the period July 2015 to September 2016

## 2. Summary

2.1 The Fund has a policy to vote at the AGMs and EGMs of FTSE 350 companies in the UK in accordance with corporate governance principles. The Fund uses an external voting advisory service provided by ISS (Institutional Shareholder Services) formerly RREV (Research, Recommendations and Electronic Voting). They analyse the resolutions at Annual General Meetings (AGMs) and Extraordinary General Meetings (EGMs) to determine their compliance with corporate governance principles and advise on voting actions accordingly. The investment managers are required to follow this advice. Investment managers must obtain prior written authority to vote contrary to RREV recommendations.

2.2 In addition to this proxy service the Fund is also a member of the Local Authority Pension Fund Forum (LAPFF).The LAPFF act in a stewardship role on behalf of LGPS funds to facilitate effective engagement with companies and policy makers. There are 70 Local Government Pension Scheme member funds of this Forum. This service will complement the voting service provided by ISS to the Fund in exercising its votes in ensuring responsible corporate governance and engagement on issues such as executive pay and carbon reduction.

## 3. Conclusions

3.1 Votes were cast in accordance with the Fund's policy in 99.9% of cases. In cases where investment managers breach voting policy they are asked to provide an explanation for this breach and confirm that they would review their internal control systems so as to avoid further voting breaches occurring in the future. One of the Fund's investment managers breached the guidance during this period

## 4. Recommendation

That Members of the committee note the content of this report.

## 5. Background

5.1 The Pension Fund since July 1997 routinely votes on all matters raised by FTSE 350 listed UK companies where it own shares. The Investment Managers are asked to vote in accordance with the recommendations of the voting advisory service provided by the Fund's external provider ISS and to report the votes annually. If the investment managers feel it is not appropriate to vote in accordance with the guidance, if they believe that such action would not be in the best financial interests of the Pension Fund, then they must obtain prior written authority from the Fund to vote contrary to ISS recommendations.

5.2 The Fund uses an external company ISS to provide the Fund with a voting advisory service. They analyse the resolutions at Company AGMs and EGMs to determine their compliance with corporate governance principles and advise on voting actions accordingly.

5.3 The Hertfordshire Pension Fund is also a member of the Local Authority Pension Fund Forum (LAPFF). The LAPFF has a membership of 71 LGPS Funds across the country with combined assets of over £175 billion, and the objectives of the LAPFF are to:

- Hold companies accountable for providing a true and fair view of their financial position and that this is dealt with by their audited accounts.

- Initiate engagement with the most widely held global companies in member portfolios on relevant governance, capital stewardship and corporate responsibility issues.

- Develop the Forum's innovative approach to executive pay incorporating views from asset managers, asset owners and companies; maintain pressure on companies with complex pay structures.

5.4 As part of its longer term objectives and recognising the global nature of the companies the LGPS is invested in, the LAPFF is looking to initiate engagement with companies that the Forum has not previously engaged with in order to build positive relationships and develop market awareness of LAPFF's approach as an investor group. Engagement will be on environmental, social or governance issues identified specific to each company but in the context of best practice for that market or sector.

## 6. Review of votes cast

6.1 A review of the voting instructions reported by the managers over the period July 2015 to September 2016 has been carried out. Over the period of the review the managers voted at all the meetings they were entitled to, this led to one or more of the managers voting at 198 company AGMs or EGMs in the UK.

6.2 Baillie Gifford, Jupiter and Allianz Global investors voted in accordance with the policy in all cases. JP Morgan voted in accordance with the policy in all but 1 case, and did not seek permission prior to exercising this vote.

6.3 JP Morgan voted at 22 meetings during the year and failed on one occasion to vote in accordance with ISS guidance at the Shire plc AGM and voted for the resolution approving the remuneration package for directors. The resolution was passed by a majority vote. After investigation JP Morgan admitted this was an error and they have subsequently amended their controls to avoid a reoccurrence in the future.

## 7. LAPFF engagement

7.1 Over the last twelve months the LAPFF has responded to a number of consultations on behalf of its membership covering areas such as the Task Force on climate disclosure phase 1 consultation, the new Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, and the consultation on Corporate Human Rights Benchmark.

7.2 The LAPFF response in particular to the Task Force on Climate Disclosure Phase 1 consultation set out its view encouraging a forward looking focus on quantitative and qualitative reporting across five areas: operational emissions; strategic resilience; research and development; the governance of company policy implementation on climate change; and public policy.

7.3 Representatives from the LAPFF have also attended a number of Company Annual General Meetings (AGMs) over the last twelve months and examples of the representations made on behalf of its membership are as follows:

- National Grid – raised the issue at this AGM about emissions reporting and the importance of understanding the full extent of a company's global emissions.
- Sports Direct – working with a number of shareholder groups calling for an independent review of this company's human capital management strategy.

- LAPFF filed shareholder resolutions at the meetings of Anglo American, Glencore, and Rio Tinto that received overwhelming shareholder support on the need for these companies to be more transparent about how they are preparing for the transition to a low carbon economy.
- National Express – LAPFF has supported shareholder resolutions with National Express requesting an independent assessment of labour conditions in one of its US subsidiaries.

**HERTFORDSHIRE COUNTY COUNCIL**

**PENSIONS COMMITTEE**
**TUESDAY, 7 MARCH 2017 AT 2:00PM**

| Agenda Item No: |
|---|
| **5** |

**FUNDING STRATEGY STATEMENT & CONSULTATION RESPONSE**

*Report of the Director of Resources*

Author: Jolyon Adam, Finance Manager, Resources
(Telephone: 01992 555078)

## 1 Purpose of the Report

1.1 To provide the Pensions Committee with the results of the consultation undertaken on the 2016 Funding Strategy Statement (FSS) for the Hertfordshire Pension Fund, as well as provide the final version of the statement for review and approval.

## 2 Summary

2.1 The draft 2016 Funding Strategy Statement, which was presented to Pensions Committee in November 2016 and Pensions Board in December 2016 was circulated to fund employers for an 8 week consultation period on 21st November. The consultation period closed on 20 January 2017.

2.2 Feedback was received from a number of employers and the fund will provide responses to all comments received, as detailed in section 4 of the report.

2.3 The draft FSS has been amended where feedback highlighted a lack of clarity or transparency in the document.

## 3 Background

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

3.2 The requirement to maintain and publish a FSS is contained in the Local Government Pension Scheme Regulations. The FSS is a summary of the Fund's approach to funding its liabilities, and includes reference to the Fund's other policies such as the Statement of Investment Principle (Investment Strategy Statement wef. 1 April 2017). The FSS applies to all employer bodies participating in the Fund and 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.

## 4 Outcome of Consultation

4.1 Consultation responses were received from a number of employers, and their comments are summarised below in Table 1, along with the response of the fund to the points raised.

**Table 1: Consultation Feedback and Responses**

| Comment | Response | Outcome |
|---|---|---|
| Approach taken that each employer or pool is assessed individually and employer contribution are set accordingly is fair and sensible | Comments noted | N/A |
| Actuarial assumptions adopted should be employer specific, in particular for life expectancy | Life expectancy assumptions are tailored to fit the membership profile of the Fund, however underlying this, at an employer level, the characteristics of each individual employer's membership are taken into account when setting contribution rates | Additional clarity provided in section C3 (d) on page 27 of the FSS on approach taken to setting assumption for life expectancy down to employer specific level |
| Should the Fund continue to allow for future improvements in life expectancy | 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. As noted in the FSS, it is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. However, there is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future | Response provided to scheme employer |
| Sustainability of the level of employer contribution rates | The Fund seeks to balance affordability, stability and prudence in setting employer contribution rates. The contribution towards the future accrued benefits is made up of three elements: | Response provided to scheme employer |

| | | |
|---|---|---|
| | • The contributions paid by members (fixed by legislation)<br>• Investment returns from fund assets (variable)<br>• Employer contributions (variable).<br><br>The actuary and the Fund's investment consultant expect investment returns to be lower in the future (due to future market expectations for global growth) and this has therefore put pressure on the employer contributions which need to rise to ensure that the future accrual is met in full | |

4.2 The FSS has been amended following the consultation, and is attached at Appendix A. The following updates and amendments have also been made, following the calculation and distribution of valuation results to employers:

- Confirmation of the maximum time horizon and probability bar for achieving funding target for each employer group (section 3.3 on page 9 of the FSS)
- Clarification on the approach for calculating cessation debts for employers ceasing in the Fund (note j on pages 13-14 of the FSS)
- Clarification on the secondary contribution rate and the approach to calculating this (section D3 on page 30 of the FSS).

## 3. Recommendations

3.1 That the Pensions Committee reviews and approves the updated Funding Strategy Statement.

# FUNDING STRATEGY STATEMENT

February 2017

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*". Payment of the Secondary rate will aim to return the employer to, or protect, a fully funded position 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. Further detail can be found in section D3.

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 | 17 years | Future working lifetime of members | Future working lifetime of members | Outstanding contract term, or future working lifetime of members (if shorter) |
| **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% | 66% - 70% | 66% | 66% - 80% | 66% - 80% | 66-75% |
| **Phasing of contribution changes** | Covered by stabilisation arrangement | Covered by stabilisation arrangement | 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, the Admission Body will be liable to pay an exit payment to the Fund and 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. The actuary will adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in the future.

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 will initially fall to the original letting/outsourcing employer (in the case of a transferee admission body) or in any other case 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 and at an employer level, the characteristics of each individual employer’s membership. 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 ultimate 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).

The funding position at 31 March 2016 is a snapshot as at that date, and will be different thereafter depending on what has happened in the financial markets. The secondary contribution rate therefore reflects not only deficit contributions but also a "market adjustment" factor which takes account of how the liabilities and assets may evolve over time. The secondary rate therefore seeks to ensure, via the employer paying a certain level of contributions, that the past service liabilities are fully funded (on the funding target) within, and by the end of, the time horizon for a minimum number of outcomes ("the likelihood"). The secondary rate contributions are therefore set to achieve full funding allowing for the projection of assets and liabilities over an appropriate time horizon, for a given proportion of possible economic outcomes which allows for the inherent liability and asset volatility over time and seeks to avoid funding plans being driven by short term market movements. 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

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|---|---|
| **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**

**PENSIONS COMMITTEE**
**TUESDAY, 7 MARCH 2017 AT 2:00PM**

| Agenda Item No: |
|---|
| **6** |

# TREASURY MANAGEMENT STRATEGY FOR PENSION FUND

*Report of the Director of Resources*

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## 1. Purpose of the Report

1.1 To propose the 2017/18 Treasury Management Strategy for the investment of Pension Fund cash held by the Administering Authority.

## 2. Summary

2.1 A treasury management strategy is prepared annually and approved by the Pensions Committee, to provide clarity about the management of these funds.

2.2 There is currently a cap of £35m for funds held by the Administering Authority for cashflow purposes. These funds are used to ensure that there is cash available for the payment of membership benefits and to fund cash drawdowns for the property and private equity Investment Managers. The Fund's benchmark allocation to cash is 1% of total pension fund assets.

2.3 This report sets out the proposed 2016/17 Treasury Management Strategy for the Pension Fund which would be effective from 1 April 2017. There are no changes in the proposed Strategy from the Strategy that was agreed by the Pensions Committee for 2016/17.

## 3. Recommendations

3.3 It is recommended that the Pensions Committee approves the proposed 2017/18 Treasury Management Strategy for lending Pension Fund cash which is set out in Appendix A.

## 4. Background

4.1 The updated LGPS (Management and Investment of Funds) Regulations 2016[1] still requires that Pension Fund cash managed by the Administering Authority be held in a separate bank account. A separate Pension Fund Treasury

[1] http://www.legislation.gov.uk/uksi/2016/946/contents/made

Management Strategy is prepared to provide clarity about the investment arrangements of Pension Fund cash managed by Officers of the Pension Fund.

4.2 The Pension Fund's treasury management strategy is based on the County Council's strategy which is revised and approved on an annual basis in accordance with CIPFA's Treasury Management in the Public Services: Code of Practice 2011 and CLG's guidance, "Guidance on Local Authority Investments". A more limited range of investment instruments are used by the Pension Fund to reflect that the funds are held to meet short term cash flow requirements only, such as the payment of pensions.

4.3 In accordance with the CLG Guidance, the Pensions Committee will be asked to approve a revised Treasury Management Strategy Statement, should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates.

4.4 As at January 2017 the Financial Conduct Authority is consulting on its third phase of implementing the Markets in Financial Instruments Directive (MiFID II). MiFID II is a package of EU legislation introduced in 2014 to regulate both retail and wholesale investment business. The draft proposals may significantly affect the ability for both Local Authorities and Pension Funds to carry out their Treasury Management Activities in their current form, and may require the Treasury Management Strategy to be revised.

## 5. Current Lending Position and Economic Context

5.1 Funds held by the Administering Authority are required for immediate cashflow requirements where the bulk of contribution income received each month funds pensions payroll. Therefore, funds are generally held in immediate access accounts, such as call accounts and Money Market Funds.

5.2 Table 1 provides an analysis of funds held by the Administering Authority at 31 December 2016.

**Table 1 Funds held at 31 December 2016**

| Total Funds at 31 December 2016 | Balance<br>£000s | Interest Rate<br>% |
|---|---|---|
| **Analysed as:** | | |
| Barclays Bank Call Account | 1,843 | 0.15% |
| Money Market Funds | 14,141 | 0.24% |

## 6. Proposed Treasury Management Strategy

6.1. The Fund's benchmark allocation to cash is 1% of the total Fund assets and it is suggested that the cap on cash held by the Administering Body be maintained in line with the 15/16 closing asset values. The Fund assets at the end of December 2016 were £4.1bn. Where there are surplus funds in excess of the £35m cap then it is proposed that these funds are distributed to Investment Managers in accordance with the Pension Fund's Investment Strategy. The Chief Financial Officer will authorise further distributions of funds to Investment Managers after taking advice from Mercer and following agreement by the Chair of the Pensions Committee. Any such distributions will be reported to the Pensions Committee at the next available meeting.

6.2. As with the County Council's treasury management strategy, the principal consideration when investing Pension Fund cash will be security and so the lending policy applied operationally by Officers may at times be more restrictive than the policy allows. The secondary consideration will be liquidity to ensure that there is always enough cash available to pay pension benefits and cash drawdowns for the property and private equity Investment Managers. Only once both of these factors are satisfied will yield be considered.

6.3. If the UK enters into a recession in 2017/19, there is a small change that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount initially invested.

6.4. The Pensions Fund's treasury strategy sets lower limits and a narrower range of financial institutions and instruments than the County Council's treasury strategy to reflect the lower balances held by the Pension Fund as illustrated in Table 1, that these are held for the short term, and that they are held principally for liquidity to facilitate payment of benefits.

6.5. The proposed 2017/18 Treasury Management Strategy has considered a full range of risks and Officers will apply the Strategy to ensure that security of deposits is the prime consideration. However, in agreeing the proposed Strategy, Members should be aware that there is always a risk of default of counterparties other than the Debt Management Office which is guaranteed by the government.

6.6. Information on treasury management performance will continue to be provided on a quarterly basis to the Pensions Committee.

## APPENDIX A: PROPOSED TREASURY MANAGEMENT LENDING POLICY 2017/18

### 1. Policy for determining which institutions should be on the lending list

1.1 The Pension Fund cash will be lent to the following types of institutions:

- Central Government
- Local Authorities
- UK Banks and Building Societies meeting the credit rating criteria set out in Table A
- Banks domiciled in other countries or their subsidiaries domiciled in the UK, providing the country has a sovereign rating of at least AA+ from each of the three credit rating agencies and the bank meets the credit rating criteria set out below. If the ratings of a parent bank fall below the minimum criteria, no lending will be undertaken with its subsidiaries even if their ratings continue to meet the minimum criteria (excepting Santander UK plc and Clydesdale Bank plc - see notes on overseas banks following Table A)
- Supranational banks (e.g. the European Investment Bank and the World Bank).
- Money Market Funds
- The Pension Fund's bank. If it does not meet the criteria for UK Banks then the Bank will be used for small balances up to £1m.

1.2 The Pension Fund will make investments using the following types of financial instruments. See sections 1.8 to 1.10 for further information on these investments.

- Call and notice accounts
- Fixed Term deposits
- Money Market Funds

1.3 The Pension Fund will apply the credit rating criteria set out in Table A for investments with UK Government, Local Authorities and unsecured investments with Banks and Building Societies and other institutions based on Fitch's long term credit rating criteria.

**Table A Minimum credit rating criteria**

| Counterparty | Limits | | |
|---|---|---|---|
| | Long term | Time | £ |
| Sovereign (country) rating | AA+ | N/A | N/A |
| UK Government | N/A | 364 days | Unlimited |
| UK Local Authorities | N/A | 364 days | £3.5m |
| Standalone Banks | A- | 364 days | £3.5m |
| Rated Building Societies | A- | 364 days | £3.5m |
| Supranational Banks | AA+ | 364 days | £3.5m |
| Money Market Funds | N/A | 7 days notice | £7m |
| | Asset Value | | |
| Unrated Building Societies | £1.0bn | 6 months | £1.75m |
| | £0.5bn | 3 months | £1.75m |

**1.4 Credit Ratings**

Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment issued, otherwise the counterparty credit rating is used. If an agency removes one of the set of ratings it issues for a bank or building society, the institution will be removed from the list. Table B provides a comparison of long term credit ratings for all agencies.

**Table B Comparison of credit ratings for all agencies providing ratings**

| Fitch | Moody's | S&P | Definition |
|---|---|---|---|
| AAA | Aaa | AAA | Prime |
| AA+ | Aa1 | AA+ | High Grade High Quality |
| AA | Aa2 | AA | |
| AA- | Aa3 | AA- | |
| A+ | A1 | A+ | Upper Medium Grade |
| A | A2 | A | |
| A- | A3 | A- | |
| BBB+ | Baa1 | BBB+ | Adequate Grade |
| BBB | Baa2 | BBB | |
| BBB- | Baa3 | BBB- | |

1.5 The Pension Fund will continue to invest in UK institutions, e.g. banks, central government and MMF, even if the UK was not rated AA+.

1.6 Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. For the avoidance of doubt, Santander UK plc (a subsidiary of Spain's Banco Santander) will be classed as a UK bank due to their substantial UK franchises and the arms-length nature of the parent-subsidiary relationship.

1.7 Sovereign credit rating criteria will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations.

1.8 **Banks Unsecured**

This relates to accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Pension Fund's bank, Barclays Bank plc.

1.9 **Government**

Investments in this category are loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency.

1.10 **Money Market Funds (Pooled Funds)**

These are shares in diversified investment vehicles consisting of any of the investment types above, plus equity shares and property. These funds provide wide investment risk diversification, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts.

## 2. Policy for determining limits for deposits

Table C and the following notes in this section set out the limits to be applied on investments in addition to the investment counterparty limits shown in Table A.

**Table C: Limits on Investments**

| Type | Description | Limit |
|---|---|---|
| Cap | The maximum amount of cash to be held and invested by the Administering Authority | £35 m |
| Maximum Transaction Value | The maximum deposit size when placing funds for fixed terms in order to spread risk. The only exceptions to this are deposits with the DMADF and Money Market Funds. | £3.5 m |
| Fixed Term Deposits | The maximum amount as a single transaction when placing fixed term deposits. The only exceptions to this are deposits with the DMADF and movements in and out of call accounts and pooled funds. | £3.5 m per transaction |
| Banking Groups | A group limit will apply where a number of banks are owned by a single institution. | £7 m per Group |
| Money Market Funds | Total investment in any one Money Market Fund | £7m per Fund |
| Money Market Fund Groups | A group limit will apply where a number of Money Market Funds are owned by a single institution. | £7 m per Group |
| UK Country Limit | Maximum percentage of portfolio permitted to be in UK institutions | 100% investment portfolio |
| Non-UK Country Limit | Maximum percentage of portfolio permitted to be in non-UK institutions (excluding Money Market Funds) | 40% investment portfolio |
| Single Non-UK Country | Maximum percentage of portfolio permitted to be in any one country, other than UK | 10% of investment portfolio |
| Sector | A sector limit applies to unsecured investments in Building Societies to limit exposure to a common risk factor – in this case the property market | 40% investment portfolio |

## 3 Policy to be followed when credit ratings change

### 3.1 Negative Watch

A status that credit rating agencies apply while they are deciding whether to lower that organisation's credit rating.

- If an institution is on negative rating watch the Council will treat it as one credit rating lower than it is currently rated.
- If an institution is at the bottom of the Council's credit rating criteria and is placed on negative watch, the Council will stop investing and attempt to call back any money which is currently invested, depending on the economic viability of withdrawing the investment.

This policy does not apply to a negative outlook on a credit rating. In the case of a negative outlook any investment decision will be considered in line with all other information available but will not prompt immediate action to review existing investments.

**3.2 Downgrading**

- If an institution is downgraded below the minimum credit rating criteria, then it will be removed from the list with immediate effect, along with any subsidiaries, and no new investments will be made.
- If funds are on call with an institution when a downgrade happens, they will be withdrawn or the balance reduced as appropriate, at the earliest possible opportunity, which may be the following working day.
- If there are outstanding fixed term deposits with an institution which has been removed from the list, terms for repayment will be sought and, if offered, fully considered and documented by Officers.
- Downgradings and the action taken will be reported in the weekly treasury management meetings and quarterly reports to members.

## 4 Other matters to be considered by Officers

4.1 In applying the policy set out above, Officers will refer to the following sources of market information on a regular basis:

- Credit Default Swap Rates
- Equity Prices
- Economic data
- Financial statements
- Outlook reports from credit agencies
- Financial Times and other news sources
- Professional journals and other publications

4.2 A regular briefing will be provided for all Officers involved in the dealing function, the Head of Specialist Accounting and/or the Assistant Director of Finance. This will provide all relevant information to enable decisions to be taken about treasury activity to ensure this remains within the policy. By its very nature the information will not be definitive and Officers will do all they can to react to these sources of information with the primary objective of security. The briefings will generally be delivered via weekly meetings. If for any reason, a meeting cannot be convened, then all relevant information will be circulated to Officers and the Assistant Director of Finance.

4.3 Officers maintain an overview of prevailing market rates in their regular contact with brokers. When considering fixed term deposits, Officers will consider quotes from brokers for a range of periods before making decisions.

HERTFORDSHIRE COUNTY COUNCIL

PENSIONS COMMITTEE

TUESDAY, 7 MARCH 2017 AT 2:00PM

| Agenda Item No: |
|---|
| **7** |

## GOVERNANCE: LGPS INVESTMENT POOLING INTER AUTHORITY AGREEMENT

_Report of the Director of Resources_

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### 1. Purpose of the Report

To update Members on the current position concerning the ACCESS Pension Pool and to propose the arrangements for setting up a joint committee with the ACCESS Authorities and for an Inter Authority Agreement with the ACCESS Authorities.

### 2. Summary

2.1 The County Council at its meeting on 22 March 2016 agreed, as recommended by the Pension Committee, to join the ACCESS pool. Accordingly the Council signed a Memorandum of Understanding (MoU) in May 2016 with the 10 other authorities in the pool to underpin the initial work of establishing the pool. ACCESS contains the following funds:

| | |
|---|---|
| Cambridgeshire | Kent |
| East Sussex | Norfolk |
| Essex | Northamptonshire |
| Hampshire | Suffolk |
| Hertfordshire | West Sussex |
| Isle of Wight | |

2.2 The ACCESS pool proposal for the pooling of assets was submitted to Government on 15 July 2016 and an initial acceptance letter was received on 27 January 2017.

2.3 This paper seeks approval for recommendations to the County Council from the Committee to create the Joint Governance Committee which will make investment pooling decisions on behalf of the 11 ACCESS Funds collectively.

Investment strategy and asset allocation decisions will be determined locally by each individual Fund and the implementation of these decisions will be undertaken by ACCESS through collective pooling of investments on behalf of the 11 ACCESS Funds.

## 3. Recommendations

The Committee recommends to County Council that:

3.1 the Director of Resources in consultation with the Chairman of the Pensions Committee is delegated the authority to finalise and agree the terms of the Inter Authority Agreement with the authorities in the ACCESS Pool as set out in the Report

3.2 the Council agrees to set up a Joint Governance Committee as set out in the Report with the authorities in the ACCESS Pool with effect from the date of completion of the Inter Authority Agreement and to appoint one member of the Council to the Joint Governance Committee

3.3 the Council delegates the functions set out in Appendix 2 to the Report to the Joint Committee with effect from the date of completion of the Inter Authority Agreement

3.4 The Chief Legal Officer is authorised to make such amendments as are necessary to the Constitution to reflect the decisions mentioned in 3.1 to 3.3 above

## 4. Background

4.1 In the summer 2015 budget the Chancellor announced the Government's intention to invite Administering Authorities to make proposals for pooling LGPS investments. Following the Autumn Statement on 25 November 2015 the Department for Communities and Local Government (DCLG) published its criteria for pooling investments focusing on 4 elements:

1. Scale – it is the Government's desire that pools of assets are created with at least £25bn of assets per pool.
2. Strong Governance – authorities are charged with defining the mechanisms by which they can hold the pool to account.
3. Reduced costs – including estimated savings over the next 15 years.
4. Improved capacity to invest in infrastructure through pooling.

4.2 In July 2016 ACCESS made a submission to Government based on pooling investments via a Collective Investment Vehicle (CIV) that would be administered and maintained by a third party Operator. The third party operator would be collectively managed by the pension funds through a joint committee established by the Authorities and made up of one member from each authority.

## 5. Inter-Authority Agreement

5.1 The ACCESS funds have jointly commissioned the external legal firm Eversheds to provide assistance in drafting a legally binding Inter Authority Agreement ("IAA") for the pooling of investments.

5.2 The IAA will be based on the governing principles that were agreed by the ACCESS pension funds at the outset of their collaboration in February 2016, including:

- Working collaboratively,
- All Councils having an equitable voice in governance,
- Avoiding unnecessary complexity, and
- Running economically and applying value-for-money considerations.

5.3 All monitoring officers of the 11 Funds including the County Council's Monitoring Officer have been fully involved in the development and agreement of the IAA.

5.4 The most significant principles that will be reflected in the IAA are as follows:

### Governance

5.5 The ACCESS Pool will be governed by a Joint Committee constituted under s101 of the Local Government Act 1972 and made up of one elected councillor chosen by each authority from their pension committee. The Joint Committee (or Joint Governance Committee as it will be known) will be "hosted" by one of the ACCESS local authorities. The host authority will undertake the secretariat function for the Joint Governance Committee. It is proposed that Kent County Council will be the initial host authority.

5.6 A Chairman and Vice-Chairman of the Joint Governance Committee will be appointed by the members of the Joint Governance Committee. Each elected member will have one vote in any decision requiring a vote, and decisions will be carried by a simple majority with the Chairman having a casting vote if necessary. The full draft constitution of the Joint Governance Committee is attached at **Appendix 1**.

5.7 The specific functions that would be delegated to the Joint Governance Committee are specified in **Appendix 2.**

### Procurement

5.8 The Joint Governance Committee will oversee the procurement of an operator. The procurement itself would be undertaken by a "Lead Authority" (one of the ACCESS authorities) on behalf of the group. Whilst the Joint Governance Committee will oversee the procurement process and make a recommendation on the preferred supplier, each of the 11 access local authorities will make their own decision to enter into a contract with the operator.

**Cost Sharing**

5.9 It is the aim of the ACCESS Pool that costs are shared equitably between the member funds. Some costs will be shared equally between the member funds, or costs will be shared according to the value of investments by each fund as follows:

5.10 Costs to be shared equally between the member funds:

- The pool establishment costs including strategic and technical advice, legal advice, project management costs and the costs associated with running either the procurement process to appoint a CIV;
- Any set-up costs charged by the operator for the overall creation of the sub-fund structure; and
- The ongoing costs of managing and governing the pool including the host authorities' costs of hosting the Joint Governance Committee and providing the secretariat function, the cost of any external advice commissioned by the Joint Governance Committee and any re-procurement processes for either the CIV Operator.

5.11 Costs in relation to funds' investments will be shared according to the value of each fund's investments, as charged by the CIV Operator for the sub-funds that each fund is invested in.

5.12 Other costs will not be shared and will be borne by the fund that they are incurred by, which includes:

- Each Fund's costs of participating in the pool, such as attendance at meetings.
- Any transition costs of moving assets to or within the pool.

**Withdrawal and termination**

5.13 Any fund can withdraw from the IAA and therefore the ACCESS Pool by giving 12 months' notice to expire on 31 March. Following the signing of the IAA, any fund that wishes to withdraw from the pool will be liable for its share of the costs (not relating directly to investments) for the remainder of the contract period of the CIV Operator.

**Other Provisions**

5.14 The IAA will cover a number of other standard areas including dispute resolution, information and confidentiality, data protection, freedom of information, equal opportunities, and change in identity of Administering Authorities.

## 6. Timescales

6.1 Government requires LGPS funds to begin transferring their investments into pools by no later than April 2018. In order for the ACCESS Pool to meet this deadline, the procurement processes for a CIV Operator will need to commence in or around April 2017

6.2 It is therefore necessary to seek decisions now to enable establishment of the Joint Governance Committee and commence the procurement processes. To achieve this, it is necessary for all of the ACCESS Authorities to make decisions at Council meetings in February/March 2017.

## 7. Financial implications

7.1 The implementation costs of establishing a CIV are estimated to be £160k for the Hertfordshire Fund. Ongoing annual operational costs are estimated between £273k and £455k.These estimates have been derived following significant market research with market participants including potential suppliers and other pools.

7.2 Eventual savings for the ACCESS Pool are projected to be £30m annually. Allowing for investment growth of 3-5% per annum, by year 10 this will be equivalent to £40-50m.[1]

[1] ACCESS pool submission to Government dated 15th July 2016

Appendix 1

## Draft Constitution of the Joint Committee

**Part 1 Membership**

1. The Joint Committee shall consist of one elected councillor appointed by each Council. The member so appointed must, at the time of the appointment, be an elected councillor serving as a member of the Committee of a Council which discharges the functions of that Council as pension administering authority.

2. Each Council may appoint a substitute. Any substitute must meet the eligibility requirements in paragraph 1. The substitute may attend any meeting of the Joint Committee or any of its sub-Committees in place of that authority's principal member if notice that the substitute will attend is given to the Secretary of the Joint Committee by the Council concerned

3. Where a substitution notice is in effect with respect to a particular member at a particular meeting, the substitute shall be a full member of the Joint Committee for the duration of the meeting in place of the principal member

4. Each Council may remove its appointed member and appoint a different member by giving written notice to the Secretary to the Joint Committee.

5. Each appointed member shall be entitled to remain on the Joint Committee for so long as the Council appointing them so wishes, but shall cease to be a member if he or she ceases to meet the eligibility criteria in paragraph 1l or if that Council removes the appointed member.

6. Any casual vacancies will be filled as soon as reasonably practicable by the Council from which such vacancy arises by giving written notice to the Secretary to the Joint Committee or his or her nominee.

7. The Joint Committee may co-opt any other person whom it thinks fit to be a non-voting member of the committee. The Joint Committee may from time to time make rules as to:

7.1 Registration and declaration of interests by co-opted members.

7.2 Standards of behaviour required to be observed by co-opted members when acting as such.

8. The Chairman of the Joint Committee will be appointed from time to time by the members of the Joint Committee. Subject to paragraph 5, the Chairman of the Joint Committee shall hold that office until their replacement is appointed which shall be at the first meeting to take place after the second anniversary of their appointment.

9. The Vice-Chairman of the Joint Committee will be appointed from time to time by the members of the Joint Committee. Subject to paragraph 5, the Vice-Chairman of the Joint Committee shall hold that office until their replacement is appointed which shall be at the first meeting to take place after the second anniversary of their appointment.

10. The Joint Committee may appoint sub-committees from among its membership as it thinks will help it to enable it to fulfil its remit. The Joint Committee may delegate its responsibilities to such sub-committees. Sub-Committees may co-opt non-voting members.

11. The Joint Committee may set up working groups to advise it on matters within it remit. Such working groups may be formed of members or officers of the constituent authorities or any other third party as the Joint Committee sees fit. Such working groups are advisory only and the Joint Committee may not delegate its responsibilities to such working groups.

12. Each member of the Joint Committee and any Sub-committee shall comply with any relevant code of conduct of their Council when acting as a member of the Joint Committee.

13. The Chairman may direct the Secretary to call a meeting and may require any item of business to be included in the summons.

14. Any 5 members of the Joint Committee may by notice in writing require the Chairman to call a meeting to consider a particular item of business and if the Chairman fails to do so within 20 working days of receipt of the notice then those 5 members may direct the Secretary to call a meeting to consider that business.

15. The Committee may, if the law permits, arrange for attendance at meetings via video conferencing. Any such attendance shall be in accordance with the law and any other requirements imposed by the Joint Committee from time to time.

**Part 2 Proceedings**

16. **Time and Place of Meetings**

The Joint Committee will meet at least four times each year. All meetings of the Joint Committee will take place at a suitable venue and at a time to be agreed by the Councils.

17. **Notice of and Summons to Meetings**

The Secretary to the Joint Committee will give notice to the public of the time and place of any meeting in accordance with Part VA of the Local Government Act 1972. At least five clear days before a meeting, the Secretary to the Joint Committee will send a summons by email and if a member so requests by post to every Member at their last known address. The summons will give the date, time and place of each meeting and specify the business to be transacted, and will be accompanied by such reports as are available.

18. **Chairing of Joint Committee**

The Vice Chairman shall preside in the absence of the Chairman. If there is a quorum of members present but neither the Chairman nor the Vice-Chairman is present at a meeting of the Joint Committee, the other members of the Joint Committee shall choose one of the members of the Joint Committee to preside at the meeting.

19. **Quorum**

19.1 The quorum of a meeting will be at least 8 members who are entitled to attend and vote.

19.2 If there is no quorum present at the start of the meeting the meeting may not commence. If after 1 hour from the time specified for the start of the meeting no quorum is present then the meeting shall stand adjourned to another time and date determined by the Secretary.

20. **Voting**

20.1 **Majority**

Each elected member shall have one vote. Co-opted members will not have a vote. Any matter will be decided by a simple majority of those members of the Councils represented in the room at the time the question is put. In the event of equality of votes the person presiding at the meeting will be entitled to a casting vote under paragraphs 39(1) and 44 of Schedule 12 of the Local Government Act 1972.

20.2 **By Substitutes**

The member appointed as a substitute shall have the same voting rights as the member for whom he or she is substituting. Where notice of substitution has been given for a particular meeting the principal member may not vote unless the notice of substitution is withdrawn before the start of the meeting.

20.3 **Show of hands**

The Chairman will take the vote by show of hands, or if there is no dissent, by the affirmation of the meeting.

20.4 **Recording of individual votes**

The minutes of the meeting shall record how a member of the Committee voted on a particular question if, at the time that the vote is taken or immediately thereafter, that member asks the Secretary or his or her representative at the meeting to record his vote.

21. **Minutes**

21.1 The Secretary to the Joint Committee shall arrange for written minutes to be taken at each meeting of the Joint Committee and shall present them to the Joint Committee at its next meeting for approval as a correct record. At the next meeting of the Joint Committee, the Chairman shall move that the minutes of the previous meeting be signed as a correct record. If this is agreed, the Chairman of the Joint Committee shall sign the minutes. The only part of the minutes that can be discussed is their accuracy.

21.2 Draft minutes or a summary of the decisions taken at the meeting and a note of the actions arising shall be circulated to the Committee and to each Council by email no later than 7 days after the date of the meeting.

22. Any elected member of the Councils who is not a member of the Joint Committee may speak at a meeting of the Joint Committee if the Chairman of the Joint Committee invites him or her to do so but an elected member of the Councils who is not a member of the Joint Committee shall not be entitled to vote at a meeting of the Joint Committee.

23. Meetings of the Joint Committee shall be open for members of the public to attend unless the Joint Committee determines that it is necessary to exclude members of the public in accordance with Part VA of the Local Government Act 1972 or the Joint Committee determines that it is necessary to close the meeting to the public because of a disturbance.

23.1 Copies of the agenda for meetings of the Joint Committee and any reports for its meetings shall be open to inspection by members of the public at the offices of the Councils with the exception of any report which the Secretary to the Joint Committee determines relates to items which in his or her opinion are likely to be considered at a time when the meeting is not to be open to the public.

24. Minutes of the meeting shall be published by the Host Authority to the extent required by Part VA of the Local Government Act 1972.

25. If a member of the public interrupts proceedings, the Chairman will warn the person concerned. If they continue to interrupt, the Chairman will arrange for their removal from the meeting room and will suspend the meeting until the member of the public has left or been removed.

26. If there is a general disturbance in any part of the meeting room open to the public, the Chairman may call for that part to be cleared.

27. **Overview and Scrutiny**

27.1 Each Council has overview and scrutiny committees which have the right to scrutinise the operation of the Joint Committee and the Joint Committee and the Host Authority will co-operate with reasonable requests for information from any of the Councils' overview and scrutiny committees.

27.2 The decisions of the Joint Committee are not subject to call-in.

28. **Regulation of Business**

28.1 Any ruling given by the Chairman as to the interpretation of this constitution with respect to the regulation of proceedings at meeting shall be final.

28.2 Subject to the law, the provisions of this Constitution and the terms of any contract, the Joint Committee may decide how it discharges its business.

Appendix 2

Draft Terms of Reference of the Joint Committee for a CIV Operator

**Part 1 Functions in relation to the Operator**

1. **Specifying Operator services:** Deciding, in consultation with the Councils, the specification of services and functions that the Operator will be required to deliver including the sub-funds and classes of investments required to enable each Council to execute its investment strategy.

2. **Procuring the Operator:** agreeing the method and process for the procurement and selection of the Operator.

3. **Appointing the Operator**: Making a recommendation to the Councils as to the identity of the Operator and the terms upon which the Operator is to be appointed.

4. **Reviewing the Performance of the Operator:** Keeping the performance of the Operator under constant review and making arrangements to ensure that the Joint Committee is provided with regular and sufficient reports from the Officer Working Group to enable it to do so including but not limited to:

4.1 the performance of the Operator against its contractual requirements and any other performance measures such as any Service Level Agreement (SLA) and key performance indicators (KPIs) and Officer Working Group recommendations on any remedial action;

4.2 sub-fund investment performance;

4.3 investment and operational costs including the annual review of investment manager costs;

4.4 performance against the strategic business plan agreed by the Councils.

5. **Managing the Operator:** The Joint Committee shall:

5.1 Make recommendations to the Councils on the termination or extension of the Operator Contract and

5.2 Make decisions about any other action to be taken to manage the Operator Contract including the giving of any instruction or the making of any recommendation to the Operator including but not restricted to recommendations on investment managers (within any regulatory constraints that may apply).

6. **Appointment of Advisers**

6.1 The Joint Committee may appoint such professional advisers on such terms as it thinks fit. Any procurement of advisers must comply with the constitution of the Authority designated to undertake the procurement and that Authority will enter into a contract with the appointed adviser on behalf of the Authorities.

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6.3 The Joint Committee shall decide which tasks shall be performed by the Client Unit and which Council shall manage the Client Unit including the employment arrangements for employees in the Client Unit.

**Part 2 Functions in relation to management of Pool Assets**

7. The Joint Committee shall make recommendations to the Councils on the strategic plan for transition of assets that are to become Pool Assets.

**Part 3 Functions Concerning Pool Aligned Assets**

8. Making recommendations to the Councils about Pool Aligned Assets (including proposals concerning the migration of investments-such as passive investments via life fund policies-to become Pool Aligned Assets) in accordance with the Inter Authority Agreement or any other delegation to the Joint Committee by the Councils.

**Part 4 Functions concerning Business Planning and Budget**

9. Make recommendations to the Councils about the annual strategic business plan for the Pool

10. Determine the budget necessary to implement that plan and meet the expenses of undertaking the Specified Functions (insofar as they will not be met by individual transaction costs paid by Councils to the Operator) in accordance with Schedule 5 hereof.

11. Keep the structures created by this Agreement under review from time to time and make recommendations to the Councils about:

11.1 the future of the Pool;

11.2 any changes to the Inter Authority Agreement; and

11.3 as to the respective merits of continuing to procure operator services by means of a third party or by creation of an operator owned by the Councils.

12. The Joint Committee is required to commence the first review of the Inter Authority Agreement by the second anniversary of its first meeting.

13. The Joint Committee is required to undertake a review of the Pool and the Inter Authority Agreement:

13.1 to be completed 18 months before the expiry of each and every Operator Contract including as a result of the exercise of any option to terminate the Operator Contract;

13.2 whenever a Council gives notice of withdrawal under clause 12 of the Inter Authority Agreement